

EMPLOYMENT DEVELOPMENT DEPARTMENT

Amendment of Title 22, California Code of Regulations Section 3254(i)-2

VOLUNTARY PLANS - RISKS ADVERSE TO THE DISABILITY FUND

Initial Statement of Reasons

BACKGROUND:

The Employment Development Department (Department) extends approval to employers to operate voluntary plans (VP) for short-term disability insurance coverage, in lieu of State Disability Insurance (SDI) coverage, as set forth in Division 1, Part 2, Chapter 6, of the California Unemployment Insurance Code (UI) and California Code of Regulations (CCR), title 22.

Existing statute and regulations allow a VP or a group of VPs to be underwritten by an admitted disability insurer under the condition that approval is only given if it would not result in a substantial selection of risks adverse to the Disability Fund. Existing regulations identify female claimants, claimants age 50 and over, and claimants earning less than \$3,600 in annual wages as less favorable risks in terms of disability insurance. Each year the Department determines the percentage of benefits paid to such claimants. Every insurer's experience with these groups is then compared to the total claims experience of the employed workers under the State plan and all VPs. The age, gender and wage distribution criteria were established to ensure the solvency of the Disability Fund.

Under Insurance Code Section 10270.2 (f), only the Department of Insurance (DOI) has authority to approve a VP insurance policy offered by an admitted disability insurer. It is only after the policy is approved that the Department can review the application from an admitted disability insurer to administer a VP. To ensure a more equitable distribution of risks between the State and private insurers, the Department requires at the time of plan approval that the employees to be covered by the plan include a specified percentage of females, employees age 50 and over, and employees earning \$3,600 or less in annual wages. In order to retain approval status, an insurer's claims experience for the groups measured must be within five percent of the total experience. If an insurer's experience is five percent or more below the total experience in any of the groups measured, a substantial selection of risks is indicated and the director shall terminate approval of plans which have been measured for claims experience.

In order to assist the Department in determining whether to revise the existing eligibility criteria for private short-term disability insurance with respect to age, gender and wages, an actuarial study was conducted. The study relied primarily on contribution and benefit payment information provided by the Department as well as public information available from the United States Census based on data from 2002 through 2004. (See *California EDD: Private Insurance Voluntary Plans Analysis of Employee Demographic Criteria, December 2007.*)

The results of the study found that the existing eligibility criteria based on age and gender continue to be acceptable and reasonable standards and that no changes are required as to those criteria. However, the study determined that the existing annual wage criterion of \$3,600 is grossly inadequate and requires amendments to be made to the governing regulations. The study recommended that the Department establish an annual wage criterion of approximately \$30,000 (based on 2002 through 2004 data) to be commensurate with current economic standards.

The study utilized statewide wage data, as well as Department data on the Weekly Benefit Amount and the Maximum Benefit Amount to determine the income benefit ratio. Based on a thorough analysis of the wage and Disability Insurance (DI) claims data, the study determined that \$30,000 is the appropriate amount for 2004 at which private insurers could still participate in the DI insurance market without disadvantaging the Disability Fund. Specifically, \$30,000 is the minimum wage amount at which the benefit ratios for 2002 through 2004 were the closest to 100% (1.0) and the relativities for 2002 through 2004 were the closest to 1.0. Establishing the eligibility criteria at the point where the population has a benefit ratio of 1.0 or 100% (where the benefits paid roughly equals the amount of contributions paid) ensures that private insurers do not only cover a portion of the population that has a lower than average contribution ratio. Furthermore, establishing the eligibility criteria at the point where the population has a relativity of 1.0 (where the calculated benefit ratio roughly equals the average benefit ratio) ensures that private insurers do not only cover a portion of the population that has a lower than average contribution ratio.

However, the study also determined that, due to wage inflation, the appropriate cut-off point for the minimum wage amount will change and become outdated over time. In order to address this wage fluctuation in the future, the report recommends basing the wage distribution criteria as a percentage of the average weekly wage, as determined by the U.S. Department of Labor. Since the \$30,000 wage threshold is roughly 70% of the 2004 average weekly wage, the report recommends basing future wage thresholds on 70% of each year's average weekly wage.

Furthermore, over the past decade, the Department has experienced an array of database migrations resulting in age and gender information that was previously captured for VP reporting to no longer be readily available or accessible. This

data is critical for determining the percentages of females and employees age 50 and older in subject employment for the purpose of establishing standards for approval with respect to gender and age. This leaves the Department with the option of either implementing programming and procedural changes to obtain such data, which has significant fiscal implications, or utilizing alternative sources of information readily available from the Bureau of Labor Statistics of the United States Department of Labor. The Department proposes to revise the regulation to incorporate the use of such alternative sources of information.

