

REVISED INITIAL STATEMENT OF REASONS

Proposed Amendment to add the following Section to Chapter 2 of Division 1 of Title 2 of the California Code of Regulations (CCR)

- **Adoption of Section 555.5, Accrual of Interest on Certain Delayed Payments, in Article 2 of Subchapter 1, Chapter 2 of Division 1 of Title 2 of the CCR.**

By proposing this regulation, the California Public Employees' Retirement System ("CalPERS") seeks to (1) define the circumstances under which interest should be included in retroactive payments to participants of a defined benefit plan administered by the CalPERS Board ("Board"), (2) establish what interest rate should apply, and (3) establish a fair administrative appeal process for participants to pursue claims that a defined benefit plan has failed to pay interest when required under the regulation. The proposed regulation is consistent with existing law and is reasonably necessary to establish fair and transparent processes.

PROBLEM THE PROPOSED REGULATION INTENDS TO ADDRESS

In the vast majority of cases, the defined benefit plans administered by the Board pay benefits in the correct amount within a reasonable administrative processing time (usually far less than 90 days). From time to time, however, benefits are underpaid due to a system delay that might fairly be characterized as unreasonable. In those instances, it may be appropriate to include interest with the retroactive payments owing to the participants.

In some situations, statutory law provides clear direction as to when interest should be paid to members and which interest rate should be used (for example refunds of member accounts and payments of death benefits more than 45 days after the system receives all of the information it needs to pay the death benefits). In many situations, however, statutory law does not provide clear direction as to when interest should be paid and at what rate. To make explicit the processes and procedures that apply to these matters, the proposed regulation provides as follows.

First, the proposed regulation draws a distinction between ordinary administrative processing time and "wrongfully withheld" payments, as those concepts reasonably apply to the defined benefit plans administered by the Board. It then establishes 90 days as a reasonable administrative processing time. If a payment owed a participant from a defined benefit plan is not authorized to the State Controller within the established 90 day time frame, then payment shall include seven percent per annum simple (non-compounding) interest. Such interest shall run from the expiration of the established 90 day time frame through the day that the Board expects the Controller to issue the warrant for the amount owed.

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

Moreover, 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 proposed regulation makes use of the Board's existing administrative appeal procedures to ensure that there is a fair process available to participants who believe they have been denied interest owing to them. Moreover, the proposed regulation defines the process for asserting a claim for unpaid interest and a time frame within which the claim must be asserted.

Lastly, the proposed regulation delegates authority to the CalPERS Executive Officer or his or her designee to grant a participant's claim for interest for \$2,000 or less, if the Executive Officer or his designee determines the claim has merit.

PURPOSE, BENEFITS, OR GOALS OF THE AUTHORIZING STATUTES

The primary purpose and benefit of the proposed regulation is that it will provide clear and transparent guidelines for the CalPERS staff when evaluating claims for payment of interest. Further, it should help resolve legal disputes with participants who claim an entitlement to unpaid interest.

The Board's authority to add the proposed regulation to the CCR derives from the Board's plenary authority and fiduciary responsibility over the assets of the public retirement system and exclusive responsibility to administer the Plans in a manner that will assure prompt delivery of benefits and related services to the members and their beneficiaries, pursuant to the California Constitution (Section 17 of Article XVI) and pursuant to the Board's rule-making authority under California Government Code Section 20121. In addition, other Sections of California Constitution and Government Code that provide authority include Section 1 of Article XV of the California Constitution, and Government Code Sections 9353, 20120, 20121, 20134, 20160, 75005, and 75505.

RATIONALE FOR DETERMINATION THAT ADOPTION IS REASONABLY NECESSARY TO ADDRESS THE PROBLEM

The decision as to whether interest is owed to a participant may turn on individualized factual scenarios that can vary substantially from case to case. As such, there is a need to establish processes and procedures to evaluate and resolve disputes over claims for interest. CalPERS believes that the proposed regulation is necessary to establish clear processes and procedures for the reasons more fully discussed below.

Subdivision (a) of the proposed regulation, titled "Board Finding and Declaration", is necessary to provide general frontend guidance to participants and CalPERS staff as to the purpose of the regulation and its meaning. The finding and declaration themselves explain why this regulation is required, and why it will inure to the benefit of CalPERS' participants.

