

## **FINAL STATEMENT OF REASONS**

### **Adoption of California Code of Regulations (CCR) Section 555.5 in Article 2 of Subchapter 1, Chapter 2 of Division 1 of Title 2 of the California Code of Regulations Accrual of Interest on Certain Delayed Payments**

#### UPDATE OF INITIAL STATEMENT OF REASONS

There have been no changes in the applicable laws or facts, or to the effect of the proposed regulations, from those described in the Initial Statement of Reasons.

#### SUMMARY OF PROPOSED REGULATION

The proposed regulation 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 time and “wrongfully withheld” payments, as those concepts apply to the defined benefit plans administered by the California Public Employees’ Retirement System (CalPERS).

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 (e.g., the member’s effective retirement date), and (2) the defined benefit plan has all of the information it needs to begin to determine the proper amount of the payment.

The proposed regulation establishes a seven percent per annum simple (non-compounding) interest rate as the appropriate interest rate for wrongfully withheld 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. The regulation makes use of the Board’s existing administrative appeal procedures under California Code of Regulations, Title 2, sections 555-555.4 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 CalPERS 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, so that staff need not respond to stale claims.

## SUMMARY OF REGULATORY EVENTS

A 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 from Mr. John Michael Jensen (Mr. Jensen) requesting a public hearing; (2) a request from Mr. Jensen to present oral comments at the hearing; (3) a 61 page document from Mr. Jensen containing multiple comments, as well as numerous attachments (addressed below); and (4) a request from the Trans Bay Joint Powers Authority for a copy of the letter requesting the public hearing.

A public hearing was held on August 18, 2015. One interested party, Mr. Jensen, presented testimony and comments (addressed below) regarding the proposed regulatory action.

Following the August 18, 2015 hearing, the CalPERS Board 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 45<sup>th</sup> day falls on a weekend or holiday, the Board may authorize the payment to the Controller on the next business day. These modifications were made to ensure that all payments, when due, are processed as efficiently as possible.

On August 20, 2015 CalPERS posted a Notice of Modifications to the Text of Proposed Regulation. 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.

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

SUMMARY AND RESPONSE TO COMMENTS RECEIVED DURING THE INITIAL PUBLIC NOTICE PERIOD OF MAY 8, 2015 THROUGH JUNE 22, 2015

COMMENT NO. 1: Mr. Jensen contends that the propose regulation is in conflict with California Civil Code section 3287.

Response: California Civil Code section 3287 (which governs the accrual of prejudgment interest) and interpreting case law provide for the accrual of seven percent interest when a governmental entity has “wrongfully withheld” payments. These authorities do not, however, require interest to accrue when payments owing from a governmental entity are subject to delay that is due to reasonable administrative processing time. This regulation is consistent with Civil Code section 3287 because it defines what constitutes “wrongfully withheld” payments and reasonable administrative processing time, as those concepts apply to the defined benefit plans administered by the CalPERS Board.

COMMENT NO. 2: Mr. Jensen contends that the propose regulation is in conflict with California Code of Civil Procedure section 382.

Response: California Code of Civil Procedure section 382 relates to class actions in litigation. This regulation does not relate to class actions in litigation and therefore it is not in conflict with Code of Civil Procedure section 382.

COMMENT NO. 3: Mr. Jensen contends that the proposed regulation is inconsistent with the Public Employees Retirement Law (PERL) (Government Code sections 20000 et. seq.) because CalPERS has existing duties to pay on time and in full which the proposed regulation will impair by allowing late payments without interest.

Response: Although the PERL requires the payment of interest in some situations, it does not require the payment of interest in the situations that are covered by this regulation. CalPERS agrees that it has a duty to pay benefits on time and in full, but determining what constitutes “on time” must account for reasonable administrative processing time. That is what this regulation does.

COMMENT NO. 4: Mr. Jensen contends that the proposed regulation is unconstitutional as it impairs vested contractual rights.

Response: This regulation provides for the payment of interest to participants who currently do not receive interest. Providing a new right to participants does not impair their vested rights.

COMMENT NO. 5: Mr. Jensen contends that CalPERS has no authority to promulgate regulations revising the effect of the Civil Code or the Code of Civil Procedure, and that CalPERS authority is limited to clarifying matters within the PERL.

Response: The CalPERS Board has constitutional and statutory authority to administer CalPERS, the Legislators' Retirement System (LRS), the Judges' Retirement System (JRS) and the Judges Retirement System II (JRSII). This regulation pertains to the payment of interest from those retirement funds. If any participant believes that he or she is entitled to additional amounts under the Civil Code or the Code of Civil Procedure, that participant may pursue that claim in the courts (after exhausting any available administrative remedies).

COMMENT NO. 6: Mr. Jensen contends that the proposed regulation is beyond the scope of the authority delegated to CalPERS.

Response: The CalPERS Board has the "plenary authority and fiduciary responsibility for ... administration of the system." Cal. Const., art. XVI, sec. 17. The CalPERS Board is the governing Board of CalPERS, the JRS, the JRSII" and the LRS. See Gov't Code §§ 9353 (LRS), 20120 (CalPERS) 75005 (JRS), 75505 (JRSII). CalPERS is governed by the PERL. Many provisions of the PERL are also incorporated by reference into the laws governing the JRS, the JRSII and the LRS. See Gov't Code §§ 9353 (LRS), 75005 (JRS), 75505 (JRSII). Consistent with its constitutional "plenary authority and fiduciary responsibility," the Board "may make such rules at it deems proper." See Gov't Code § 20121. Further, the Board has statutory authority to correct errors and omissions, such as "wrongfully withheld" payments that result from errors or unreasonable delays. See Gov't Code § 20160 *et seq.*

COMMENT NO. 7: Mr. Jensen contends that the proposed regulation is unconstitutional as it functions to delay the date of maturity of a pension right.

