

**STATEMENT OF JANE OATES
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U.S. DEPARTMENT OF LABOR
BEFORE THE
COMMITTEE ON FINANCE
UNITED STATES SENATE**

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Good morning. Chairman Baucus, Ranking Member Hatch, and distinguished members of the Committee. Thank you for this opportunity to discuss the Unemployment Insurance (UI) program and the Administration's legislative proposal to improve integrity in the UI program. I also want to thank you for enacting improvements to the National Directory of New Hires (NDNH) and the Treasury Offset Program (TOP) in the last Congress - two important integrity proposals we have advocated for in the past that will provide new tools to states to improve prevention, detection, and collection of improper payments.

Reducing improper payments and strengthening program integrity are priorities for the Administration government-wide. They are equally a priority within the Department of Labor (Department). We are aggressively working to identify new strategies and tools to support our state partners in addressing the rising UI improper payment rate. I might also add that addressing improper payments relates to UI trust fund solvency. Particularly now, when trust funds are under extreme pressure and states are borrowing at near record levels, it is essential to ensure that UI benefit

payments are made properly and that all employers pay their fair share of unemployment contributions.

I appreciate the Committee's interest in this critical issue.

BACKGROUND

I am pleased to report that the UI program has a longstanding commitment to ensuring its financial integrity. The program uses highly sophisticated sampling and auditing methods and other tools to prevent, detect, and recover overpayments. As you know, the UI program operates as a federal-state partnership, which means that state action is key to addressing the UI improper payment rate. Every state operates a UI Benefit Payment Control unit that utilizes a wide variety of tools to detect, establish, and collect overpayments. When potential overpayments are detected, individuals are given the opportunity to demonstrate that the payment was not made in error before collection efforts begin. All states also operate a quality control system to identify claims errors and support corrective action in the state's UI system. Using the Benefit Accuracy Measurement (BAM) survey, states sample approximately 24,000 paid and denied claims each year, nationwide. Each state thoroughly investigates its own benefit payments for accuracy. For claims that were improperly paid, the investigation determines the cause of, and the party responsible for, the error and the amounts over (or under) paid. The UI improper payment rate is estimated from the resulting data for this nationally representative random sample.

The Employment and Training Administration (ETA) routinely reports an annual improper payment rate based upon data collected from very thorough BAM audits that detect many errors that are not within the control of the state agency. As a result, we report two rates for the UI program: the overall annual rate based on all sources of error; and the operational rate, which represents those improper payments we believe are more readily controlled – that is, identified and addressed – under normal state operations. Unfortunately, the UI improper payment rate has increased during the most recent reporting period (July 2009 to June 2010) required under the Improper Payments Information Act. During this reporting period the rate was 11.2 percent, of which 10.6 percent represents overpayments. The operational rate for the same period was 5.7 percent. As explained below, that increase may, in large part, be due to the strains put on the UI system from the large increase in claims as we entered the recession.

As you review improper payment statistics for the UI program, there are several things to keep in mind. States are required by the Social Security Act as interpreted by a U.S. Supreme Court decision, California Human Resources Development Department v. Java, 402 U.S. 121 (1971), to pay benefits as soon as administratively feasible. States constantly struggle with getting timely, sufficient information from the individual's prior employer to make an accurate eligibility determination. Errors result from this structural challenge.

The four main reasons for improper payments in the UI program, listed in order of importance, are: (1) payments are made to individuals who have returned to work

and continue to claim benefits; (2) information regarding the claimant's separation from work is received after a determination of eligibility is made and the claim is paid, often due to failure of employers or their third-party administrators to provide timely and adequate information on the reason for an individual's separation from employment; (3) claimants fail to meet the state's work search requirements; and (4) claimants fail to register with the state's Employment Service pursuant to state law. Attachment A is a graphic display of the root causes for UI improper payments.