Subdivision (b) of the proposed regulation, titled “Applicability”, is necessary to make clear that the proposed regulation only applies to participants of the CalPERS defined benefit plans where a specific statute addressing the terms and condition of interest accrual does not exist. Additionally, we believe that subparts (b)(1) through (b)(4) are necessary to make sure that the applicability of the proposed regulation is not misunderstood to apply to any other claims against CalPERS other than benefit calculation claims. The proposed regulation is for limited purposes only.

Subdivision (c) of the proposed regulation, titled “Reasonable Administrative Processing Time”, provides a 90 day timeframe. We believe that 90 days is a reasonable and appropriate timeframe that strikes the right balance between the participants’ interests and CalPERS’ operational needs. 90 days permits a reasonable processing time for staff to obtain and evaluate information necessary for making an accurate payment. Additionally, we believe that if the 90th day falls on a weekend or holiday, staff would not be available to authorize the payment. The next business day is a reasonable day for the Board to authorize payment.

Subdivision (c)(1) through (c)(7) of the proposed regulation define what it means for the Board to have “All information necessary to make the payment” for purposes of subdivision (c). We believe that a list of the type of information that the Board must receive before the 90 day timeframe begins is necessary to ensure that interest only accrues in instances where the Board has received the accurate and complete information.

The term “not limited to” in Subdivision (c) is necessary to ensure that all relevant information, including that which may not be currently titled or otherwise subject to description, be included in the information the Board may consider.

The term “accrual of rights” in Subdivision(c)(1) is necessary to help establish the date payment is due.

The term “final eligibility determinations” in Subdivision(c)(2) is necessary to help establish the date payment is due.

The term “directions received from a court” in Subdivision(c)(3) is necessary to help establish the date payment is due.

Subdivision (d) of the proposed regulation, titled “Appropriate Interest”, provides the interest rate. CalPERS believes that seven percent per annum simple (non-compounding) interest is reasonable for certain delayed payments and consistent with the default interest rate established by Article XV, Section 1 of the California Constitution.

Subdivision (e) of the proposed regulation, titled “Administrative Remedies”, specifies a process for participants to pursue claims that a defined benefit plan has failed to pay interest when required by the regulation. CalPERS believes that it is reasonable for the

Executive Officer or his or her designee to be able to grant a participant's claim for interest under the regulation for \$2,000 or less in certain instances. CalPERS believes that \$2000 is a reasonable amount after balancing the participants' interests and CalPERS' interest to minimize expending unwarranted resources on administrative appeals under this regulation.

Subdivision (f) of the proposed regulation, titled "Time Limitation To Initiate Administrative Remedies", specifies how a participant must assert his or her claim for such interest within a specified timeframe or the claim is barred. CalPERS believes that a three year timeframe is reasonable and strikes this right balance between participants' interests and CalPERS' interests in minimizing expending resources on stale claims.

SPECIFIC PURPOSE FOR THE ADOPTION OF THE PROPOSED REGULATION

Purpose of the Proposed Addition of Section 555.5, "Accrual of Interest on Certain Delayed Payments"

The proposed regulation is intended to define the circumstances under which interest should be included in retroactive payments of a defined benefit plan. It does so, first, by drawing a distinction between ordinary administrative processing time and "wrongfully withheld" payments, as those concepts reasonably apply to the defined benefit plans administered by the Board.

The proposed regulation establishes 90 days as reasonable administrative processing time for payments owed to participant of defined benefit plans. The 90 days would not start running until (1) the right to the payment has accrued, and (2) the defined benefit plan has all of the information it needs to determine the proper amount of the payment.

The proposed regulation contains a definition of the types of information necessary for it to make a payment. That information includes, but is not limited to, "any accurate and complete information that the Board must receive from a participant, an employer or any other party, when such information may impact the amount owed to the participant."

The proposed regulation provides that if a payment owed to a participant from a defined benefit plan is not authorized to the State Controller within the time period established under the regulation, then payment shall include seven percent per annum simple (non-compounding) interest. 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. That process requires a participant who claims that interest has not been paid as required under the regulation to exhaust his or her administrative remedies with the Board before seeking relief in any court.

