

SUBCOMMITTEE NO. 5

Agenda

Senator Nancy Skinner, Chair
Senator Joel Anderson
Senator Jim Beall



Thursday, May 18, 2017
9:30 a.m. or upon adjournment of Session
State Capitol - Room 3191(room change)

Consultant: Anita Lee

AGENDA PART B

Vote Only Items

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Vote Only Items

7100**EMPLOYMENT DEVELOPMENT DEPARTMENT****Issue 1: Disability Insurance Program**

Summary. For 2016-17, this proposal requests a decrease of \$140.9 million in Disability Insurance (DI) benefits authority. For 2017-18, this proposal requests a decrease of \$132.0 million in DI benefits authority.

California's DI program contributes to the economic security of California by providing benefits to eligible workers. The DI program provides benefits to workers who are unable to work due to pregnancy or non-work related illness or injury. Although Workers' Compensation laws cover work-related disabilities, DI benefits may also be paid for work-related illnesses or injuries under certain circumstances.

Effective July 1, 2004, the DI Program expanded to include the Paid Family Leave (PFL) program. The PFL program provides up to six weeks of benefits to individuals who must be away from work to care for a seriously ill family member, domestic partner, or for the birth, adoption, or foster care placement of a child. Effective July 1, 2014, the PFL program was extended to allow workers to collect benefits while caring for seriously ill grandparents, grandchildren, siblings and parent-in-laws.

Benefit Payments: For 2016-17, benefit payments are projected to decrease by \$140,949,000 from the level estimated in the October 2016 Revise. The proposed change includes a decrease of \$151,466,000 in benefit payments for the DI program and an increase of \$10,517,000 in benefit payments for the PFL program. The DI program's Average Weekly Benefit Amount (AWBA) increased from \$524 to \$525 and the PFL program's AWBA decreased from \$582 to \$579.

In 2017-18 benefit payments are projected to decrease by \$131,992,000 from the level estimated in the October 2016 Revise. The proposed change includes a decrease of \$152,382,000 in benefit payments for the DI program and an increase of \$20,390,000 in benefit payments for the PFL program. The DI program's AWBA decreased from \$556 to \$555 and the PFL program's AWBA decreased from \$615 to \$611.

Staff Recommendation. Approve as Proposed.

Issue 2: Unemployment Insurance Program

Summary. For 2016-17, this proposal requests an increase of \$23.5 million in Unemployment Insurance (UI) benefits authority. For 2017-18, this proposal requests an increase of \$245.0 million UI benefits authority.

The Administration also proposes an increase of \$1.8 million to reflect an increase in interest due to the federal government borrowing that has occurred to provide unemployment benefits without interruption.

Background. As an employer-funded program, California's UI program contributes to the economic security of California by providing benefits to eligible workers. The UI program provides benefits to individuals who become unemployed through no fault of their own. Individuals file claims with the Employment Development Department (EDD) and, if determined eligible, are paid UI benefits. The Emergency Unemployment Compensation (EUC) program has expired as of December 28, 2013. Although the EUC program has expired, the EDD continues to process minimal workload related to the extensions. This proposal adjusts the authority needed to pay claims established in the October 2016 Revise. The EDD has adjusted the projections for UI workload and estimated UI claims based upon changes in the January 2017 economic outlook provided by EDD's Labor Market Information Division.

Benefit Payments: For 2016-17, benefit payments are projected to increase by \$23.53 million from the level previously estimated in the October 2016 Revise. Total benefit payments are estimated to be \$5.8 million. Increases are being driven by the increase in the unemployment level and an increase to the Average Weekly Benefit Amount (AWBA) from \$312 to \$316.

For 2017-18, benefit payments are projected to increase by \$245 million from the level previously estimated in the October 2016 Revise. Total benefit payments are estimated to be \$6 billion. Similar to the current year, the increase is driven by an increase in the unemployment level and the AWBA increasing from \$315 to \$320. The 2016-17 and 2017-18 projected benefit amounts include a buffer of three percent for economic uncertainties. Without this buffer, benefits would decrease by \$69.6 million in 2016-17 and increase by \$68.4 million in 2017-18.

Staff Recommendation. Approve as proposed.

Issue 3: School Employees Fund (SEF)

Summary. For 2016-17, this proposal requests a decrease of \$10.7 million in budget authority for School Employee Fund Local Assistance. For 2017-18, this proposal requests an increase of \$5.0 million in budget authority for SEF Local Assistance.

Background. The SEF is a joint pooled risk fund administered by EDD, which collects contributions based upon a percentage of total wages paid by public schools and community college districts. The contribution rate is calculated annually based upon the formula established per Section 823 of the California Unemployment Insurance Code. Money deposited in the SEF is used to reimburse the Unemployment Fund for the cost of Unemployment Insurance benefits paid to former employees of those school employers who have elected this option in lieu of paying the tax-rated method, as is required of private sector employers.

Upon recommendation by the School Employer Advisory Committee, and subsequent approval by the EDD Director, the SEF contribution rate is 0.05 percent for 2016-17 and an estimated 0.05 percent for 2017-18. The economy's steady growth and the implementation of the new Local Control Funding formula will support school budgets as benefits return to normal historical levels. Currently, there are approximately 1,331 public school districts and county offices of education (including charter schools) and 72 community college districts that have elected to participate in the fund.

Local Assistance (disbursements) includes benefit charges and claims management fees. The estimated Local Assistance for SFY 2016-17 is \$10,686,000 lower than reported in October 2016, for a total of \$86,203,000. The estimated Local Assistance for SFY 2017-18 is \$5,000,000 higher than reported in October 2016, for a total of \$79,918,000. Changes to Local Assistance estimates for both 2016-17 and 2017-18 were adjusted from the October 2016 forecast based on actual data from the current year and reflect a trend of UI benefits that continue to return to historical levels, which is consistent with the current economic outlook.

Staff Recommendation. Approve as proposed.

7300 AGRICULTURAL LABOR RELATIONS BOARD**Issue 4: Funding for Agricultural Labor Relations Board**

Governor's Budget proposal. The Agricultural Labor Relations Board (ALRB) requests the the current limited term funding of \$573,000 General Fund for limited-term positions: 1.5 hearing officer II positions and one Attorney IV position be made permanent. The workload for these positions has not decreased and is projected to increase as new satellite offices are fully opened and education and outreach efforts are increased.

Background. In 2015-16, ALRB received a budget augmentation of \$1.6 million for 13 positions. The General Counsel received nine of these positions were to expand local operations at two new regional offices. However, the second office just opened in February, and as of the end of 2016, only one new regional office was opened, and roughly 30 percent of the general counsels 39 positions were vacant.

ALRB is requesting permanent augmentation for 1.5 hearing officer II positions, which would bring the ALRB's total permanent hearing officer staffing to three positions. The hearing officer is the presiding administrative law judge and every case that comes before a hearing officer is fact-specific and unique in the complexity of the law involved. Hearing officer decisions are multifaceted and complex as cases can involve thousands of employees, resulting in numerous legal questions within a single case. Prior to the 2015-16 budget, it took 200 to 600 days to schedule a hearing. However, with the additional limited-term positions, hearings were scheduled within a 60 to 90 day time frame, which provided greater assurances to farmworkers will be available to participate in a hearing.