The recession has had an impact on the UI improper payment rate. Entering the recession, average UI claims increased by 3.2 million, or 120 percent, in only a one-year period. Although additional federal support helped, many state workforce agencies struggled to keep up with increased workloads and were compelled to utilize integrity staff to process claims instead of focusing on improper payments. In addition, a significant number of UI improper payments are not within the control of the state to prevent, such as when decisions awarding benefits are reversed on appeal. Other root causes of UI improper payments are very challenging and expensive to address, such as those due to the lack of documentation of a claimant's work search efforts. Today, however, states are actively working with the Department to aggressively implement strategies to bring down the UI improper payment rate, which is discussed in more detail below.

States also carry out integrity activities for state collection of employer UI contributions. Similar to the BAM survey, the Tax Performance System evaluates the quality of state UI tax operations. A sample of activity for each major tax function is

examined, including the collections operation and the field audit unit. Tax operations in the states employ a variety of tools including information sharing with the IRS under the Questionable Employment Tax Practice program, and targeting audits to detect and recover unreported contributions. All states audit one percent of their contributory employers to determine if they are properly reporting their employees and paying the correct amount of contributions. In addition, several states have enacted laws penalizing employers for misclassifying employees as independent contractors.

On November 20, 2009, President Obama signed Executive Order 13520: “Reducing Improper Payments and Eliminating Waste in Federal Programs”. This Executive Order requires identification of the Federal programs with the highest dollar value or majority of government-wide improper payments, which are called high-priority programs. Due to its size, the UI program has been identified as a high-priority program. While states are striving to improve their integrity functions and the Department has many initiatives under way to support states’ efforts to reduce the UI improper payment rate, additional statutory authority and resources are needed to enhance our collaborative efforts and to continue to improve payment accuracy. To this end, the Department sent the draft Unemployment Compensation Program Integrity Act of 2011, or as we call it, the Integrity Act, to Congress on June 11, 2011. The Department estimates this legislative proposal would cut spending by 2.5 billion over ten years. Much of this decline in spending would lead to lower taxes for employers, with 556 million in net savings to the government over that period. These estimates include budgetary savings in the form of further reductions in improper UC payments

and higher state unemployment tax collections, which do not score under budgetary rules. Much of the savings resulting from these measures will go straight back to employers in the form of lower tax rates. By making the system more fair for everyone we can lower the costs for this vital national program.

UNEMPLOYMENT COMPENSATION PROGRAM INTEGRITY ACT OF 2011

The Integrity Act consists of several provisions that will reduce UI overpayments, underpayment of employer taxes, and misclassification of employees as independent contractors; it will also improve the collection of overpayments and delinquent contributions.

Specifically, the legislative proposal would provide flexibility to states that want to augment their resources for integrity activities by permitting them to use a portion of recovered overpayments and delinquent contributions specifically for integrity purposes. Under current Federal law, all overpayments of UI benefits and all delinquent payments of UI contributions by employers that are collected by a state must be deposited in the state's unemployment fund where they may be used only for the payment of UI benefits and not for administrative costs. The Integrity Act would permit states to use up to 5 percent of each overpayment recovered to augment administrative funding for preventing, detecting, and recovering benefit overpayments. Similarly, states would be permitted to use up to 5 percent of delinquent contributions collected for preventing and detecting employer fraud and evasion, and recovering required employer contributions, including the misclassification of employees as

independent contractors and the identification of employers who attempt to manipulate the taxing provisions to pay less than their fair share of contributions. Having dedicated resources to support integrity activities is critical to ensuring that states are engaging in these crucial activities. When states are faced with large numbers of claimants as in the current recession, they often divert integrity resources to other mission-critical functions, such as timely benefit payments to unemployed workers. However, the combination of lower resources for integrity activities and a higher volume of claims inevitably lead to more improper payments. By creating resources dedicated to tackling improper payments we can preserve the integrity of the system and keep costs down for employers.

Currently, every state assesses penalties on employers who are delinquent in tax payments. The Integrity Act would apply a similar penalty on UI claimants with outstanding fraudulent overpayments and boost resources for integrity activities. It would require states to assess a penalty of not less than 15 percent of the amount overpaid on any claim for benefits that is determined to be due to the claimant's fraud. States would be required to place the penalties collected in a subaccount of the state's account in the Unemployment Trust Fund and only withdraw these funds for integrity activities.