NECESSITY:

Under UI Code sections 305 and 306, the Director of the Department is authorized to adopt, amend, or repeal regulations for the administration of the functions of the Department and the enforcement of the Director's functions under the UI Code. Under UI Code sections 3251, 3253, 3254, and 3255, a qualified employer is able to provide Disability Insurance and Family Temporary Disability Insurance benefits to employees electing coverage under the employer's VP.

The following proposed amendments to CCR, title 22, section 3254(i)-2 will:

- Update the wage distribution criteria related to the standards for approval for a voluntary plan or a group of voluntary plans underwritten by an admitted disability insurer;
- Establish the wage distribution criteria as indexed for inflation, rather than being fixed, and allow for adjustments to be made by adopting a method based on the state average weekly wage; and
- Change the date by which the Director is required to establish the standards for approval with respect to gender, age and wage distribution from July 1 of each fiscal year to October 31 of each calendar year.
- Substitute the use of alternative sources of data available from the Bureau of Labor Statistics of the United States Department of Labor to establish the standards for approval with respect to gender and age.

Section 3254(i)-2. Risks Adverse to the Disability Fund.

The provisions of CCR, title 22, section 3254(i)-2, specify the "standards for approval" for private disability insurance carriers and require the Director to set the standard not later than June 1 preceding each fiscal year. This standard must represent a cross section of subject employment, and meet certain criteria in regards to gender, age, and wage distribution. Currently, the standard for approval regarding wage distribution is based on wages paid in the amount of \$3,600 per year which is based on the standard of living from approximately 40 years ago.

The proposed regulation amendments to section 3254(i)-2 are as follows:

Subdivision (b) – The proposed regulation amendment adds definitions for “state average annual wage” and “calendar year”, and deletes the definitions for “the four calendar quarters of computation” and “fiscal year”. This is necessary to establish new definitions for the purpose of the section and delete the former definitions which will no longer be used.

Subdivision (c) – The proposed regulation amendment would establish new requirements regarding the standards for approval with respect to age, gender, and wage distribution. The proposed regulation amendment would change the date the director is required to establish the standards for approval from June 1 preceding each fiscal year to October 31 preceding each calendar year. This amendment is necessary to allow the Department to develop and establish the standards for approval for age, gender and wage distribution simultaneously and make the establishment date consistent with the time of year that applications for approval of a VP are generally submitted and processed by the Department.

Subdivision (c)(1) – The proposed regulation amendment would delete the criteria that required the Department to establish the standard for approval with respect to gender based on determining the average percentage of females in subject employment during each of the four calendar quarters, as specified. Historically, the subject employment information related to gender was obtained from the Department’s databases. Due to the occurrence of database/programming migrations over the past decade that information is no longer readily available or accessible.

The proposed regulation amendment would allow the Department to determine the annual average percentage of females in employment based on data from the most recent Current Population Survey developed by the Bureau of Labor Statistics of the United States Department of Labor. This amendment is necessary to allow the Department to utilize a viable source of information that is readily available as an alternative to implementing programming and procedural changes in order to capture and access the needed information, which would result in a significant fiscal impact on the Department.

The amendment also deletes the requirement to exclude employees, who earned less than the amount prescribed under UI Code section 2652 during the specified four calendar quarters, from the computation related to determining the percentage of females in subject employment. This requirement would no longer be applicable since the Department proposes to utilize the most recent Current Population Survey developed by the Bureau of Labor Statistics of the United States Department of Labor to establish the standard for approval with respect to gender.

Subdivision (c)(2) – The proposed regulation amendment would delete the criteria that required the Department to establish the standard for approval with respect to age based on determining the average percentage of employees age 50 and older in subject employment during each of the four calendar quarters, as specified. Historically, the subject employment information related to age was obtained from the Department’s databases. Due to the occurrence of database/programming migrations over the past decade, that information is no longer readily available or accessible.

The proposed regulation amendment would allow the Department to establish the standard for approval with respect to age by determining the annual average percentage of employees age 50 and older in employment based on data from the most recent Current Population Survey developed by the Bureau of Labor Statistics of the United States Department of Labor. This amendment is necessary to allow the Department to utilize a viable source of information that is readily available as an alternative to implementing programming and procedural changes in order to capture and access the needed information, which would result in a significant fiscal impact on the Department.