ALRB is also requesting permanent augmentation for the attorney IV position. In January 2014, to address the ALRB's increased state and federal court litigation workload, the Labor and Workforce Development Agency (LWDA) temporarily redirected resources to provide a limited-term Attorney IV position to the board to oversee, coordinate, and assist board counsel and attorneys assigned from the Office of the Attorney General to handle litigation. The 2015-16 budget provided a two year limited term attorney IV position for the ALRB, which expires in July. The primary responsibility of the attorney IV is appellate work where the position works with the three board counsel positions to represent the ALRB in the most sensitive and complex matters.

Staff notes two years ago, as a part of the 2015-16 budget act, the state provided additional positions with the understanding that there would be two additional regional offices. However, the second office recently opened in February. Given this and the vacancy rate, it may be premature to make these positions permanent. The subcommittee may wish to extend these limited term positions for another two years, and revisit the position authority moving forward

Staff Recommendation. Approve two-year limited term positions for 1.5 hearing officer II positions and one Attorney IV position.

7320**PUBLIC EMPLOYMENT RELATIONS BOARD****Issue 5: Augmentation for Public Employment Relations Board**

Summary. The May Revision proposes \$750,000 General Fund in 2017-18 and 2018-19, \$620,000 in 2019-20, and \$590,000 in 2020-21 and ongoing to provide the appropriate level of permanent funding to support all existing permanent positions, reduce existing backlogs, and improve PERB's timeliness for issuance of resolutions and case determinations.

Background. Beginning in 2002, PERB held open two Board member positions and their supporting staff, in order to utilize the resulting salary savings to meet PERB's other operational needs. Additionally, over the last 14 years it has been necessary for PERB to take other measures to balance its budget, such as holding as many as 9.5 positions vacant at any given time as well as participating in the state's layoff process. Most recently, in 2015-16, PERB instituted a self-imposed hiring freeze and reduced operations to remain within the budget appropriation, which increased the backlog of cases filed with the Office of the General Counsel by 68 percent.

A permanent increase in appropriation to fund the vacant Board member positions and their supporting staff is necessary to reduce the existing case backlog as well as ensure PERB can fill all current authorized positions. The salary and benefit cost for these positions is estimated at \$885,000. Pursuant to the Legislature's approval, \$435,000 was provided in the 2016-17 BCP to be allocated towards this structural shortfall, leaving a remaining balance of \$450,000. For FY 2016-17, PERB held 3.0 positions vacant to manage this structural shortfall and began filling positions on a limited term basis when salary savings from vacant appointee positions accrued.

PERB's caseloads fluctuate seasonally and with changes in the state's economy; however, historical data collected and reported annually reflects a constant workload growth that also correlates with the expansion of PERB's statutory responsibilities. In its approval of additional funding for FY 2016-17, the Legislature requested that PERB provide caseload and position tracking. The data collected thus far reflects an incremental growth in backlogged cases incurred due to vacancies within the office of the General Counsel. The positions were recently filled and the new staff are addressing the caseload.

PERB has determined that an effective timeline to complete investigations and issue determinations is within 60 days of the filing of an unfair practice case or representation matter. Currently, the office of the General Counsel takes more than five months to investigate and issue determinations in these matters and it often takes a year or more for the Board to receive a proposed decision, and years for the Board to issue a final determination. These delays are inconsistent with PERB's goals to provide meaningful resolution of labor disputes in a timely manner.

Staff Recommendation. Approve as proposed.

7350 DEPARTMENT OF INDUSTRIAL RELATIONS**Issue 6: Enhanced Enforcement Compliance and Apprenticeship Services**

Summary. The Department of Industrial Relations requests 11 positions and \$1.7 million special funds in 2017-18, 25 positions and \$3.4 million special funds in 2018-19, with 19 positions and \$2.6 million special funds ongoing, to fulfill the provisions of recently chaptered legislation:

- Assembly Bill 1066 (Gonzalez), Chapter 313, Statutes of 2016: Phase-In Overtime for Agriculture Workers
- Assembly Bill 1978 (Gonzalez), Chapter 373, Statutes of 2016: Property Service Workers
- Senate Bill 693 (Hueso), Chapter 774, Statutes of 2016: Workforce Expansion
- Senate Bill 1001 (Mitchell), Chapter 782, Statutes of 2016: Immigrant Workers Document Protections
- Senate Bill 1063 (Hall), Chapter 866, Statutes of 2016: Equal Pay – Race and Ethnicity
- Senate Bill 1167 (Mendoza), Chapter 839, Statutes of 2016: Indoor Heat Regulations

Background.

Assembly Bill 1066 (Gonzalez). AB 1066 removes an exemption for agricultural employees regarding hours, meal breaks, and other working conditions. The bill includes specific wage requirements, bringing farmworkers in line with the majority of employees in California who are protected by the existing mandate that any hours worked in excess of eight hours per day or 40 hours per week be paid at 1.5 times the regular pay. The bill provides for a phase-in approach for overtime requirements that gradually implement the eight hour workday for farmworkers over a four-year period.

The department requests \$40,000 for outreach in 2017-18, and two positions and \$308,000 in 2018-19, with \$267,000 ongoing to support its Division of Labor Standards Enforcement (DLSE) for increased workload created by the passage of AB 1066.

Assembly Bill 1978 (Gonzalez). AB 1978 establishes specific standards and protections for property service workers (otherwise known as janitors). The intent of the new law is to combat wage theft, ensure compliance with existing labor laws, and also lower instances of sexual harassment, sexual violence, and human trafficking in the property services industry, where it is particularly prevalent. The bill requires biennial in-person sexual violence and harassment training requirement for employees and employers, as well as requiring the registration of janitorial contractors with DIR.

The department requests an augmentation of three positions and \$442,000 in 2017-18, nine positions and \$1 million in 2018-19, with nine positions and \$967,000 ongoing. These positions will support DLSE in implementing the requirements under AB 1978.

Senate Bill 693 (Hueso). The Division of Apprenticeship Standards (DAS) promotes and develops apprenticeship training and enforces minimum apprenticeship standards. Among other

mandates, DAS is the division within DIR responsible for approving new apprenticeships programs, ensuring that programs are adhering to its approved training standards, registering apprentices in approved programs, investigating apprentice complaints against programs, and issuing State certificates of completion to graduates of programs.

Because only registered apprentices may be paid a lower prevailing wage on publicly-funded “public works” projects, DAS regularly receives inquiries from the public to verify that a worker is a registered apprentice. Employers also contact DAS when they wish to confirm that worker has completed an apprenticeship and has graduated into a journey person. SB 693 allows a public entity to require a bidder, contractor, or other entity to use a skilled and trained workforce to complete a contract or project. DIR notes that the additional resources will allow the department to respond to inquiries and verification regarding DAS approved programs. The Department requests one position and \$123,000 in 2017-18, (\$116,000) to provide resources for DAS to address additional workload as a result of SB 693.

