Senate Budget and Fiscal Review—Nancy Skinner, Chair

SUBCOMMITTEE NO. 5 Agenda

Senator Maria Elena Durazo, Chair
Senator Shannon Grove
Senator Dave Cortese
Senator Josh Newman

Tuesday, March 1, 2022
9:00 AM
State Capitol - Room 4203

Consultant: Christopher Francis, Ph.D.

Items for Discussion

0559 Secretary for Labor and Workforce Development Agency

Issue 1: Overview and Governor's Budget

The Labor and Workforce Development Agency was established to address issues relating to California workers and their employers. The Agency is responsible for labor law enforcement, workforce development, and benefit payment and adjudication. The Agency works to combat the underground economy and help legitimate businesses and workers in California through a combination of enforcement and education activities.

3-YEAR EXPENDITURES AND POSITIONS T

		Positions			Expenditures		
		2020-21	2021-22	2022-23	2020-21*	2021-22*	2022-23*
0350	Office of the Secretary of Labor and Workforce Development	39.2	28.0	30.0	$44,719	$6,295	$6,800
TOTALS, POSITIONS AND EXPENDITURES (All Programs)		**39.2**	**28.0**	**30.0**	**$44,719**	**$6,295**	**$6,800**

Natalie Palugyai was appointed Secretary of the California Labor & Workforce Development Agency by Governor Newsom on July 14, 2021. Secretary Palugyai is the first Latina to serve as California Labor Secretary. Prior to leading the Labor & Workforce Development Agency, Natalie served as Senior Advisor for Strategic Initiatives at Johns Hopkins University, where she lead the university's Global Operations Initiative, establishing both governance frameworks and corporate structuring strategies in support of academic and research expansion globally. She has also spent almost half of her public service career within the U.S. Department of Labor where she served first as a compliance officer with the Office of Federal Contract Compliance Programs and most recently as a Senior Management Advisor for the Secretary of Labor under President Barack Obama's Administration.

Background.

As California moves from the COVID-19 crisis to recovery, urgent labor shortages in all aspects of care delivery are projected to grow even more acute. California has made significant investments to improve health and economic outcomes. However these efforts will not be fully realized without the workforce to deliver these services. In addition, too many workers in these essential positions currently live in poverty, with low wages and limited growth opportunities. The $1.6 billion investment in workforce development will create innovative and accessible opportunities to recruit, train, hire and advance an inclusive health and human services workforce, with improved diversity and higher wages. This investment will build ladders of opportunity and economic mobility across the health and human services sectors for individuals and families, especially young people of color, across California. The *Workforce for a Healthy California* envisions a comprehensive partnership between CHHS and LWDA that encompasses entry level and advanced training, pathways for career advancement and changes in reimbursement and certification to improve the quality of jobs.

The *Workforce for a Healthy California* initiative calls for multiple program investments to build the healthcare workforce in targeted occupations facing workforce shortages and to increase the participation of populations who will bring language capability and cultural competency to multiple roles in health care, as well as policy strategies to improve job quality in low-wage healthcare jobs. Proposed program investments include training for Community Health Workers, nurses at all levels, allied health workers, Emergency Medical Technicians, social workers and psychiatric residents. Training will also target English Language Learners, foreign-trained medical professionals, youth and entry-level healthcare workers for career advancement. Planning for this initiative will be conducted in partnership with Health Care Access Information (HCAI) and focus on projected labor market demand and workforce shortages. New training programs to be developed will build on best practice research and utilize multiple training modalities and technology platforms, along with a focus on practical experience: apprenticeship, paid internships and other earn and learn models. Planning will also identify potential policy changes, including licensing and certification requirements, as well as incentives for hiring, retention and career advancement, such as wage increases and expanded access to benefits, in close partnership with healthcare employers.

The Budget includes a one-time $1.7 billion investment over three years in care economy workforce development—across both the Labor and Workforce Development Agency (Labor Agency) and California Health and Human Services Agency (CalHHS)—that will create more innovative and accessible opportunities to recruit, train, hire, and advance an ethnically and culturally inclusive health and human services workforce, with improved diversity, wages, and health equity outcomes.

The Care Economy investments will be jointly coordinated by the Labor Agency and CalHHS through the CalHHS/Health Care Access and Information (HCAI) Health Workforce Education and Training Council. The following proposals are included in the Governor's Care Economy Workforce Investments and include coordination with LWDA. Staff notes that some of these proposals are covered in Subcommittee No. 3 on Health and Human Services but the first three proposals will be covered in this agenda.

