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LFC HEARING BRIEF

AGENCY: Workforce Solutions Department; General Services Department

DATE: July 14, 2011

PURPOSE OF HEARING: Status of New Mexico's Unemployment Insurance Trust Fund

WITNESS: Celina Bussey, Secretary WSD; Edwynn L. Burckle, Secretary, General Services Department

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EXPECTED OUTCOME: Update on Unemployment Insurance Trust Fund

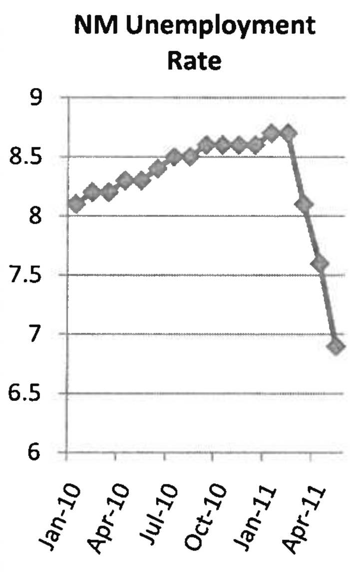
BACKGROUND INFORMATION

The New Mexico Unemployment Insurance (UI) Trust Fund is held at the U.S. Treasury. The fund's deposits and withdraws are primarily comprised of NM employer contributions and benefits paid out to claimants, respectively. Additionally, the trust fund includes federal grant funds such as UI Modernization and extended benefit reimbursements; Combined Wage Claims (deposits and withdraws based on interstate agreements where qualifying individuals have earned wages in more than one state in a base period); and interest earnings.

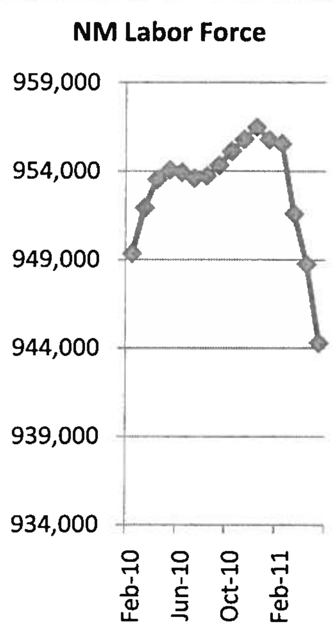
Three years ago, the NM UI trust fund was one of the most solvent in the United States, with a balance of $553.3 million. However, as of the close of the 1st quarter calendar year 2011, Workforce Solutions Department (WSD) reported the UI Trust Fund balance was $174.2 million. Due to almost a 500 percent increase in unemployment insurance claims over the past two years, the Workforce Solutions Department has experienced unprecedented demand on the trust fund. Daily payments to claimants have ranged from $750 thousand to $1 million. In FY11, $318.8 million was spent on unemployment benefits.

Although New Mexico's unemployment rate has dropped for 3 consecutive months, job growth is lagging. WSD reported New Mexico experienced a loss of 6,300 nonfarm jobs or 0.8 percent from May 2010 to May 2011. WSD relies on employment figures from the Bureau of Labor Statistics. New Mexico has undergone 31 consecutive months of negative job growth. Another concern is the declining labor force. From May 2010 to May 2011, the labor force has decreased by 1.03 percent or 9,769 workers.

The May forecast of the New Mexico Bureau of Business and Economic Research (BBER) suggests slightly stronger economic growth in the next several months. BBER reports first quarter year-over-year nonfarm employment grew by 0.8 percent in 2011, which is slightly above the previous estimate of 0.4 percent. Employment is expected to grow 1.5 percent in 2012 and 1.4 percent in 2013. BBER's estimates differ from those of the Bureau of Labor Statistics (BLS) because of a perceived error in the BLS October totals, which resulted in a reduction of 6,000 jobs in the professional and business services sector. BBER has added back this amount to their 2011 first quarter averages.