The amendment also deletes the requirement to exclude employees, who earned less than the amount prescribed under UI Code section 2652 during the specified four calendar quarters, from the computation related to determining the percentage of employees age 50 and older in subject employment. This requirement would no longer be applicable since the Department proposes to utilize the most recent Current Population Survey developed by the Bureau of Labor Statistics of the United States Department of Labor to establish the standard for approval with respect to age.

Subdivision (c)(3) - The proposed regulation amendment would delete: (1) the requirement to establish a standard for approval with respect to wage distribution in each calendar quarter, as specified, and (2) the current wage criteria identified as those employees earning less than \$3,600 during four calendar quarters, as specified.

The amendment also deletes the requirement to exclude employees, who earned less than the amount prescribed under UI Code section 2652 during a specified four calendar quarters, from the computation when determining the percentage of employees in subject employment that earned less than \$3,600 in wages during the specified four calendar quarters. This requirement would no longer be applicable since the Department proposes to utilize California employment annual averages regarding wages based on its internal data to establish the standard for approval with respect to wage distribution.

The proposed regulation amendment would allow the Department to establish the standard for approval with respect to wage distribution on an annual basis. It would also establish a new wage distribution criterion based on determining the

annual percentage of employees in employment who earned less than 70% of the state average annual wage, as determined by the U.S. Department of Labor. This amendment is necessary to establish a wage distribution criterion that is commensurate with current economic standards and allow for adjustments to be made to the criterion based on changes to those economic standards. The need to amend this section is due to the outdated wage criterion currently cited in the regulation. The proposed amendment would allow the Director to establish a wage criterion that is indexed for inflation, rather than fixed, in order to allow for any adjustments to be made to the standard for approval to reflect the current economic standards at the time the standard for approval is published. It would allow the Department to utilize its internal data to identify the annual percentage of employees in employment that earned less than seventy percent (70%) of the state average annual wage, as specified, for the purpose of establishing the standard for approval with respect to wage distribution for each calendar year.

Subdivision (d) – The proposed regulation amendment would establish October 31 preceding each calendar year as the required date for the director to publish and notify each admitted disability insurer of voluntary plans of the standards for approval with respect to gender, age and wage distribution. This amendment is necessary to provide consistency with other amendments to this section by aligning the required dates for Department action and specifying that the standards for approval will be established each calendar year to allow the simultaneous establishment of all three standards.

Subdivision (e) – New requirements have been inserted into this subdivision and from this point on the remainder of the subdivisions have been renumbered accordingly. The proposed regulation amendment would establish and delineate employee enrollment information requirements with which an employer or group of employees must comply when filing an application for approval of a voluntary plan. This amendment is necessary to provide the Department with a detailed account of eligible employees to determine whether a plan or a group of plans meet the standards for approval with respect to age, gender and wage distribution.

Subdivision (f) – The existing language in subdivision (e) is now subdivision (f). The proposed regulation amendment makes corresponding changes to specified references as a result of reformatting the section. The amendment also reformats the existing requirements in subdivision (3) to further clarify the criteria.

Subdivision (g) – The existing language in subdivision (f) is now subdivision (g). The proposed regulation amendment makes corresponding changes to references regarding the age, gender and wage criteria, other subdivisions as a result of reformatting the section, and required effective dates (i.e. January 1, calendar year) to conform to the proposed changes in prior subdivisions.

The amendment also adds examples in the form of tables to illustrate the methodology and requirements by which the Department approves a voluntary plan underwritten by an admitted disability insurer. This amendment is necessary to clarify the voluntary plan approval process by illustrating how the Department utilizes California employment annual averages, based on United States Department of Labor data and Department data, and employee demographic information provided by an employer when determining if a voluntary plan meets the minimum requirements for the gender, age and wage distribution criteria.

Subdivision (h) – The existing language in subdivision (g) is now subdivision (h). The proposed regulation amendment makes corresponding changes to references regarding other subdivisions as a result of reformatting the section, and required effective dates (i.e. January 1, calendar year) to conform to the proposed changes in prior subdivisions. The amendment clarifies the term “insurer” by adding the phrase “admitted disability”. The amendment also reformats the existing requirements in subdivision (3) to clarify the criteria.

Subdivision (i) – The existing language in subdivision (h) is now subdivision (i). The proposed regulation amendment makes corresponding changes to references regarding other subdivisions as a result of reformatting the section and required effective dates (i.e. January 1, calendar year) to conform to the proposed changes in prior subdivisions. The amendment clarifies the term “insurer” by adding the phrase “admitted disability”. The amendment also replaces the word “withdrawal” with “termination” throughout the subdivision to make the regulatory language more consistent with the statutory language.