Senate Bill 1001 (Mitchell). SB 1001 created a new protection that makes document abuse a strict liability violation regardless of intent. Specifically, this bill expands protection to immigrant applicants seeking employment by explicitly stating that it is unlawful to request more or different documents than required by federal law as a prerequisite to employment. The bill provides that an applicant for employment or an employee who believes their rights have been violated under this law may file a complaint with DLSE for equitable relief and penalties not to exceed \$10,000 per violation. The department requests three positions and \$437,000 in 2017-18 and 2018-19 as a two-year limited-term funding, to support its DLSE for increased workload created by SB 1001.

Senate Bill 1063 (Hall). Existing law prohibits payment of a wage less than the wage rate paid to employees of the opposite sex for substantially similar work, when viewed as a composite of skill, effort, and responsibility, and performed under similar working conditions. SB 1063 adds a new and discrete equal pay protection to the existing protection for gender-based disparity to also include a prohibition against paying lesser wage to an employee based on race or ethnicity. The amendments made by SB 1063 are an individual worker protection that will be enforced by the DLSE’s Retaliation Complaint Investigation unit within DIR. The department requests three positions and limited-term augmentation of \$415,000 in 2017-18 and \$392,000 in 2018-19, to implement the requirements of SB 1063 that will expand equal pay protections to include a prohibition against paying a lesser wage to an employee based on race or ethnicity.

Senate Bill 1167 (Mendoza). The Division of Occupational Safety and Health (DOSH) is the sole agency responsible for protecting workers from health and safety hazards on the job. DOSH protects workers in almost every workplace in California through its enforcement, research, and standards, and consultation programs. SB 1167 requires DOSH to develop a new heat-illness prevention standard for indoor workers which would specify necessary measures to control indoor exposures to heat and would make compliance and enforcement easier and more effective. The new standard completed by this bill could prompt engineering and administrative changes to reduce risks of heat stress for indoor employees.

The Department requests one position and \$212,000 for 2017-18 and seven positions and \$1.1 million in 2018-19, with \$1.3 million ongoing, to provide resources for DOSH to address the new activity of indoor heat exposure inspections to protect California workers as required by SB 1167.

Staff Recommendation. Approve as budgeted.

Issue 7: Implementation of Chaptered Legislation Relating to Workers Compensation

Summary. In April, the Administration submitted a Spring Fiscal Letter proposing 73.0 additional positions and \$14.71 million in 2017-18 (\$13.6 million ongoing) from the Workers' Compensation Administration Revolving Fund to implement and meet the ongoing requirements of Senate Bill 1160 (Mendoza), Chapter 868, Statutes of 2016, and AB 1244 (Gray) Chapter 852, Statutes of 2016.

Background. SB 1160 and AB 1244 looked to address demonstrated fraud in the worker's compensation system. Recent news stories, including coverage by the Center of Investigative Reporting, show that workers' compensation provider fraud is endemic - notably in Los Angeles County -costing stakeholders and the system over \$1 billion in liens that had accumulated in the system at the time of this writing. In particular, the current workers' compensation lien claim and litigation system has proven to be highly exploitable by fraudulent medical providers.

SB 1160 was a reform bill intended to remove unnecessary litigation from the workers' compensation system that was exposed by SB 863 reforms. SB 1160 expedites medical treatment to injured workers within the first 30 days after their injury by exempting conservative treatment from utilization review, standardizing utilization review procedures, modernizing data collection in the system to improve transparency, and implementing anti-fraud measures in the filing and collection of lien claims for medical treatment. AB 1244 addresses medical provider fraud within the workers' compensation system and creates a new adjudication, stay, and suspension process for dealing with convicted and indicted providers that have medical lien claims within the system. These two bills are estimated to save the system \$800 million

Of the positions requested, 12.0 positions are needed to support three information technology projects which will help facilitate the necessary reform efforts: 1) Doctor's First Report of Injury; 2) Utilization Review Management and Provider Suspensions; and 3) Consolidated Lien Proceedings. Of the remaining 61.0 positions, 50.0 positions are specific to the anti-fraud provisions of these two bills focused on: 1) the work of the Anti-Fraud Unit; 2) Provider Suspension Hearings; and 3) Special Lien Proceedings.

The adoption of the two reform bills significantly increased the Department's role in combating fraud. The small investment in proposal staff are required to perform a variety of functions for hundreds of claims to achieve the estimated \$800 million in savings to the worker's compensation system. Given the level of savings that could be achieved, the Subcommittee may wish to revisit this issue in 2018-19 to insure that the department has adequate resources to carry out the newly mandated tasks.

Staff Recommendation. Approve as proposed.

Issue 8: Occupational Safety and Health Penalty Federal Compliance Trailer Bill

Summary. The Administration is proposing trailer bill to align state occupational safety and health administration plan to meet minimum federal standards. Under existing federal law, a state OSHA plans must meet minimum standards in order to gain federal approval and corresponding federal funding. Federal OSHA has identified a concern regarding how California's state plan handles certain retaliation claims relating to reports of an injury. The TBL would clarify that workers that report an injury that does not relate to a specific OSHA complaint or worker's compensation claim are still protected from retaliation. These changes would alleviate federal concerns regarding California's state plan and minimize the state's risk of losing federal approval and funding.

Staff Recommendation. Approve proposed trailer bill language.

Issue 9: Public Works Enforcement

Summary. The Administration is proposing six positions and \$805,000 in 2017-18, and \$759,000 in 2018-19 from the Labor and Workforce Development Fund to education awarding bodies of their requirements to comply with registration requirements, and one attorney position with \$212,000 in 2017-18 and \$204,000 ongoing from the State Public Works Enforcement Fund. Additionally, the Administration is proposing to trailer bill language to increase enforcement and compliance with registration compliance. This item was heard at the March 30th hearing.

Background

The Administration notes that the annual revenues from the recently created contractor registration fee are less than estimated when the fee was established and do not cover current spending levels for public works enforcement. Specifically, the administration estimates that expenditures from the State Public Works Enforcement Fund (SPWEF) in 2016-17 will be \$13 million, while revenues coming into the SPWEF from the contractor registration fee will be only \$10 million. If fee revenues continue at this level and no adjustments are made to spending levels, SPWEF's reserves would be virtually exhausted in 2017-18.

The Administration believes that one reason revenues have not met expectations is that some contractors may not be complying with the registration requirement. During 2015-16, less than 30,000 contractors registered and paid the fee, compared to an initial rough estimate of 40,000 or more registrations. Through its enforcement efforts, DLSE found about 600 instances where contractors were working on a public works project during 2015-16 without registration. Contractors that are found to be bidding or working on a public works contract without registration are subject to a penalty of up to \$2,000 and may face temporary disqualification from bidding or working on public works projects for repeat violations.