Source: WSD



Source: WSD

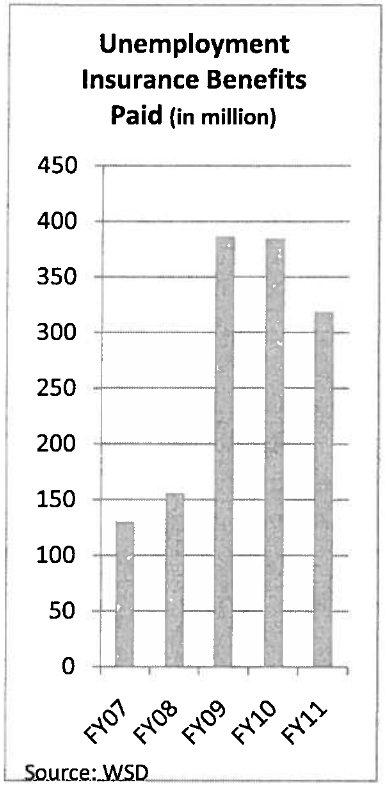
NEW MEXICO'S UI TRUST FUND

<u>Benefits Paid.</u> Weekly benefit allowance (WBA) is based on an amount equal to 53.5 percent of the average weekly wage for insured work paid in the quarter of a base period in which total wages were highest. The base period is the first 4 of the last 5 completed calendar quarters immediately preceding the filing of a new claim. The WBA plus any dependant allowance is multiplied by 26 weeks to arrive at the maximum benefit allowance (MBA).

The federal government has provided for additional weeks of unemployment insurance benefits via the Emergency Unemployment Compensation (EUC) 4-tier system and extended benefits during periods of high unemployment (HUP). Tiers III and IV are based on HUP, as well. A three-month rolling average unemployment rate above 6 percent triggers Tier III and an average rate above 8.5 percent triggers Tier IV. UI benefits could be available for up to a total of 99 weeks if New Mexico's unemployment rate consistently stayed above 8.5 percent.

	Max. # of Weeks	**Available**
Regular UI	26	All claimants
EUC, Tier I	13 +7	All claimants
EUC , Tier II	13 + 1	All claimants
EUC, Tier III	13	High Unemployment Periods 3-month avg. > 6%
EUC, Tier IV	6	High Unemployment Periods 3-month avg. > 8.5%
Extended Benefits (EB)	13	High Unemployment Periods 3-month avg. > 6.5 % (requires a 50 percent state match for new claims after 12/31/11)
HUP EB	7	High Unemployment Periods 3-month avg. > 8 % (requires a 50 percent state match for new claims after 12/1/10)

On June 6th, WSD announced New Mexico triggered off Tier IV due to New Mexico's three-month rolling average unemployment rate falling below the 8.5 percent threshold necessary to qualify for Tier IV. By triggering off Tier IV, the number of maximum weeks available for a claimant to receive benefits dropped 6 weeks to 93 weeks.



In May, the unemployment rate dropped again to 6.9 percent which made the 3-month rolling average drop below the 8.0 percent threshold required for the HUP EB. Currently, the maximum unemployment insurance benefits a claimant may potentially be eligible for in New Mexico will be 86 weeks.

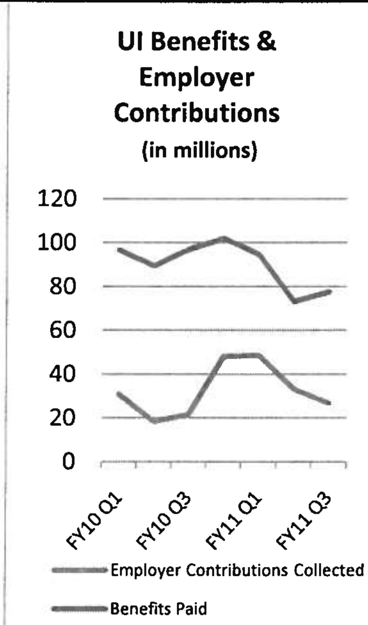
Legislative Changes to UI benefits. In the 2007 legislative session, the Legislature increased the average weekly unemployment benefit by $4 to $242 and increased the dependent allowance benefit by $10 to $25 for each qualifying child under the age of 18. Also, certain enhancement benefits enacted in 2003 were made permanent, including benefits for victims of domestic violence, full-time students, part-time workers, and military spouses.