Response: This regulation does not delay the date that a pension right "matures" or "accrues" in any way. By law, benefits are due within a reasonable administrative processing time after they accrue. This regulation merely establishes parameters for determining what constitutes a reasonable administrative processing time as that concept is applied to CalPERS, the LRS, the JRS and the JRSII.

COMMENT NO. 8: Mr. Jensen contends that the proposed regulation lacks consistency with other Death Benefit and Industrial Disability Retirement provisions in the PERL.

Response: Interest accrual on delayed death benefit payments is governed by Government Code section 21499. This regulation expressly states that it does not apply to payments that are governed by section 21499. This regulation is, however, consistent with section 21499, and indeed follows the same model as section 21499, which also establishes 45 days as a reasonable administrative processing time. There is no provision in the PERL that requires payment of interest on disability benefits.

COMMENT NO. 9: Mr. Jensen contends that the proposed regulation lacks consistency in that it seeks to apply to claims retroactively.

Response: This regulation provides a mechanism to pay interest in cases in which CalPERS, the LRS, the JRS and the JRSII currently do not pay interest. Thus, to the extent it is “retroactive” at all, that retroactivity provides a benefit to participants of those systems that is not currently available.

COMMENT NO. 10: Mr. Jensen contends that the proposed regulation destroys the remedies available to claimants in the matter of *Kesterson et al. v. California Public Employees’ Retirement System, et al.* (Los Angeles County Superior Court Case No. 502628).

Response: The plaintiffs in *Kesterson et al. v. California Public Employees’ Retirement System* will be able to make whatever arguments they deem appropriate in that litigation and the court in that case will decide whether, and to what extent, this regulation impacts their claims.

COMMENT NO. 11: Mr. Jensen contends that the proposed regulation fails to satisfy the requirements of Government Code section 11349 in that: 1) it lacks reference; 2) lacks clarity; and 3) is duplicative.

Response: The CalPERS Board has authority to pass this regulation under Government Code section 20121. Further, this regulation clarifies when CalPERS will pay interest as part of its duty to correct errors and omissions under Government Code section 20160 *et seq.* The terms of the regulation are clear and they are not duplicative because they provide for the payment of interest to participants in circumstances in which those participants would not currently receive interest.

#### SUMMARY AND RESPONSE TO COMMENTS RECEIVED DURING THE PUBLIC HEARING ON AUGUST 18, 2015

COMMENT NO. 1: Mr. Jensen contends that action should be delayed on 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.

Response: *Flethez v. San Bernardino County Employees’ Ret. Assn.* (2015) 189 Cal.Rptr.3d 823 relates to the calculation of prejudgment interest in cases where the courts have overturned a retirement board’s denial of a disability application. The regulation does not relate to that situation, but rather relates to the accrual of interest at the administrative level, before any judgment has been entered by the courts. In the unlikely event that the Supreme Court radically departs from the well-settled “wrongful withholding” requirement for prejudgment interest to accrue, the CalPERS Board can revisit the regulation at that time.

COMMENT NO. 2: Mr. Jensen contends that the proposed regulation disenfranchises CalPERS members by requiring them to exhaust their administrative remedies before pursuing a court action.

Response: It is a requirement of California law that a party exhausts his or her administrative remedies before resorting to the Courts. The provision of an administrative remedy does not disenfranchise anyone. Further, the regulation is providing for the payment of interest in situations in which CalPERS, the LRS, the JRS and the JRSII currently do not pay interest.

#### COMMENTS RECEIVED ON THE MODIFIED TEXT DURING THE 15 DAY PERIOD BETWEEN AUGUST 20, 2015 AND SEPTEMBER 4, 2015.

COMMENT NO. 1: Mr. Jensen contends that action should be delayed on 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.

Response: *Flethez v. San Bernardino County Employees' Ret. Assn.* (2015) 189 Cal.Rptr.3d 823 relates to the calculation of prejudgment interest in a case where the courts have overturned a retirement board's denial of a disability application. The regulation does not relate to that situation, but rather relates to the accrual of interest at the administrative level, before any judgment has been entered by the courts. In the unlikely event that the Supreme Court radically departs from the well-settled "wrongful withholding" requirement for prejudgment interest to accrue, the CalPERS Board can revisit the regulation at that time.

COMMENT NO. 2: Mr. Jensen contends that the modification of the proposed regulation was a major change that requires CalPERS to republish the proposed regulation and establish a new 45-day comment period.

Response: The fundamental structure and purpose of the regulation did not change. The only thing that changed was a shortening of the time period that constitutes reasonable administrative processing time from 90 days to 45 days. This shortening works to the benefit of participants because interest will accrue sooner.

#### REASONS FOR REJECTING ANY PROPOSED ALTERNATIVES THAT WOULD LESSEN ADVERSE ECONOMIC IMPACT ON SMALL BUSINESS

The proposed regulation does not affect small businesses because the regulations would apply only to CalPERS members in local agencies, school districts, and State departments pursuant to the California Public Employees' Retirement Law (PERL). Since small businesses are not subject to the PERL, the proposed regulations would not have a significant statewide adverse economic impact directly affecting these

businesses including the ability of these small businesses in California to compete with businesses in other states.

#### ALTERNATIVES DETERMINATION

CalPERS has determined that no alternative it considered or that was otherwise identified and brought to its attention would be more effective in carrying out the purpose for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed actions, or would be more cost-effective to affected private persons and equally effective in implementing the statutory policy or other provision of law.

#### LOCAL MANDATE DETERMINATION

The proposed regulations do not impose any mandate on local agencies or school districts.