Governor's Proposal

The Governor proposes a few actions to address the funding shortfall in the SPWEF in 2017-18 and later years. First, the Governor proposes to provide funding to DLSE on a two-year limited-term basis for six positions to conduct outreach with awarding bodies to improve their awareness of their responsibility to ensure that contractors have complied with this requirement, with the intent of increasing compliance and fee revenue over time. As part of this outreach, DLSE would encourage awarding bodies to require contractors to "prequalify," or demonstrate compliance with various labor law requirements, including the contractor registration requirement, before bidding on public works contracts. Under current law, awarding bodies are authorized, but most are not mandated, to require contractors to prequalify.

The Governor's proposal would reduce expenditures from the SPWEF by moving the support of the prevailing wage determination function from the SPWEF to the LECF beginning in 2017-18 and beyond. This action would free up \$2.2 million in the SPWEF on an ongoing basis and would largely address the funding imbalance going forward, even if contractor registration fee revenues remain flat in future years.

For 2017-18 only, the Governor proposes to shift the portion of statewide administrative costs allocated to the SPWEF (such as the fund's portion of reimbursements to the state Department of Finance and Department of Human Resources) to other special funds administered by DIR. This one-time action frees up an additional \$1.1 million in the SPWEF in 2017-18.

Current law gives DLSE the authority to "debar," or prohibit a contractor from bidding or working on public works contracts, for up to three years if the contractor violates public works requirements under certain conditions. The Governor's proposal would provide \$212,000 from the SPWEF for one additional Attorney III position to allow DLSE to conduct additional debarment proceedings.

In addition to the budget change proposal, the Administration is proposed trailer bill language. Below is a summary of some of the key provisions included in the TBL:

- **Small Projects Exemption.** Provides administrative relief for contractors and awarding agencies on small projects. Among the provisions, the TBL creates a new minimum threshold triggering registration requirement for projects over \$25,000 for new construction; over \$15,000 for maintenance.
- **Unregistered Contractor Sanctions.** Among its provisions, the TBL requires all contractors and subcontractors engaged in the performance of a public work must be registered. If the Labor Commissioner determines that a contractor or subcontractor has violated the registration requirement, unregistered contractors shall forfeit as a civil penalty to the state \$100 per day up to \$8,000. A registered public works contractor or subcontractor who enters into a contract with an unregistered lower-tier subcontract to perform any public work shall be subject to one or both of loss of registration from the current year, and a civil penalty of \$100 per day, up to \$10,000.
- **Awarding Agency Sanctions.** Specifies that an Awarding Agency (AA) authority that fails to provide the notice to DIR, or enters into contract with or permits unregistered contractor or subcontractor to engage in work, is subject to fine of \$100 per day up to \$10,000. Additionally, if Labor Commissioner determines that AA willfully violated requirements of this section or chapter on 2 more projects within a 12 month period, the AA shall be ineligible to receive state funding or financial assistance for any construction project undertaken by the AA for one year. Penalties received shall be deposited into the State Public Works Enforcement Fund.

The May Revision proposed amendments to the trailer bill. Specifically, the new trailer bill language removed the provision regarding debarment, or loss of registration and disqualification of registration for the following year, as well as allowing registrants to register for multiple years at a time, and raising the registration fee from \$300 to \$400.

DLSE to report by March 2019 on (1) changes in the amount of contractor registration fees collected; (2) the estimated effect of any efforts to increase compliance with the contractor registration fee, including outreach to awarding bodies and other steps to increase awarding body accountability for ensuring contractor registration; (3) what adjustments are necessary to the

level of the contractor registration fee in order to support ongoing public works enforcement costs and repay the SPWEF's outstanding loans to other funds; and (4) the feasibility of shifting support for the prevailing wage determination function back to the SPWEF.

Staff Recommendation. Adopt proposed trailer bill language, and modify the budget change proposal to move the support of the prevailing wage determination function from the SPWEF to the LECF beginning in 2017-18 for two years. Additionally, adopt supplemental reporting language for the DLSE to report by March 2019 on (1) changes in the amount of contractor registration fees collected; (2) the estimated effect of any efforts to increase compliance with the contractor registration fee, including outreach to awarding bodies and other steps to increase awarding body accountability for ensuring contractor registration; (3) what adjustments are necessary to the level of the contractor registration fee in order to support ongoing public works enforcement costs and repay the SPWEF's outstanding loans to other funds; and (4) the feasibility of shifting support for the prevailing wage determination function back to the SPWEF.

Issue 10: Strategic Enforcement of Labor Standards

Summary. The Administration proposes a three year phase-in and an increase of 31 positions and \$4.6 million in 2017-18, 58.5 positions and \$8.6 million in 2018-19, 82.5 positions and \$11.6 million in 2019-20, and \$11.4 million ongoing from the Labor Enforcement and Compliance Fund. These resources seek to combat wage theft and labor law violations. Additionally, the Administration is proposing accompanying trailer bill to address enforcement issues. The subcommittee approved the position authority and funding at its March 30th hearing, however did not act on the trailer bill language.

Trailer Bill Language. The May Revision proposes the following changes summarized below:

- 1) **License Revocation:** The proposed amendments also clarify that the Labor Commission may refer a *final* unpaid wage judgment that have been unpaid for at least 30 days to the licensing agency to initiative disciplinary action to suspend or revoke current license or to deny renewal of a license. A valid wage claim does not turn into a judgment until all appeals have been exhausted, all judgments are considered final.
 - a. Added provision that the Labor Commissioner will not refer an employer to the respective licensing board if the licensee has a notarized and approved installment payment plan. If the licensee misses an installment the licensee is no longer excused from a referral under this section.
 - b. Upon full payment of a final judgment, at the licensee's request, the Labor Commissioner shall promptly notify the licensing agency that a wage judgment has been satisfied.
- 2) **Tolling Statute of Limitations:** The proposed amendments limits tolling period to 12 months. Specifically, upon issuing a notice to an employer about an opening an investigation the wages owed and related penalties and reimbursements as enumerated will toll for 12 months.
- 3) **Evidentiary Sanctions.** The proposed amendments provides that generally an employer will have no less than 15 days to respond to a Labor Commissioner's request for records. The Labor Commissioner may extend the time to produce records under at her discretion, under a variety of scenarios, including if the employer made good faith efforts to comply, and if a timely good faith response to the Labor Commissioner that additional time is needed.

Staff notes that while the proposed amendments have addressed a variety of stakeholder concerns, staff notes that the department is still in negotiating with stakeholders. In particular, stakeholders have concerns regarding provisions related to license revocation, attorney fees, and allowing DLSE to request a temporary reinstatement of a worker during an unlawful retaliation investigation. Staff notes that the Department and stakeholders are still collaborating on those provisions of the bill.

Staff Recommendation. Adopt placeholder trailer bill language.

7501 Department of Human Resources (CalHR)**Issue 11: Dependent Re-Verification Process.**

Summary. The Governor's budget includes one position and \$175,000 in reimbursement authority for 2017-18, \$118,000 and in 2018-19, and ongoing, to perform the new workload to develop, implement and administer the dependent re-verification process.