In an effort to decelerate impending trust fund insolvency, the legislature reduced a number of benefits. On July 1, 2011, statutory changes to UI benefits went into effect including a decrease in the number of qualifying dependents eligible to receive the weekly $25 dependent allowance; elimination of UI benefit payments to individuals attending school full-time, except those in an approved vocational training institution program, unless recipient demonstrates he is actively seeking full- or part-time work; and a limit on extended benefits.

WSD reported the proposed modification in benefits to full-time students will reduce expenditures by an estimated $10 million in FY12 and an estimated $10.7 million in FY13. The proposed dependent allowance reduction from four to two dependents was reported to reduce expenditures by an estimated $3.4 million in FY12. In FY13, the reduction in dependent allowance will reduce expenditures by an estimated $2.2 million. Lastly, WSD noted that eliminating the payment of the state's 50 percent share of extended benefits unless fully reimbursed by the federal government would occur during the first quarter of FY12 with an estimated off-set of $62.9 million and an estimated $50.8 million in FY13.

Employer Contributions. As unemployment rates increase, UI fund revenues from employer contributions tend to drop. This is because when workers lose jobs employers are not making unemployment contributions on behalf of those employees.

Employer contributions are dictated by several elements including the employer contribution tax schedule 0-6, the 16 employer reserve rates based on experience within each contribution schedule, and the wage base.



Source: WSD

For calendar year 2011, New Mexico is on employer contribution schedule 1. The employer contribution tax schedule for 2012 is uncertain. There is a pending law suit before the NM Supreme Court regarding the vetoed language which would have set employer schedule 3 for CY2012.

The statutory triggers for the unemployment insurance contribution schedule, found in NMSA 1978 § 51-1-11, depend on the ratio of fund balance on June 30 to total payroll at the end of the previous calendar year. Using 2010 payroll data, the following table illustrates the necessary minimum UI fund balances for each schedule. As of the end of March 2011, the fund balance was $174.2 million. The preliminary trust fund balance for June 30, 2011 is $133.1 million. If the statutory triggers were in effect for CY2012, Schedule 5 would prevail according to the chart below.

2010 Total Payroll = $21,802,598,044

Contribution Schedules	Percent of Total Payroll	Minimum Required Fund Balance
Schedule 0	fund balance > 2.3%	501,459,755
Schedule 1	2.3% > fund balance > 1.7%	370,644,167
Schedule 2	1.7% > fund balance > 1.3 %	283,433,775
Schedule 3	1.3% > fund balance > 1.0 %	218,025,980
Schedule 4	1.0% > fund balance > 0.7 %	152,618,186
Schedule 5	0.7% > fund balance > 0.3%	65,407,794
Schedule 6	0.3 % > fund balance	<65,407794

The 16 employer reserve rates within each contribution schedule allows for experience-rating where the employers generating the fewest claimants have the lowest rates. Currently, New Mexico's 16 employer rates range from 0.05 percent to 5.4 percent. The maximum rate, regardless of the contribution schedule in effect, is 5.4 percent. The national average minimum and maximum employer rates in 2010 were 0.654 percent and 7.702 percent, respectively. New Mexico's new employer rate is 2.0 percent compared to the national average new employer rate of 2.663 percent.

Regional States: Minimum - Maximum Employer Rates
- Average minimum = 0.179%
- Average maximum = 6.6%

NMSA 1978 § 51-1-42 states, in part:

The base wage upon which contribution shall be paid during any calendar year shall be sixty percent of the state's average annual earnings computed by the division by dividing total wages reported to the division by contributing employers for the second preceding calendar year before the calendar year the computed base wage becomes effective by the average annual employment reported by contributing employers for the same period rounded to the next higher multiple of one hundred dollars ($100); provided that the base wage so computed for any calendar year shall not be less than seven thousand dollars ($7,000).

State	Minimum Rate (%)	Maximum Rate (%)
Arizona	0.02	5.9
Colorado	0.0	5.4
Kansas	0.11	7.4
Nevada	0.25	5.4
New Mexico	*0.05*	*5.4*
Oklahoma	0.10	5.5
Texas	0.72	8.6
Utah	0.20	9.2

Regional States: New Employer Rates
- Average New Employer Rate (excluding Utah) = 2.34%

State	New Employer Rate (%)
Arizona	2.0
Colorado	1.7
Kansas	4.0
Nevada	2.95
New Mexico	*2.0*
Oklahoma	1.0
Texas	2.7

The individual employee wage base for CY 2011 is $21,900. It is calculated pursuant to the provisions of NMSA 1978 § 51-1-42. Only the first $21,900 of an employee's wages is subject to state unemployment taxes in 2011.