This would ensure that individuals who have defrauded the system — who are frequently required to do no more than repay the fraudulently received benefits — will be penalized and that the penalty will be used in a way that will result in improved program integrity. While many states currently have these penalty provisions, the

amounts received are often used for non-UI purposes. If the state decides that any amounts it deposits in this special fund are not needed for the designated purposes, the state may use these amounts for the payment of benefits. At the same time, it is important to ensure that claimants accused of fraud are afforded appropriate due process, and the Department plans to issue policy guidance and provide technical assistance to states to ensure that is the case.

The Integrity Act would help prevent overpayments as well by giving employers an incentive to respond timely and adequately to an agency's request for information. In determining whether an individual is eligible for UI, states rely on information provided by employers. When this information is not received in a timely manner, is inaccurate, or is incomplete, an ineligible individual may receive benefits. To encourage employers to provide complete, timely, and accurate information about their former employees, this legislative proposal would provide that if the state determines that an overpayment was the employer's fault due to failure to respond timely or adequately to an agency request for information, and that the employer has a pattern of failing to respond timely or adequately to such requests, the state may not relieve the employer's account of the benefit charges.

Lastly, the Integrity Act would help states identify overpayments by requiring that rehires be reported by all employers to the NDNH. State UC agencies have found their state directories and the NDNH to be extremely useful in identifying individuals who claim UC benefits after they have returned to work and, under amendments enacted in 2004 and 2010, states are using the NDNH for this purpose. The NDNH

allows states access to a wider universe of employers, including federal agencies and multi-state employers who report all new hires to a single state.

However, the effectiveness of this system is limited because employers do not currently report the rehire of individuals who have not been separated from employment for at least a year, which limits a state's ability to determine whether individuals were improperly receiving UC benefits. This amendment would require employers to report individuals who were rehired after being separated from employment for at least 60 days. This reporting requirement will benefit these employers directly by ensuring that they are not inappropriately charged for UI payments to current employees.

EXISTING INTEGRITY EFFORTS

The provisions I have outlined above in the Integrity Act will bolster existing integrity efforts already in place at the state and Federal levels. The Department, working with our state partners, has been focused on the issue of improper payments for many years. A number of robust strategies are under way, new strategies are in the process of being rolled out, and we have been working collaboratively with our state partners to identify additional strategies that concentrate on the prevention of overpayments focusing on the root causes which will yield the highest impact. These strategies include:

(1) preventing claimants from continuing to claim benefits after they return to work through state workforce agencies' use of the NDNH;

(2) reducing improper payments through prevention and early detection of eligibility problems and speeding claimants' return to work by conducting Reemployment and Eligibility Assessments (REAs);

(3) receiving more timely and accurate separation information from employers or their representatives through use of the State Information Data Exchange System (SIDES), an automated separation information exchange;

(4) recovering outstanding overpayments by intercepting Federal income tax refunds using the U.S. Department of the Treasury's TOP; and

(5) providing tools, resources, and intensive technical assistance to states, and initiating innovative pilots to improve prevention in order to bring the improper payment rate down.

I will elaborate on each of these strategies.

National Directory of New Hires

To address the issue of individuals continuing to claim benefits after returning to work, one of the most effective tools for detecting improper payments, as mentioned previously, is the use of NDNH, a database maintained by the Department of Health and Human Services for child support enforcement purposes. The database contains quarterly wage and unemployment compensation benefit payment information, and information on new hires reported by employers. The Department has, under current authority, mandated expanded use of the NDNH for both detection and prevention activities and provided new protocols to states for using the NDNH most effectively. States will also be provided funding opportunities to implement these new protocols

and to put in place automated processes to immediately alert claimants that the state understands they have returned to work to prevent continued claiming and more improper payments.