Background. In January 2011, CalPERS Board of Administration endorsed the Health Benefits Purchasing Review (HBPR) project to develop strategies and initiatives to ensure the continuation and sustainability of the CalPERS Health Benefits Program. The HBPR resulted in the development of 21 initiatives, including dependent eligibility verification designed to influence health care delivery, improve health outcomes, and delivery sustainable programs. The purpose of the dependent eligibility verification project was to ensure all dependents enrolled in a CalPERS health plan met CalPERS' eligibility criteria and to prevent members and employers from having to pay health care costs for those who do not qualify. During verification, each subscriber with at least one dependent enrolled on their health plan was required to provide specific supporting documentation based on dependent type (e.g., spouse, domestic partner, child, parent-child relationship). The 2013-15 CalPERS Dependent Eligibility Verification project disenrolled 8,379 ineligible state employee dependents from the CalPERS health plans for a savings of over \$60 million.

Senate Bill 98, (Committee on Budget and Fiscal Review), Chapter 28, Statutes of 2015 designates CalHR to establish standards for the employing office of the state employee to conduct health dependent eligibility at least once every three years for spouses, domestic partners, children, stepchildren, and domestic partner children; and at least once annually for other children enrolled as dependents under parent-child relationship. Eligibility is the same for dental benefits as it is for health benefits.

CalHR is requesting funding to perform project management and other duties to administer dependent re-verification process and workload associated with oversight to ensure that departments are removing ineligible dependents from health and dental benefits. CalHR will hire a full-time staff personnel program analyst (SPPA), a classification that is responsible for the most complex and difficult personnel management assignments at the statewide human resources leadership level. The SPPA will conduct biweekly project meetings with CalPERS and departmental HR representatives, creating policy memos, training and procedural manuals, user guidance, and assisting state departments with re-verification process issues. On a continuing basis the SPPA will analyze enrollment data, monitor departmental compliance with health and dental dependent enrollments, train department HR staff on eligibility rules and enrollment, verification and termination procedures.

CalHR notes that on August 2017, the SPPA will begin monitoring departments to ensure that they are removing ineligible dependents from dental benefits, and develop a procedural manual to for the re-verification process, and conduct multi-departmental trainings. From 2018 onward, the SPPA will begin the re-verification process, among other duties described above.

Staff Recommendation: Approve as budgeted.

7920 CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM**Issue 12: Revised Creditable Compensation**

Summary. The May Revise proposes a technical correction regarding the amount of General Fund contribution to CalSTRS based on the revision of the credible compensation. Credible compensation are types of compensation that are factored into the calculation of the pension benefit.

Background. The revision in the credible compensation results is an increase in funding \$3.7 million reported by CalSTRS for fiscal year 2015-16. This increase consists of \$801,000 in defined benefit payment, \$1.9 million in the pre-1990 defined benefit level, and \$993,000 for supplemental benefit maintenance account.

Staff Recommendation. Approve as proposed.

9800 Augmentation for Employee Compensation and Control Section 3.61**Issue 13: Scheduled Employee Compensation Augmentation Increases**

Governor's Budget Proposal. The Governor's May Revision proposes the following items related to employee compensation augmentations:

Budget Item 9800 allows for adjustments in departmental budgets to account for changes in employee compensation, including salaries, health and retirement benefits. This proposal would increase Item 9800-001-0001 by \$32.12 million, would increase Item 9800-001-0494 by \$9.98 million, and would increase Item 9800-001-0988 by \$4.92 million to reflect changes discussed below.

Control Section 3.61 is used to prefund retiree health benefits through departmental budgets. The May Revision requests control section 3.61 be amended to reflect additional employer contributions for prefunding other postemployment benefits based on a recent agreement that has been collectively bargained with Physicians and Dentists (Bargaining Unit 16). Additionally, the Director of Finance has determined state employees of the Judicial Branch are required to contribute 2.3 percent effective July 1, 2017. As a result, the state will match Judicial Branch state employees' contributions of 2.3 percent effective July 1, 2017.

The May Revision also requests various General Fund items be increased by \$152.68 million, various special fund items be increased by \$39.88 million, various non-governmental cost funds be increased by \$26.68 million, and reimbursements for various items be increased by \$20.31 million to reflect salary and benefit increases for recently negotiated memorandum of understanding with bargaining units represented by the Service Employees International Union (SEIU), Firefighters (BU8), Craft and Maintenance Workers (BU12), Stationary Engineers (BU13), Psychiatric Technicians (BU18), Health and Social Service Professionals (BU19), and Excluded employees.

Background: Item 9800 includes all augmentations in employee compensation. These reflect increased enrollment in health and dental plans, updated employment information for salary increases previously provided in the Governor's budget, revised estimates reflect increased enrollment in health and dental plans, updated employment information for salary increases previously provided in the Governor's Budget, revised pay increases for Judges, updated costs related to the salary survey estimates for the California Highway Patrol (Bargaining Unit 5), and increases to salaries and revised benefits recently negotiated with Physicians and Dentists (Bargaining Unit 16).

While these figures include estimated health premium rates, the Department of Finance notes that final health rates are not expected to be adopted by the California Public Employees' Retirement System Board of Administration until June 2017. If the actual rates differ from the estimated rates, a technical correction to the budgeted amounts will be made.

Staff Recommendation: Approve as proposed.

ITEMS FOR DISCUSSION/VOTE**7100 EMPLOYMENT DEVELOPMENT DEPARTMENT****Issue 14: Workforce Innovation Opportunity Act Discretionary Federal Funds**

Summary. The Governor's May Revision proposes \$59 million in state-level discretionary federal Workforce Innovation Opportunity Act (WIOA) funding in 2017-18, a \$6.8 million decrease relative to 2016-17. This decrease reflects a reduction in available federal funding.

Background. Federal law provides that a certain portion of federal WIOA funding, up to 15 percent, may be held by the state for "statewide workforce investment activities," while the remainder of WIOA funds are passed on to Local Workforce development boards to provide services to unemployed or underemployed adults and youth. The statewide funds are sometimes referred to as "discretionary funds." The actual amount of discretionary funds that may be reserved at the state level, subject to the 15 percent cap, depends on congressional appropriations. In 2015-16, the state was able to reserve 10 percent of WIOA funds as discretionary funds. In 2016-17, the state may reserve 15 percent of WIOA funds as discretionary workforce funds.

The May Revision proposal discontinues funding in 2017-18 for several items that are receiving funding in 2016-17, totaling \$10 million. The largest of these include:

- Regional staff capacity for state plan implementation (\$1.2 million in 2016-17).
- WIOA program evaluation (\$1.4 million in 2016-17).
- Technical assistance and staff training for state agencies, local areas, and One-Stop partners (\$4.5 million in 2016-17).
- Incentive funds for high performance local workforce boards pursuant to SB 698 (Lieu), Chapter 497 Statutes of 2011 (\$1.7 million in 2016-17).