Difficulties predicting trust fund balance. Projecting trust fund balances is an extremely complex endeavor. As described above, benefits and contributions are comprised of several components which influence fund balance projections.

There are also assumptions made about the unemployment rate in order to project annual level of benefits paid to claimants. If projected unemployment rates are substantially different from actual unemployment rates, the overall fund balance projection will be off. As experienced during the first half of 2011, unemployment rates have been on the decrease leading to lower benefits paid than originally projected. UNM's Bureau of Business and Economic Research had projected total unemployment rates to be 8.8 percent in 2011. The unemployment rate average for the first 5 months of 2011 is 8.0 percent. Assumptions must be adjusted regularly to incorporate changes in the unemployment rate.

<u>Federal Unemployment Tax Act (FUTA) Credit Reductions:</u>

- If state has a loan balance on January 1 during two consecutive years and cannot pay back the balance by November 1 of the second year, employers face the first FUTA tax credit reductions (increase of 0.3 percent). The second year, employers lose another percentage of the FUTA credit and the same continues for each year thereafter. The extra revenue goes directly to pay back principal on the loan.
- Loss of FUTA credits also requires extra paperwork for employers on tax returns.
- FUTA tax credit reductions apply equally to all employers in a state and occur automatically without state legislation.

LFC staff has concerns with how the primary inputs and outputs of the trust fund, contributions and benefits, respectively, differ in various WSD responses to inquiries. Prior quarters' totals for contributions and benefits need to be reliable in order to have confidence in forecasting fund insolvency.

Challenges with DOL projection model – The modeling program used to project the UI fund balance involves two separate but connected programs: a projection model and a financial forecast. Consequently, if the financial forecast is incorrect the fund balance projection will also be unreliable. Three variables play a main role in the financial forecast: the U.S. Bureau of Labor Statistics' total labor force projection for New Mexico, the U.S. DOL's New Mexico insured unemployment rate and the NM average weekly wage. Also, if the legislature makes a change to a variable which goes into effect on July 1, the model cannot be updated until the following January.

<u>Options to improve insolvency.</u> The Legislature, through passage of HB 59, sought to balance revenue generation with benefit reductions. HB 59 moved the employer contribution schedule from 1 to 3. WSD reported that the change to contribution schedule 3 starting in 2012 would generate an estimated $277.4 million in FY12 and an estimated $337.9 million in FY13. However, at the time of the legislative session, WSD was still projecting New Mexico's UI trust fund would experience a deficit in 2012 even with the move to employer contribution schedule 3. Adoption of a higher employer contribution schedule is the primary method used by states to increase revenues. According to the National Association of State Workforce Agencies, 35 states raised their unemployment taxes on employers in 2010.

Fund insolvency could also be addressed by implementing additional cuts to benefits. WSD provided cost savings estimates for CY2012 for each of the following benefits if eliminated:

- Part-time work: a minimum of 20 hours of work per week
  - $7.3 million
- Alternative Base Period: The Alternative Base Period consists of the last four completed calendar quarters before the starting date of the claim. Alternate base period will allow some of a claimant's more recent wages to be counted towards establishing their claim and therefore will expedite eligibility.
  - $4.8 million

Adequate Trust Fund Balance
The U.S. DOL suggests that, to be minimally solvent, a state's reserve balance should provide for one year's projected benefit payment needs on the basis of the highest levels of benefit payments experiences by the state over the past 20 years.

Additional options include:

- Increase new employer rate, use an industry average for the new employer rate, or charge higher new employer rates to certain industries and employer types, such as construction and foreign entities.
- Increase percent by which wage base is calculated.
- Assess a short term solvency fee or surcharge fee on employers.
- Eliminate eligibility for term and seasonal employees.

What if insolvency occurs? The U.S. Department of Labor offers Federal UI interest free cash-flow loans that must be repaid by October 1 of the same calendar year. There are also interest-bearing loans available through the U.S. DOL. Interest on these loans is currently at a rate of nearly 4.1 percent. Interest payments cannot be paid from regular state UI tax collections or federal revenues.

