



Agenda Item 9

September 17, 2015

ITEM NAME: Final Proposed Regulation for Payment of Interest

PROGRAM: Customer Services and Support

ITEM TYPE: Action

RECOMMENDATION

Staff recommends the Board of Administration (Board) approve for submission to the Office of Administrative Law (OAL) the final proposed regulation establishing rules and procedures by which interest payments would be made to a defined benefit plan participant when a defined benefit plan has delayed payment in the correct amount owed to a participant beyond a reasonable administrative processing time.

EXECUTIVE SUMMARY

The final proposed regulation (Attachment 1) would (1) clarify the circumstances under which interest should be included in retroactive payments to participants of a defined benefit plan, (2) establish what interest rate should apply; (3) establish a fair administrative appeal process for participants to pursue timely claims that a defined benefit plan has failed to pay interest when required under the regulation; and (4) establish delegated authority in the Executive Officer to grant a participant's claim to interest up to a stated amount. The regulation will be added to Chapter 2 of Division 1 of Title 2 of the California Code of Regulations as Section 555.5. The proposed regulation clarifies and does not change existing law.

STRATEGIC PLAN

This agenda item supports Strategic Goal A by making explicit certain processes and procedures for the efficient administration of pension benefits.

BACKGROUND

At the April 2015 Board meeting, the Board approved a proposed regulation to establish rules and procedures by which interest payments would be made to a defined benefit plan participant when a defined benefit plan has delayed payment in the correct amount owed to a participant beyond a reasonable administrative processing time. Subsequently, a Notice of Proposed Regulatory Action was filed with OAL to initiate a 45-day written comment period during which interested parties may submit public comments relevant to the proposed regulatory action. Specifically, the proposed regulation for which final approval is requested is intended to clarify the circumstances under which interest should be included in retroactive payments to participants of a defined benefit plan by drawing a distinction between reasonable administrative processing times and "wrongfully withheld" payments, as those concepts apply to the defined benefit plans administered by the Board.

The proposed regulation, as modified, establishes 45 days as a reasonable administrative processing time. That 45 day period would commence when (1) the right to the payment has accrued, and (2) the defined benefit plan has all of the information it needs to begin to determine the proper amount of the payment. This regulation will not impact the goal to make all payments owing to participants as quickly as practicable. In practice, staff ordinarily has been able to process such payments in less than 45 days. Generally, most payments to participants from defined benefit plans are made before any interest would accrue under this regulation. That would continue to be the case if this regulation is adopted by the Board.

The proposed regulation establishes a seven percent per annum simple (non-compounding) interest rate as the appropriate interest rate for wrongfully delayed payments. This is the default interest rate established by Article XV, Section 1 of the California Constitution.

The proposed regulation specifies a process for participants to pursue claims that a defined benefit plan has failed to pay interest when required by the regulation. This aspect of the proposed regulation is important, because a decision as to whether interest is owed will turn on individualized factual scenarios that can vary substantially from case to case. The regulation makes use of the Board's existing administrative appeal procedures under Board Regulation 555, *et seq.*, to ensure that there is a fair process available to participants who believe they have been denied interest owing to them.

The proposed regulation delegates authority to the Executive Officer or his or her designee to grant a participant's claim for interest under this regulation for \$2,000 or less, if the Executive Officer or his or her designee determines that the claim has merit. This delegation of authority is proposed so that staff need not expend unwarranted resources on administrative appeals under this regulation.

The proposed regulation specifies that a participant must make a claim for interest under this regulation within three years of receiving the payment that the participant claims should have included interest. This provision will help staff avoid expending resources on stale claims.

As a clarification of existing law, the proposed regulation will be applicable to all payments in process now and in the future, and to all claims for interest that have not been finally resolved by the effective date of the regulation.