The May Revision also decreases funding for some previously funded items while making offsetting increases in other previously funded items. Notably, the May Revision makes the following adjustments to existing items:

- **Funding for Regional Workforce Accelerator Program Reduced by \$8.3 Million.** The May Revision provides a total of \$2 million in discretionary funding for the Regional Workforce Accelerator Program, an \$8.3 million reduction relative to 2016-17 funding. The Regional Workforce Accelerator Program awards funds to local programs to test strategies for serving populations with barriers to employment. Recently, the Regional Workforce Accelerator program emphasized strategies to improve employment outcomes for formerly incarcerated and immigrant populations. This program has provided grants to 36 programs that serve people with low income, 35 programs that support disadvantaged youth, 19 programs that support ex-offenders, 11 programs that support people with disabilities, and 17 programs that support veterans. In total, 9,657 participants were served with the grants, and leveraged about \$17.3 million in other funds.

- **Funding for Slingshot Increased by \$5.6 Million.** The May Revision provides a total of \$10.5 million for “Slingshot 2.0,” an increase of \$5.6 million relative to 2016-17 funding. The Slingshot programs have been used to provide assistance to local workforce development areas in carrying out regional planning and service delivery efforts based on regionally selected solutions to regional problems. Funding in the May Revision for Slingshot 2.0 appears to be intended to continue support for regional planning and coordination with government, community and industry leaders, as well as building on projects initiated through the Regional Workforce Accelerator Program.
- **Funding for Model Multiple-Employer Industry Sector Programs Increased by \$1 Million.** The May Revision provides a total of \$3 million for the Model Multiple-Employer Industry Sector Programs item, a \$1 million increase over 2016-17 funding. This item awards funding to local workforce regions to implement or build on sector partnership strategies. Emphasis is on multiple-employer workforce initiatives that develop career pathways to industry sectors with projected significant job openings or job growth. This line-item will help implement the State Plan goal of income mobility through attainment of industry-valued credentials and apprenticeship- as well as WIOA priority of utilizing on-the-job training, customized training, incumbent worker training, internships, paid or unpaid work experience opportunities, or transitional jobs.

The May Revision appears to propose just one completely new item—\$600,000 for services for in-school at risk youth. According to the administration, the funding is intended to expand youth services offered by state staff at local job centers, establish partnerships with other local agencies and community-based organizations, and educational institutions that work with youth.

In addition to the adjustments listed above, the Governor proposes to continue funding other services for targeted populations. Including the following:

- **Governor’s Award for Veterans’ Grants** - \$5.0 million. This grant will expand upon existing projects that accelerate employment and re-employment strategies for California veterans. Funds will focus on the efforts to transition veterans into high-wage, high-demand occupations to include: healthcare; professional, scientific and technical services; construction; transportation; security; utility and energy sectors; and information technology. The intent is to build meaningful and sustainable industry investment and partnership, system innovation, and to develop initiatives that have the best potential to place targeted veterans, including recently separated veterans, into self-sufficient jobs and on pathways to careers
- **Disability Employment Accelerator** - \$2.0 million. Funds will be used to design, develop, and implement projects that accelerate employment and re-employment strategies for people with disabilities by creating more effective linkages with California’s employer community. These strategies will help increase employer awareness and dispel myths and perceived barriers regarding hiring people with disabilities.

Workforce Innovation Opportunity Act Local Assistance Adjustments. Lastly, The May Revision proposes a decrease of \$19.45 million in 2017-18 to align budget authority with current federal allotments for local area activities.

Staff Recommendation. Approve as proposed.

7120**CALIFORNIA WORKFORCE DEVELOPMENT BOARD****Issue 15: Road Repair and Accountability Act – Pre-apprenticeship Training Programs**

Summary: The May Revision proposes \$5 million and 1.0 position payable from the Road Maintenance and Rehabilitation Account, State Transportation Fund for 2017-18 through 2021-22 to implement pre-apprenticeship training programs, focused on formerly incarcerated, women, and minorities, in support of Senate Bill 1 (Beall) Chapter 5, Statutes 2017 projects.

Background. SB 1 creates the Road Maintenance and Rehabilitation Program (RMRP) to address deferred maintenance on the state highway system and the local street and road system and appropriates \$5 million annually from 2017-18 through 2021-22 to the State Board to assist local agencies to implement policies to promote preapprenticeship training programs to carry out specified projects funded by the RMRP. Streets & Highways Code Section 2038 requires the State Board to develop guidelines for public agencies receiving RMRP funds to participate in, invest in, or partner with, new or existing pre-apprenticeship training programs. The State Board will develop local guidance and a statewide pre-apprenticeship skills training grant program to address the projected labor demand to support the transportation projects funded by the RMRP and to build pipelines into middle-class jobs in the construction trades for underserved Californians, including women, minorities, at-risk youth, and the formerly incarcerated.

The State Board will design a pre-apprenticeship training program that establishes and expands high-quality construction pre-apprenticeships across the state. Partnerships funded through this program will serve a minimum of 300 participants a year, with employment and income gains tracked through the state's workforce data reporting system. The State Board will utilize the Employment Development Department's (EDD) contracting, monitoring and reporting resources to ensure appropriate investment of resources, and the State Board and EDD will provide technical assistance to support and document grantee success. The State Board will issue regular updates on system innovation, lessons learned, and best practices to encourage program expansion, replication, and continuous improvement. The State Board will establish and execute an outcomes-driven work plan to develop and disseminate workforce guidelines for local transportation agencies, including a) research, analysis, and stakeholder engagement; b) the production of briefs and/or toolkits; and c) a statewide outreach plan including, e.g., webinars, briefings, and stakeholder convening.

The subcommittee may wish to consider how to promote linkages and coordination between various initiatives and partnerships between the Board, California Department of Corrections and Rehabilitation (CDCR) and CalTrans.

Staff Recommendation. Approve as proposed. Adopt placeholder budget bill language for State Board to also encourage partnerships and collaboration with other pre-apprenticeship programs beyond this proposal with CDCR and CalTrans.

7900 CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM**Issue 16: CalPERS Supplemental Payment**

Summary. The Governor's proposes borrowing \$6 billion from the state Pooled Money Investment Account (PMIA)—an account that invests money from the state and local governments—and use this money provide a supplemental payment to CalPERS to pay down a portion of state pension liabilities. According to the Administration, this would reduce unfunded liabilities, and save a net of \$11 billion over three decades. Moreover, the General Fund share of the repayment would come from Proposition 2.