Estimates earlier this year indicated that New Mexico will need to take out a loan in 2012 of $25 million to $30 million when the trust fund becomes insolvent. The loan would need to be repaid by October 2012 to avoid penalties, such as interest accrual and potential Federal Unemployment Tax Act (FUTA) credit reductions. Loss of FUTA credit would result in New Mexico employers being faced with increased federal unemployment taxes. Additional concerns include possible loss of Reed Act unexpended funding.

As of March 1, 2011, 31 states and the U.S. Virgin Islands are currently borrowing from the Federal Unemployment Account to cover unemployment benefits. These states have jointly borrowed upwards of $45.7 billion. South Dakota, Texas, Maryland and Tennessee repaid their loans in full by the end of 2010.

Many states are imposing "interest assessments" or "interest surcharges" to help pay back federal loans. These special assessments are set aside in a separate account. The timing of a surcharge is critical because legislation has to be in place and funds have to be available by October of the calendar year that the loan was issued.

Unemployment Overpayments and Fraud. WSD's benefit accuracy measurement program determines accuracy of paid and denied UI claims. Frequent causes of overpayments include failure to report gross earnings or other deductible income correctly and continuing to receive UI benefits after returning to work. The department is required to randomly sample 480 UI claims each year to determine whether payments complied with the laws and policies of New Mexico. Based on the random sample, U.S. DOL estimates total overpayments for all states. The following two rates are reported for overpayments of UI benefits:

- Annual – includes all possible fraud, non-fraud recoverable and non-recoverable overpayments; and
- Operational – includes those overpayments the states are reasonably expected to detect and establish for recovery.

New Mexico's annual rate of overpayments which include all causes and responsible parties is $97.8 million, or 28.68 percent for 2009 and the state's operational rate of overpayments is $22.5 million or 6.61 percent. In August, U.S. DOL releases the annual overpayment report which will include both the 2010 "Annual" and the "Operational" rates for all states.

Fraud, for UI purposes, is knowingly making a false statement, misrepresenting a material fact, or withholding information to obtain UI benefits. Consequences include being barred from receiving benefits for up to one year. All fraud cases require the claimant to repay benefits and are subject to possible criminal prosecution, fines and imprisonment.

Currently, the WSD's Benefit Payment Control (BPC) unit has: 5 investigators; 1 unit administrative assistant; and 1 unit supervisor. WSD is in the process of hiring 3 additional investigators and 1 office clerk. According to the State Personnel Office June 2011 Table of Organizational Listing (TOOL), the BPC unit is expending $248,429 for the salaries of the 7 FTE.

To date, WSD's recovery rate for 2011 is 24.77 percent. In CY 2009 and CY2010, there were no cases prosecuted for fraud.

GENERAL SERVICES DEPARTMENT

Unemployment Compensation. Private employers in New Mexico pay a tax to finance the unemployment insurance benefits paid to their former employees. This tax rate goes up or down depending upon how much their former employees collect. The risk management division (RMD) at General Services Department (GSD), however, reimburses the state of New Mexico, dollar for dollar, for unemployment insurance benefits paid to former state employees, in lieu of paying the tax. To facilitate this, RMD collects assessments from state agencies, schools, and local public bodies for the quarterly reimbursement of claims paid to former state employees by the Workforce Solutions Department.

Cost controls. A private or "experienced-rated" employer has the right to protest unemployment compensation benefit charges even in situations where they were not the last employer at the time a claim was filed. However, as a "reimbursable employer", the state must pay into the unemployment compensation trust fund an amount equal to the benefits charged to its account for **all** payments made on behalf of former state employees **regardless** of the reason they left employment. GSD is expanding its involvement by representing state agencies before unemployment compensation hearings to deny unqualified applicants.

Impact on rates. It is in the state's best interest to limit the payment of unnecessary benefits to former state employees. State agencies will incur higher assessments based upon any unnecessary charges, and the impact may not be fully felt the next fiscal year. Eventually, cumulative unnecessary benefit payments could continue to push unemployment compensation benefit assessments higher for state agencies. For FY12, GSD had already increased rates for state agencies, schools, and local public bodies by approximately 25 percent over FY11.

