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FISCAL IMPACT REPORT

ORIGINAL DATE 03/10/17

SPONSOR Munoz LAST UPDATED _____ HB _____

SHORT TITLE Unemployment Compensation Rate SB 465

ANALYST Klunt

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY17	FY18	FY19	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total		See fiscal implications				

(Parenthesis () Indicate Expenditure Decreases)

SOURCES OF INFORMATION

LFC Files

Responses Received From

Workforce Solutions Department (WSD)

SUMMARY

Senate Bill 465 (SB 465) proposes to increase the maximum Unemployment Insurance (UI) employer contribution rate for experienced employers from 5.4 percent to 10.8 percent.

FISCAL IMPLICATIONS

Workforce Solutions Department (WSD) reported the following:

The Department's Unemployment Insurance Tax & Claims system is currently programmed for maximum contribution rate percentage of 5.4 percent, with the total rate reflecting an additional 1.0 percent penalty amount in some circumstances, pursuant to the existing statute, NMSA 1978 § 51-1-11. Some system changes will be required to adjust the maximum percentage of the contribution rate to 10.8 percent and the calculation of the total rates for all employers. Correspondence and screens on the presentation layer would have to be reviewed for static language changes. The specific impacts of the change would have to be tested and validated in conjunction with the timing of implementation. The system is designed and parameterized to facilitate this type of adjustment; however, there would be a total implementation cost of \$94,400 to include additional IT staff and contractors needed for design, development, testing and implementation, as well as communication updates both in print and within the related

sites and systems needed for the rulemaking and outreach to employers and third-party administrators. The timeframe for the change and release of this update would require at least one quarter (three months) to ensure that NMDWS captures any potential unknown impacts such as financial reporting adjustments that will be required.

In addition, SB 465 is silent on when the increase to the maximum contribution rate would go into effect. Rates are typically calculated on an annual basis and issued to employers in the fall before the rate effective year. However, if the change in the contribution rate is to take immediate effect, there would likely be substantial cost in recalculating an employers' quarterly rate mid-quarter for those employers that may be required to pay contribution rates above 5.4 percent. Off cycle rate changes will result in an increased requirement for testing activities. New rate notices would need to be sent to those employers affected immediately by the change, with significant cost in recalculation mid-quarter, as well as the cost in preparing and sending new Unemployment Insurance tax rate notices and other necessary communications. The total implementation cost for an off cycle rate change would be approximately \$236,000.

SIGNIFICANT ISSUES

The Social Security Act of 1935 compelled states to enact Unemployment Insurance (UI) programs nationally. UI is a joint state-federal social insurance program which provides benefits to eligible workers who become temporarily unemployed through no fault of their own, and meet certain other eligibility requirements. Benefits are paid from a state administered UI trust fund financed by a tax on employers.

Currently employer tax rates for contributing employers with more than 24 months of experience with New Mexico's UI program are set using a benefit ratio formula. Under this formula, an employer's last three year of benefit charges are divided by the employer's last three years average taxable payroll. This calculation yields the benefit ratio, which is then multiplied by a reserve factor ranging from 0.5 to 4.0. The reserve factor is set according to the health of the trust fund, with low fund balances triggering higher reserve factors. The maximum contribution rate available is 5.4 percent, but employers who have substantial benefit charges can also receive up to a 1 percent excess claims rate, which they pay in addition to their contribution rate.

Workforce Solutions Department (WSD) reported the following:

Doubling the maximum rate cap for employer contribution rates from 5.4 percent to over 10.8 percent would have a significant financial impact on many employers. The department estimates that over 4,200 employers with rates greater than 5.4 percent but currently capped at 5.4 percent would be directly impacted by the increase. Approximately half of all states currently have the same 5.4 percent maximum contribution rate as New Mexico according to the 2016 Comparison of State Unemployment Insurance Law published by the U.S. Department of Labor. If the maximum employer contribution rate was increased from 5.4 percent to 10.8 percent, New Mexico would have the second highest maximum rate cap in the country.

The rate calculation methodology is as follows. The contribution rate is calculated by multiplying the employer's benefit ratio by the reserve factor and then multiplying that product by the experience history for the employer:

Employer Contribution Rate:

$$\frac{\text{Benefits Charged Against Employer Account (3 yrs)}}{\text{Employers Average Taxable Payroll (3 yrs)}} \times \text{Reserve Factor}$$

The total rate is then calculated:

$$\begin{aligned} &\text{Contribution Rate (currently capped at 5.4 percent)} \\ &+ \\ &\text{Excess Claims Rate (capped at 1 percent)} \\ &= \\ &\text{Total Rate} \end{aligned}$$

It is also important to note that Unemployment Insurance quarterly contribution amounts for each individual employer involve several different factors including the rate calculation itself and the taxable wage base that is unique to each state. This is the tax base in which an employer pays the Unemployment Insurance tax on wages paid to (or earned by) each worker within a calendar year up to a specified amount. In New Mexico, the computation of the annual taxable wage base is indexed to the percentage of the state average annual wage figure. The taxable wage base varies each year, and for 2017 is \$24,300. This factor is important to consider along with the maximum employer contribution rate because in general, states with higher maximum contribution rates tend to have lower taxable wage bases or wage bases set at the Federal Unemployment Tax Act (FUTA) level of \$7,000. If the maximum employer contribution rate was increased to 10.8 percent, New Mexico would have the second highest maximum cap of all states but would also the highest maximum contribution rate of the 17 states with taxable wage bases greater than \$20,000.