Background

Pooled Money Investment Account. The PMIA holds funds on behalf of the state, as well as cities, counties, and other local entities in the separate Local Agency Investment Fund (LAIF). As of the quarter that ended in March 2017, the balance of the PMIA was roughly \$70 billion. Reserve balances in both the General Fund and other funds tend to grow during periods of economic expansion when revenues are higher. The state's portion accounted for two-thirds of this total while the local portion represented the remaining one-third. Much of the state funds invested in the PMIA are held in the Surplus Money Investment Fund (SMIF), the portion of the PMIA that holds most balances of the state's special funds. The PMIA is managed by the State Treasurer's Office and is governed by the Pool Money Investment Board, which includes the Treasurer, Controller, Director of the Department of Finance. In addition to be a short term investment account, the PMIA helps the state manage seasonal cash deficits. During times of cash imbalances, the General Fund borrows billions of dollars from other state funds held in the PMIA. The General Fund pays the PMIA back with interest each year.

Proposition 2. Proposition 2 amended the State Constitution to require the state to make certain extra annual debt payments and budget reserve deposits each year. These payments are required through 2029-30. Thereafter, the required annual debt payments become optional, but amounts not spent on debt must be deposited into the rainy day reserve. Unlike reserve requirements, which the Governor and Legislature may reduce during a budget emergency, the state may not reduce the required annual amounts of debt payments under Proposition 2 for any reason through 2029-30.

There are three types of outstanding debts eligible for payments under Proposition 2. They are: (1) certain budgetary liabilities (including the amounts the state's General Fund owes special funds, as described above), (2) certain payments of statewide pension system liabilities, and (3) prefunding for state retiree health benefits. Proposition 2 requires payments for pension and retiree health liabilities to be "in excess" of "current base amounts."

Governor's Proposal. In the May Revision, the Governor proposes borrowing \$6 billion from the SMIF to make a supplemental payment to CalPERS. This \$6 billion contribution would be in addition to the actuarially required contributions to CalPERS—referred to as an "additional

discretionary payment” to CalPERS. Rather than borrow from individual special funds as the state has done in past, this loan would come from PMIA as a whole.

The Administration proposes making lump installments throughout 2017-18 to accommodate for cashflow needs, however, the precise plan, such as the amount and when each of these installments occur is still being worked out.

CalPERS estimates that the \$6 billion in additional discretionary payment would substantially mitigate state employer contributions, specifically reducing the state’s annual contribution by \$638 million annually by 2023-24. These benefits will be distributed among General Fund and special funds that make pension payments.

Loan Repayment. The administration has not determined a precise plan for the state General Fund and other funds to repay the \$6 billion loan from the PMIA. The administration provided staff and the LAO a “working plan” that would pay the loan off in eight years. While the administration indicates that this payment period is flexible, it intends to take no longer than ten years to pay off the loan. Under the working plan, the General Fund would cover repayments on behalf of both itself and associated special funds in 2017-18 with a \$427 million repayment (consisting of a \$365 million principal payment plus a \$62 million interest payment) counted toward Proposition 2 debt payment requirements. Other funds would begin making payments in 2018-19 and would later proportionally compensate the General Fund for the 2017-18 payment.

Under the administration’s current projection of interest costs, total loan repayments—principal and interest payments—would be roughly \$7 billion. The administration’s proposal would, as the LAO understands it, distribute these costs across the General Fund and other funds based on the proportional split of pension contributions by fund source. Consequently, the General Fund and other funds would be charged for around 60 percent and 40 percent of these costs, respectively.

Proposition 2 Would Cover General Fund Portion of Loan Repayments. For the General Fund’s share of future loan repayments, the administration proposes establishing General Fund repayments based on the varying Proposition 2 debt payment requirements.

Special Funds Would Repay Loan Using Available Resources. Some of these funds may not have sufficient resources to cover those costs. In these cases, interim General Fund support may be necessary—essentially to loan some special funds and other funds money to cover their initial annual costs under this plan. Affected special funds would then owe this money (with interest) to the General Fund. The administration has not assessed how many funds would face this issue, nor the amount of General Fund resources needed to support them. Representatives of the administration have told staff and the LAO that they would work out these details during the summer after the final budget is adopted. Therefore the Administration does not know how many special funds will have difficulty making loan repayments under the proposal.

The LAO proposes the following recommendations:

Before the Legislature acts on the Governor’s proposal, the LAO recommends requiring the administration to perform more due diligence and report the results publically. These analysis include:

- **Legal Opinions.** Require the Administration to consult with fiduciary counsel—whether at the Attorney General’s Office or elsewhere—to determine if the proposal has problematic fiduciary implications for either the PMIB or CalPERS board. In addition, LAO recommends the administration be required to seek an Attorney General opinion and/or a public validation proceeding in the courts regarding the constitutionality of borrowing from the PMIA for this.
- **Risks and Uncertainties.** Require the Administration to report to the Legislature a comprehensive analysis conducted by professional actuaries—using stochastic modeling and other actuarial simulations—quantifying the uncertainties around the proposal. This analysis could include a determination of the probability that the proposal will produce a net benefit for the state—considering both CalPERS and the PMIA’s respective investment returns in the future. This analysis could also consider alternatives for prepayments in terms of their net benefit.
- **Special Funds’ Ability to Pay.** Require the Administration to identify state funds that likely cannot make the repayments in the first few years of implementation, the amount of those shortfalls, and a proposed solution that would allow each fund to pay over the long term. The administration could be required to provide (1) its best estimates of how much money special funds will need to borrow from the General Fund to make their payments, by year, and how their repayments to the General Fund will be structured, and/or (2) specific plans to change each affected special fund’s revenues or spending to cover these shortfalls.

Recommend Legislature Consult With California Actuarial Advisory Panel (CAAP). The CAAP consists of eight actuaries and was established in statute in 2008 to provide public agencies with impartial and independent information on pensions, retiree health benefits, and best practices. The LAO recommends that the Legislature formally ask the CAAP to provide an opinion on (1) the administration’s plans and estimates and (2) whether the state should make such a payment towards either pension or retiree health liabilities.

Recommend Legislature Act on Plan Later in Session After Receiving More Information. Final legislative action on the administration’s proposal can wait until after June 15. In particular, the LAO recommends the Legislature wait to act on this plan until after the administration has submitted the analyses listed above, which perhaps could be developed by the 2017 legislative session. If the analyses showed a high likelihood of net benefit to the state and there were no major legal concerns, the Legislature could pass implementing legislation.

Recommend Flexible Proposition 2 Debt Payments in Budget Plan. To pass a budget in June, the Legislature must include a schedule of required debt payments under Proposition 2. Instead of approving the proposal now without sufficient analysis, the Legislature could “pencil in” a flexible plan for Proposition 2. Under these provisions, the administration’s proposed \$427 million repayment would be released if the Legislature adopted implementing legislation later in the session. If no such legislative plan passed, the budget package would include an alternative purpose for the \$427 million loan repayment. For example, the Legislature could

direct the administration to make an additional, supplemental payment to CalPERS of this amount—but without any borrowing from PMIA.

Staff Comments. Staff notes that this is a significant proposal that the Administration is requesting in the May Revision process. The proposal may have merit, however, given the substantial impacts this this may have, staff recommends holding this item open for additional review.