ANALYSIS

The Notice of Proposed Regulatory Action was published in the California Regulatory Notice Register 2015, No. 19-Z, File No. Z2015-0427-01, on May 8, 2015. The 45-day comment period commenced on May 8, 2015, and closed June 22, 2015. A total of four submissions were received within the comment period: (1) a letter requesting a public hearing; (2) a request to present oral comments at the hearing; (3) a 61 page document containing multiple comments, as well as numerous attachments; and (4) a request from an employer for a copy of the letter requesting the public hearing.

A public hearing was held before the Finance and Administration Committee on August 18, 2015. One interested party presented testimony and comments regarding the proposed regulatory action.

Following the August 18, 2015, hearing the California Public Employees' Retirement System (CalPERS) modified subdivision (c) of the proposed regulation to adjust, for purposes of the proposed regulation, the time period from 90 calendar days to 45 calendar days in which all payments owed to a participant from a defined benefit plan shall be authorized by the CalPERS board to the Controller after receipt of all information necessary to make the payment. The modification also adjusts from 90 calendar days to 45 calendar days the proviso that if the 45th day falls on a weekend or holiday, the Board may authorize the payment to the Controller on the next business day. All changes are reflected in the final proposed regulation with double strikethrough and double underlined text.

On August 20, 2015, CalPERS posted a Notice of Modifications to the Text of Proposed Regulation (Attachment 2). The Notice provided for a 15 day comment period, commencing August 20, 2015 and ending on September 4, 2015, during which interested parties could submit written comment on the modifications of the text of the proposed regulation.

SUMMARY OF WRITTEN COMMENTS TO MODIFICATION OF TEXT

CalPERS received two written comments to the modifications of the text of the proposed regulation. The first comment, dated August 25, 2015, was submitted by Mr. John Jensen. It consists of a two-page letter and exhibits (Attachment 3). The second comment, dated September 2, 2015, was also submitted by Mr. Jensen. It consists of a one-page letter and exhibits (Attachment 4). Mr. Jensen contends generally that the proposed regulation is unnecessary and inconsistent with existing law. Mr. Jensen further contends that the Board should delay moving forward with the proposed resolution until the California Supreme Court renders a final decision in the matter of *Flethez v. San Bernardino County Employees Ret. Assn.*, (2015) 189 Cal.Rptr.3d 823.

Mr. Jensen also contends that the modification of the proposed regulation is a major change that requires CalPERS to republish the proposed regulation and establish a new 45-day comment period. Mr. Jensen requests a second public hearing.

CalPERS' staff has considered Mr. Jensen's written comments to the proposed regulation, as modified, and disagrees with his assertions. All required publication and hearing procedures have been satisfied. Accordingly, CalPERS' staff is not recommending any changes to the proposed regulation, as modified, at this time.

BUDGET AND FISCAL IMPACTS

The fiscal impact of the proposed regulation is difficult to quantify, but likely minimal. The proposed regulation would result in interest payments on some payments to participants that may not otherwise be made. The instances in which payments would be subject to the accrual of interest should be rare, however, as the vast majority of all participant payments that would be subject to this regulation are generally made within the time frames contemplated by the proposed regulation. Further, the additional costs associated with the regulation may be offset by the savings resulting from the efficiency and predictability that the regulation would bring to the defined benefit plans administered by the Board.

BENEFITS/RISKS

The primary benefit of approving the proposed regulation is that it will provide clear and transparent guidelines for staff and participants of defined benefit plans administered by the Board. It will clarify existing legal standards for determining when a payment is deemed to have been "wrongfully withheld." It does not alter existing law. Further, it should help resolve legal disputes with members and beneficiaries claiming entitlement to interest.

The primary risk of the proposed regulation is that administration of the regulation will consume staff time and resources, but staff believes that this risk can be mitigated through an efficient and reasonable administration of the proposed regulation.

ATTACHMENTS

- Attachment 1 – Proposed Regulation as Modified
- Attachment 2 – Notice of Modification of Text of Proposed Regulation
- Attachment 3 – Written Comment – August 25, 2015 Letter and Exhibits
- Attachment 4 – Written Comment – September 2, 2015 Letter and Exhibits

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