Furthermore, the amendment deletes the provision that establishes a predetermined effective date when terminating approval of a VP. This amendment is necessary to provide the Department with the flexibility to terminate approval of any VP, at any time, when there has been a failure to comply with the terms and conditions of the plan, as specified in section 3262-1 of the CCR. The Department will continue to provide a notice of termination to the admitted disability insurer 65 days prior to the termination effective date.

Subdivision (j) – The existing language in subdivision (i) is now subdivision (j). The proposed regulation amendment makes corresponding changes to references regarding the age, gender and wage criteria, and required effective dates (i.e. December 1, calendar year) to conform to the proposed changes in prior subdivisions. The amendment clarifies the term “insurer” by adding the phrase “admitted disability”. The amendment also deletes the provision excluding pregnancy benefits from the data considered under subdivision (j)(2) because such benefits are now payable under the State plan.

Subdivision (k) – The existing language in subdivision (j) is now subdivision (k). The proposed regulation amendment makes corresponding changes to

references regarding the age, gender and wage criteria, and required effective dates (i.e. January 1, calendar year) to conform to the proposed changes in prior subdivisions. The amendment clarifies the term “insurer” by adding the phrase “admitted disability”.

Subdivision (l) – The existing language in subdivision (k) is now subdivision (l). The proposed regulation amendment makes corresponding changes to references regarding other subdivisions as a result of reformatting the section and required effective dates (i.e. January 1, calendar year) to conform to the proposed changes in prior subdivisions. The amendment clarifies the term “insurer” by adding the phrase “admitted disability”. The amendment also replaces the word “withdrawal” with “termination” throughout the subdivision to make the regulatory language more consistent with the statutory language.

Subdivision (l)(2) - The amendment deletes the provision that establishes a predetermined effective date when terminating approval of a VP. This amendment is necessary to provide the Department with the flexibility to terminate approval of any VP, at any time, when there has been a failure to comply with the terms and conditions of the plan, as specified in section 3262-1 of the CCR. The Department will continue to provide a notice of termination to the admitted disability insurer 65 days prior to the termination effective date.

TECHNICAL, THEORETICAL, AND EMPIRICAL STUDY, REPORT OR SIMILAR DOCUMENTS RELIED UPON:

The rulemaking file contains the following documents:

- a) *California EDD: Private Insurance Voluntary Plans - Analysis of Employee Demographic Criteria*, December 2007
- b) U.S. Department of Labor, Unemployment Insurance Financial and Labor Force Data, Fourth Quarter, 2004, California
[\[http://ows.doleta.gov/unemploy/content/data_stats/datasum04/4thqtr/finance.asp#California\]](http://ows.doleta.gov/unemploy/content/data_stats/datasum04/4thqtr/finance.asp#California)
- c) U.S. Department of Labor, Bureau of Labor Statistics, Employment Status Of The Civilian Noninstitutional Population By Sex, Race, Hispanic Or Latino Ethnicity, And Detailed Age, 2007 Annual Averages, California
[\[http://www.bls.gov/lau/ptable14full2007.pdf\]](http://www.bls.gov/lau/ptable14full2007.pdf)

PLAIN ENGLISH CONFORMING STATEMENT:

The Department has drafted the proposed amendments in plain English pursuant to section 11346.2(a)(1) of the Government Code.

CONSIDERATION OF ALTERNATIVES:

In accordance with section 11346.2(b)(3)(B) of the Government Code, there were no reasonable alternatives to be considered by the Department.

SMALL BUSINESS IMPACT:

The Department has determined that the proposed amendments will have no effect on small businesses because the proposed amendments would enhance and update the VP Standards for Approval and authorize the Department to utilize viable sources of information, as an alternative to incurring cost prohibitive programming and procedural changes, resulting in a more efficient administration of the VP program with no adverse impact on small businesses.

ECONOMIC IMPACT STATEMENT:

The Department does not anticipate the proposed amendments will result in any costs to the federal government, to State government, to local county governments, to private individuals, or to businesses or small businesses. Thus, no costs were shown on the Economic and Fiscal Impact Statement.

The Department has made an initial determination that the proposed amendments will not have a significant statewide adverse economic impact directly affecting businesses including the ability of California businesses to compete with businesses in other states. The proposed regulation amendments would enhance and update the VP Standards for Approval and authorize the Department to utilize viable sources of information, as an alternative to incurring cost prohibitive programming and procedural changes, resulting in a more efficient administration of the VP program with no adverse impact on VPs administered by an admitted disability insurer. The Department has determined that the proposed amendments will not affect the creation or elimination of jobs within the State of California, the creation of new businesses or the elimination of existing businesses within the State of California, or the expansion of businesses currently doing business within the State of California.