Staff Recommendation. Hold Open

CONTROL SECTION 3.60**Issue 17: Control Section 3.60 State Retirement Contribution Rates**

Summary. The May Revision proposes to amend Control Section 3.60 be amended to reflect changes in state retirement contribution rates adopted by the CalPERS Board on April 18, 2017. Additionally, the Administration is proposing to amend Control Section 3.60 to also allow the Department of Finance to make supplemental payments to CalPERS for the state's retirement contributions using Proposition 2 funding.

Governor's Proposal. The reduction in employer contribution rates is a result of new hires entering the system under lower benefit formulas pursuant to the Public Employees' Pension Reform Act of 2013, greater than expected contributions to the system, and lower cost of living increases than estimated.

The newly adopted state employer contribution rates result in total state costs of \$473.85 million, a decrease of \$100.56 million from the \$574.41 million included in the Governor's Budget. Of the \$100.56 million decrease, the General Fund is \$67.23 million, special funds are \$19.31 million, and other nongovernmental cost funds are \$14.02 million. Additionally, it is requested that CalPERS' fourth quarter deferral be reduced by \$14.12 million General Fund from the Governor's Budget to reflect the changes in retirement rates. The net effect of these changes on the General Fund is a decrease of \$53.11 million in fiscal year 2017-18 compared to Governor's Budget.

In addition to the above adjustments, the Administration is also requesting language to be added to the control section, which implements provisions of the previous proposal to borrow \$6 billion to make a one-time payment to reduce state pension liabilities at CalPERS. Specifically, the language would provide \$427 million General Fund to make supplement the state's retirement contributions in 2017-18. The Department of Finance would transfer these funds either to the Public Employment Retirement Fund, or the Surplus Money Investment Fund (SMIF) for repayment of principal and interest of a cash loan that was made to supplement the state's retirement contributions.

Staff Comments. As noted in the previous item, the Governor's May Revision proposal to borrow \$6 billion to reduce state pension liabilities is a substantial request to during May Revise, and therefore may warrant further legislative review.

Staff Recommendation. Approve amendments to update state retirement contribution rates adopted by CalPERS. Hold open the proposal to transfer up to \$427 million General Fund in supplemental state retirement contribution.

Issue 18: CalPERS Administrative Budget Adjustments

Governor's Proposal: The Governor proposes various budget bill amendments to incorporate the CalPERS proposed budget, which the Board is anticipated to approve at its May 2017 board meeting. The proposals are as follows:

- 1) Decrease Item 7900-001-0822 by \$20.44 million (Public Employees' Health Care Fund)
- 2) Increase Item 7900-001-0950 by \$20.44 million (Public Employees' Contingency Reserve Fund)
- 3) Decrease Item 7900-003-0830 by \$118.49 million (CalPERS board administrative costs paid by the Public Employment Retirement Fund)
- 4) Increase Item 7900-015-0815 by \$31,000 (CalPERS board administrative costs paid by the Judges' Retirement Fund)
- 5) Decrease Item 7900-015-0820 by \$20,000 (CalPERS board administrative costs paid by the Legislators' Retirement Fund)
- 6) Decrease Item 7900-015-0830 by \$5.41 million (CalPERS board administrative costs paid by the Public Employees Fund)
- 7) Decrease Item 7900-015-0833 by \$291,000 (CalPERS board administrative costs paid by the Annuitants' health Care Coverage Fund)
- 8) Increase Item 7900-015-0849 by \$436,000 (CalPERS board administrative costs paid by the Replacement Benefit Custodial Fund)
- 9) Increase Item 7900-015-0884 by \$195,000 (CalPERS board administrative costs paid by the Judges' Retirement System Fund)

With the exception of the first two items, the items mentioned above are display items for informational purposes to reflect a corresponding change in CalPERS' continuous appropriation authority. All of these changes reflect the fiscal year 2017-18 budget proposed during the April 19, 2017 Board meeting, and anticipated to be approved in May. The budget proposed by CalPERS reflects a decrease of \$123.55 million primarily driven by a continued reduction in external investment management fees.

It is also requested that Control Section 4.20, which establishes the surcharge levied on the state to fund the Contingency Reserve Fund (CRF), be amended to support the administrative expenses of the CalPERS health care program. The CRF was established in 1962 as a means to pay for administrative costs across the CalPERS healthcare program. Employers pay for administrative costs through a surcharge on health premiums.

Background.

The first two items listed above and changes to the Control Section 4.20 deal with the Healthcare Fund Administrative Expenses. The Subcommittee heard the topic during the March 30th hearing. In January, the Administration proposed trailer bill language, and amendments to C.S. 4.20, to do the following:

- 1) **Require All Administrative Costs Be Paid from Contingency Reserve Fund (CRF).**
All administrative expenses currently being paid from the Health Care Fund (HCF)

would be paid from CRF. Any future administrative expenses - regardless of health plan - would be paid only from the CRF. The Health Care Fund (HCF) was established in 1988 to fund CalPERS “self-funded” plans, such as Preferred Provider Organization (PPOs). Contributions to the HCF are built into these plans’ premiums.

- 1) **Changes Language Related to Local Government Contributions to CRF.** The proposed language makes a number of changes to Section 22901 of the Government Code related to local government’s contributions to the CRF. The language would require local governments to pay (1) the same surcharge to the CRF that the state pays and (2) additional surcharges for any administrative services provided to the local government that is not provided to the state.
- 2) **Budget Bill Reduces CRF Reserve.** In past budgets, Control Section 4.20 has specified that CalPERS would maintain a three-month reserve in the CRF. The proposed budget bill language for Control Section 4.20 directs CalPERS to maintain a one-month reserve in the CRF.

2016 Budget Act. Last year, the Subcommittee approved and the final budget included trailer bill language proposed by the Department of Finance to address the concerns with the administrative expenses related to the Health Care Fund and Contingency Reserve Fund to provide additional budget oversight.

- Government Code Section 22910: Clarifies existing statute establishing that CalPERS health care administrative expenses in the Contingency Reserve Fund must be approved by Legislature; and
- Government Code Section 22911: Establishes that CalPERS health care administrative expenses in the Health Care Fund must be approved by Legislature.

The approval of these two code section changes ensured Legislative oversight and brought both the CRF and HCF with regard to administrative funds under budget.

Staff Comments. Last year, the Administration also proposed and the Legislature rejected similar trailer bill language to establish that the CRF be used for administrative expenses. At the time, the subcommittee noted that policy issues associated with the administrative expenses for local governments seem more appropriate for consideration by the policy committees, not the budget committee. In January, the Administration again noted that trailer bill language is needed to require CalPERS to place all their administrative costs under the CRF. However, if the subcommittee approves Items 1 and 2 above, it may grant this without additional legislation to grant CalPERS this authority. This action is inconsistent with last year’s action taken by the Legislature to reject the proposal, and it is unclear how this conforms to what authority there is to do so, and whether this is counter to legislative oversight.

Staff Recommendation. Adopt items 3-9 of the May Revision Proposal. Reject Items 1 and 2; and reject the changes to C.S. 4.20 including the change from the 2016 Budget Act to change the reserve, and approve a one-month reserve.