Reemployment and Eligibility Assessments

The Reemployment and Eligibility Assessment (REA) initiative also has been an important investment in UI integrity. This initiative provides funds to states to perform in-person reemployment assessments typically conducted in a One-Stop Career Center. When an REA is conducted, individuals' UI eligibility is reassessed, the individual is provided with labor market and career information, and a reemployment plan is developed that includes referrals to One-Stop services. These REA activities reduce improper payments through early detection and prevention of eligibility problems and speed claimants' return to work.

During FY 2011, Congress provided nearly \$60 million in funding to states to support REA and integrity activities, for which we thank you. Currently 38 states, Puerto Rico, and the District of Columbia have REA programs. The FY 2012 budget requests \$70 million, which will fund 980,000 claimant REAs and save state unemployment trust fund accounts an estimated \$237 million. Another integrity proposal contained in the President's FY 2012 Budget is a request for \$10 million for incentive awards to states to improve their UI integrity activities related to improper payments.

A program evaluation for REAs has been completed and a report to Congress will be submitted this month. We were pleased to learn that the findings of the

independent review show the benefits resulting from the program substantially exceed the cost of providing REAs and that the program helped claimants get jobs quicker than they otherwise would have. By helping to speed the return to work REAs help both the claimant and the UI system. Individuals participating in REAs had a lower duration of benefits and were less likely to exhaust their regular UI benefits during a difficult economic period. Fewer benefits paid improves trust fund solvency, and quicker re-employment improves people's lives. REAs are a win for everyone.

State Information Data Exchange System (SIDES)

Another key initiative that addresses one of the top root causes of UI improper payments is the SIDES. This initiative is designed to help employers provide the information required to determine a claimant's eligibility to states more quickly by providing a secure electronic data exchange between states and employers or their third party administrators. In addition to speeding up the process, the SIDES system includes prompts and edits to improve completeness and accuracy of the information. Implementation of SIDES slowed during the recession due to other technology demands on the UI system; however, the Department is working with states, employers, and employers' representatives to rapidly accelerate implementation.

Treasury Offset Program

I am pleased to report that as of February 2011, the necessary regulation and system are in place for states to implement use of the Treasury Offset Program, which enables states to recover UI overpayments by offsetting Federal income tax refunds against UI debts. States that were ready to implement this system are already showing

impressive recovery numbers as a result. State UI agencies gained access to the TOP in February 2011. Between that time and June 1, 2011, three states (Michigan, New York and Wisconsin) have collected approximately \$25 million in overpayments.

Collaboration with States

We have engaged eleven states whose improper payments have the highest impact on the national UI improper payment rate in a collaborative effort to aggressively bring down the rate and to provide leadership to other states. Each state has formed a task force and developed a state-specific strategic plan with support and technical assistance from the Department of Labor. The Department is providing other tools and resources to support state efforts including implementing a campaign to target messages to claimants designed to prevent improper reporting of work/earnings while filing for UI benefits, messages to employers on the importance of responding timely and adequately to state requests for separation information, and adopting an additional state performance measure focused on improper payments that more effectively targets prevention. We are also working with states with the highest improper payments resulting from issues associated with registration of claimants with the state's Employment Service to analyze the state-specific challenges and develop strategies to address them.

RESULTS

Working with the states, we have seen a reduction in error rates and improper payments, and an increase in collections, through REAs, TOP, and other efforts. System

changes in Louisiana and South Carolina have resulted in substantial reduction of Employment Security registration errors. Louisiana's corrective actions have reduced the registration error rate 90 percent -- from 47.13% in 2010-Q1 to 4.76% in 2011-Q1. Similarly, South Carolina's actions have reduced the registration error rate by more than 75 percent -- from 15.94% in 2009-Q1 to 3.72% in 2011-Q1.

Work flow changes in Texas resulted in reduction in benefit year earnings errors. In fact, Texas reduced the benefit year earnings error rate from 4.37% in 2006 to 2.64 in 2010.

CONCLUSION

Again, let me thank you for the opportunity to talk to you about the integrity of the UI program. I look forward to working further with the Committee as you consider ways to enhance Federal and state efforts to reduce improper payments in the UI program, including passage of the Integrity Act. I will be glad to respond to any questions you may have.