The regulation provides that the CalPERS Executive Officer or his or her designee is authorized to grant a participant's claim for interest under the regulation for \$2,000 or less, if the Executive Officer or his or her designee determines that the claim has merit. When a participant has asserted a claim for interest under the regulation for \$2,000 or less and the Executive Officer or his or her designee has rejected the claim in writing, the participant shall be deemed to have exhausted his or her administrative remedies.

The regulation specifies that any participant who claims that interest has not been paid as required under the regulation must assert his or her claim for such interest in writing received by the Board within three years after the participant received the payment that the participant claims should have included interest, or else that claim is forever barred.

BENEFITS ANTICIPATED FROM THE REGULATORY ACTION

The primary benefit of the proposed regulation is that it will provide clear and transparent guidelines for CalPERS staff and participants of defined benefit plans administered by the Board. Further, it should help resolve legal disputes with members and beneficiaries claiming entitlement to interest.

TECHNICAL, THEORETICAL AND/OR EMPIRICAL STUDIES, REPORTS, OR DOCUMENTS RELIED UPON BY THE AGENCY

Economic and Fiscal Impact Statement (STD. 399) was prepared and relied upon.

ECONOMIC IMPACT ASSESSMENT

In accordance with Government Code Section 11346.3(b), CalPERS has made the following assessments regarding the proposed regulation:

Creation or Elimination of Jobs within the State of California

The proposed regulation is intended to define the circumstances under which interest should be included in retroactive payments to participants of a defined benefit plan by drawing a distinction between ordinary administrative processing time and "wrongfully withheld" payments, as those concepts reasonably apply to the defined benefit plans administered by CalPERS. The proposed regulation will be administered by existing CalPERS staff. The proposed regulation affects the interests of individual participants in CalPERS' defined benefit plans and not the interests of any business entity. No jobs within the State of California will be created or eliminated by the proposed regulation.

Creation of New or Elimination of Existing Businesses within the State of California

The proposed regulation is intended to define the circumstances under which interest should be included in retroactive payments to participants of a defined benefit plan by drawing a distinction between ordinary administrative processing time and “wrongfully withheld” payments, as those concepts reasonably apply to the defined benefit plans administered by CalPERS. The proposed regulation will be administered by existing CalPERS staff. The proposed regulation affects the interests of individual participants in CalPERS’ defined benefit plans and not the interests of any business entity. No businesses within the State of California will be created or eliminated by the proposed regulation.

Expansion of Businesses within the State of California

The proposed regulation is intended to define the circumstances under which interest should be included in retroactive payments to participants of a defined benefit plan by drawing a distinction between ordinary administrative processing time and “wrongfully withheld” payments, as those concepts reasonably apply to the defined benefit plans administered by CalPERS. The proposed regulation will be administered by existing CalPERS staff. The proposed regulation affects the interests of individual participants in CalPERS’ defined benefit plans and not the interests of any business entity. It is not expected that any existing businesses within the State of California will be expanded or prevented from expansion by the proposed regulation.

Benefits of the Regulation to the Health and Welfare of California Residents, Worker Safety, and the State’s Environment

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. Further, it should help resolve legal disputes with participants claiming entitlement to interest. The proposed regulation will not adversely impact the health and welfare of California residents, worker safety, or the State’s environment.

ALTERNATIVES TO THE REGULATORY ACTION AND CALPERS REASON FOR REJECTING THOSE ALTERNATIVES

No other alternatives were considered by the Board as the proposed regulation is needed to ensure the efficient administration of pension benefits. However, the Board invites interested persons to present statements or arguments with respect to alternatives to the proposed regulation during the written comment period.

As CalPERS has identified no burden on private persons by the proposed action, CalPERS has not identified any reasonable alternatives that would be as effective or less burdensome.

CalPERS will consider any reasonable alternatives proposed through the public comment period associated with this regulatory action.

ALTERNATIVES TO THE REGULATORY ACTION THAT WOULD LESSEN ADVERSE IMPACT ON SMALL BUSINESS

The proposed regulation is designed to apply to CalPERS and the participants of the defined benefit plans administered by the Board (the PERS, the JRS, the JRS II and the LRS). The proposed regulation affects the interests of individual participants in CalPERS' defined benefit plans and not the interests of any business entity. CalPERS has not identified any adverse impacts on small businesses. As such, reasonable alternatives that would lessen the impact on small businesses were not considered.