Some employers will also be required to pay an additional 1.0 percent as an excess claims premium, pursuant to NMSA 1978 § 51-1-11(J), which would mean some employer contribution rates will be between 10.8 percent-11.8 percent. The department estimates that this would impact approximately 2,800 employers who have rates, before any cap is applied, greater than 10.8 percent. These employers would have a total rate between 10.8 percent-11.8 percent. Under current law, their rates, subject to the excess claims premium, are between 5.4 percent-6.4 percent. If an employer has a rate greater than 10.8 percent currently, with the current rate cap of 5.4 percent applied and an excess claims premium of 1.0 percent for a total rate of 6.4 percent, the employer would pay \$1,555.20 per employee based on the 2017 taxable wage base. With an increased maximum cap of 10.8 percent and a potential excess claims premium of 1 percent for a total rate of 11.8 percent, the employer would be subject to \$2,867.40 per employee.

The increase in the contribution rate up to 10.8 percent plus the excess claims premium could result in a reduced incentive for those employers to increase wages for their employees. There is also a potential concern that doubling the contribution rate currently paid by some employers could put those affected employers out of business or may result in more instances of misreporting proper wages for their employees in order to avoid paying the increased amount in taxes.

The increase in the maximum contribution rate could also affect certain industries more than others which would increase the starting contribution rate for new employers and potentially hamper the growth of new business in New Mexico. Businesses that have been contributing employers for less than twenty four months are assessed a rate based upon the average of all rates for their industry.

The current balance of the Unemployment Insurance Trust Fund as of February 16 is \$411M. At present, the reserve is adequate and the proposed increase that doubles the maximum tax rate for employers is unnecessary from a revenue prospective.

TECHNICAL ISSUES

WSD notes that all legislation to amend the State’s formula for calculating UI contribution rates must be approved and deemed by the United States Department of Labor to conform to federal law. NMDWS has submitted the request for an opinion from USDOL regarding this proposed legislation.

OTHER SUBSTANTIVE ISSUES

In 2015, New Mexico implemented a new employer contribution structure with tax rates which vary by employer and is primarily dependent the employer’s experience rating and the overall fiscal condition of the UI trust fund. This computation structure was a result of stakeholder input and discussion; however, some employers experienced substantial UI tax increases due to their individual experience rating. It is important to note an employer’s contribution rate can be lowered relatively quickly since benefit charges are based on the previous three year experience. Therefore, as employers engage in practices to reduce benefit charges in conjunction with trust fund reserves growing the UI system will stabilize and contribution rates may decline.

Employer Contribution Rate

$$\frac{\text{Benefits Charged Against Employer Account (3 yrs)}}{\text{Employers Average Taxable Payroll (3 yrs)}} \times \text{Reserve Factor}$$

Reserve Factor

More than Adequate Reserves = Between 0.5 and 0.9999 percent

Adequate Reserves = 1.0 percent

Less than Adequate Reserves = Between 1.0001 and 4.0 percent

The analysis of regional minimum, maximum, and average benefits indicates that New Mexico is in general alignment with surrounding states. However, the duration of benefits is significantly above average, resulting in longer durations of unemployment and larger draws from the fund. The eligibility of 26 weeks is federally mandated and therefore not adjustable; however best practice in other states has focused on reducing the duration of benefits by implementing programs to re-employ workers quicker. As a secondary benefit, reducing duration would also reduce benefit charges to employers and therefore possibly reduce the employer contribution rate.

Comparison of Surrounding States Weekly Benefit Amounts			Comparison of Surrounding States Average Weekly Benefit Amounts and Duration			2014 NM UI Benefit Highlights		
State	Weekly Benefit Amount		State	Average Weekly Benefit	Average Duration in Weeks	CY14		National Ranking
	Minimum	Maximum				Exhaustion Rate	Average Duration	
Arizona	\$126	\$240	Arizona	\$224	16.0	43.3%	11th Highest in the Nation	
California	\$40	\$450	California	\$303	18.1			
Colorado	\$25	\$532	Colorado	\$374	14.9			
Kansas	\$118	\$474	Kansas	\$358	13.6			
Nevada	\$16	\$412	Nevada	\$318	16.1	19.1 weeks	5th Highest in the Nation	
New Mexico	\$77	\$412	New Mexico	\$307	19.1			
Oklahoma	\$16	\$490	Oklahoma	\$324	16.6			
Texas	\$64	\$465	Texas	\$360	15.9			
Utah	\$26	\$496	Utah	\$352	13.2			
Wyoming	\$34	\$475	Wyoming	\$360	14.6			
Average	\$54	\$445	Average	\$328	15.8	\$306.52	25th Among States	

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