Impact on risk funds. Since FY10, economic conditions have led to more former employees of state agencies, schools, and local public bodies filing for unemployment compensation than in previous fiscal years. In FY12, this has resulted in budget adjustments to the state unemployment compensation fund by 30 percent and the local public body compensation fund by 26 percent over FY11 appropriations. To increase fund soundness, GSD obtained board of finance approval for a loan of $5 million from the public liability fund. For FY13, it is assumed GSD will incorporate the loan in the unemployment rate development to repay the $5 million plus interest to the public liability fund.

WSD is two quarters behind submitting billing statements to GSD so it is difficult to use claims data to project how much revenue is needed to maintain actuarial *soundness* of the fund. The TALX Corporation professional services contract with GSD for third party unemployment compensation claims administration was set to expire June 30, 2011. GSD extended the contract 90 days while the agency evaluates bringing the claims administration process in-house. It is unclear how TALX is meeting the performance measure of providing "statistical data and management reports" to the agency in absence of more timely claims data.

Local Public Body Unemployment Fund (354)

FY11 Budgeted Revenues		$1,533,700
FY11 Total Revenues		$823,634
FY11 Total Expenditures		$1,520,174
	Expenditures over Revenues	-$696,540
	% of Revenues (Assessments) Collected as of July 13, 2011	0.54

State Unemployment Fund (353)

FY11 Budgeted Revenues		$5,809,200
FY11 Total Revenues		$5,688,951
FY11 Total Expenditures		$5,733,711
	Expenditures over Revenues	-$44,760
	% of Revenues (Assessments) Collected as of July 13, 2011	0.98

Note: Revenues are lower than expenditures in both funds due to higher expenditures (BARs). The quarter ending December 2010 was the last quarter claims were posted against the funds.

QUESTIONS

1) Does New Mexico lose Reed Act funding if WSD takes out a DOL loan?
    a. Follow-up: How much unexpended Reed Act funding does New Mexico stand to lose if a DOL loan is borrowed?
2) The Legislature appropriated $2.5 million from the UI Modernization Reed funding for facility upgrades to WSD buildings statewide. What improvements have been made with these funds?
3) How can collections be improved?
4) What funding goals are being developed or are in place to ensure long term solvency?

MA/amm

Employer Reserve	Contribution Schedule 0	Contribution Schedule 1	Contribution Schedule 2	Contribution Schedule 3	Contribution Schedule 4	Contribution Schedule 5	Contribution Schedule 6
10.0% and over	0.03%	0.05%	0.10%	0.60%	0.90%	1.20%	2.70%
9.0%-9.9%	0.06%	0.10%	0.20%	0.90%	1.20%	1.50%	2.70%
8.0%-8.9%	0.09%	0.20%	0.40%	1.20%	1.50%	1.80%	2.70%
7.0%-7.9%	0.10%	0.40%	0.60%	1.50%	1.80%	2.10%	2.70%
6.0%-6.9%	0.30%	0.60%	0.80%	1.80%	2.10%	2.40%	2.70%
5.0%-5.9%	0.50%	0.80%	1.10%	2.10%	2.40%	2.70%	3.00%
4.0%-4.9%	0.80%	1.10%	1.40%	2.40%	2.70%	3.00%	3.30%
3.0%-3.9%	1.20%	1.40%	1.70%	2.70%	3.00%	3.30%	3.60%
2.0%-2.9%	1.50%	1.70%	2.00%	3.00%	3.30%	3.60%	3.90%
1.0%-1.9%	1.80%	2.00%	2.40%	3.30%	3.60%	3.90%	4.20%
0.9%-0.0%	2.40%	2.40%	3.30%	3.60%	3.90%	4.20%	4.50%
(-0.1%)-(-0.5%)	3.30%	3.30%	3.60%	3.90%	4.20%	4.50%	4.80%
(-0.5%)-(-1.0%)	4.20%	4.20%	4.20%	4.20%	4.50%	4.80%	5.10%
(-1.0%)-(-2.0%)	5.00%	5.00%	5.00%	5.00%	5.00%	5.10%	5.30%
Under (-2.0%)	5.40%	5.40%	5.40%	5.40%	5.40%	5.40%	5.40%