2022-23 Governor's Budget: Care Economy Workforce Investment Proposal						
Investments	**Agency/Dept**	**Funds (In Millions)**	**BY**	**BY+1**	**BY+2**	**Source**
High Road Training Partnerships	LWDA/CWDB	$340	$120	$110	$110	GF
Healthcare Workforce Advancement Fund	LWDA/EDD	$90	$90	$0	$0	GF
Emergency Medical Services Corps	LWDA/EDD	$60	$20	$20	$20	GF
Community Health Workers	HHS/HCAI	$350	$50	$150	$150	GF

Comprehensive Nursing Initiative	HHS/HCAI	$270	$90	$90	$90	GF
Expanding Social Workers	HHS/HCAI	$210	$70	$70	$70	GF
Psychiatric Resident Program	HHS/HCAI	$120	$40	$40	$40	GF
Multilingual Health Initiatives	HHS/HCAI	$60	$20	$20	$20	GF
Opioid Treatment	HHS/HCAI	$26	$26	$0	$0	Opioid Settlement Fund
Clinical Infrastructure: Reproductive health	HHS/HCAI	$20	$20	$0	$0	GF
Indian Health Program Grant Restoration	HHS/DHCS	$12	$12	$0	$0	GF
Workforce Council for Healthcare Training	HHS/HCAI	$3	$3	$0	$0	GF
English Language Learners health Careers	CA Community College	$130	$130	$0	$0	Prop 98
Total Funding		**$1,691**	**$691**	**$500**	**$500**	

LWDA requires an Assistant Secretary, a Research Data Specialist II, and $67,000 in temporary staffing and consultation to plan and execute this initiative, and to build a successful and sustainable collaboration with CHHS.

Governor's Budget.

The Governor's budget includes two positions and $500,000 General Fund for 2022-23, 2023-24, and 2024-25 for staff to develop and implement the Workforce for a Healthy California Initiative in partnership with California Health and Human Services Agency.

Staff Recommendation. Hold Open.

7120 California Workforce Development Board

The California Workforce Development Board collaborates with both state and local partners to establish and continuously improve the state workforce system, with an emphasis on California's economic vitality and growth. The Board also provides leadership for a unified state plan that works in partnership with other state entities such as the Health and Human Services Agency, the Departments of Social Services and Rehabilitation, the Community Colleges, and the Department of Education. The workforce system is comprised of state and local programs and services that prepare current and future workers to meet the ever-evolving demands of California's businesses and industries. These services include matching job seekers with career opportunities and jobs; supplying high-skill workers to business and industry; providing labor market and economic information necessary for state, local, and regional planning; preparing the neediest youth for advanced learning and careers; and encouraging the inclusion of special populations as critical elements of the workforce.

3-YEAR EXPENDITURES AND POSITIONS †

		Positions			Expenditures		
		2020-21	2021-22	2022-23	2020-21*	2021-22*	2022-23*
6040	California Workforce Development Board	36.5	76.0	76.0	$72,100	$405,542	$204,490
TOTALS, POSITIONS AND EXPENDITURES (All Programs)		**36.5**	**76.0**	**76.0**	**$72,100**	**$405,542**	**$204,490**

Issue 2: High Road Training Partnerships for Health and Human Services

Background

The CWDB is statutorily responsible (CUIC §14005, §14013) for the development and expansion of the High Road approach to workforce development, including the High Road Training Partnerships and High Road Construction Careers initiatives.

The High Road is a specific industry sector approach focused on equity, job quality, and climate resilience. It starts with industry-based partnership and the engagement of private and public sector employers and organized labor to create the conditions for the recruitment, training, retention, and advancement of workers from disadvantaged communities. The High Road also aligns the workforce system, labor training programs, and community organizations to clear workforce pathways to High Road industry partnerships and quality jobs.

As California moves from the COVID-19 crisis to recovery, urgent labor shortages in all aspects of care delivery are projected to grow even more. The State has made significant investments to improve health and economic outcomes, but without the workforce to delivery these services, these efforts will not be fully realized. Too many workers in these essential positions currently live in poverty, with low wages and limited growth opportunities. The state must build a well-trained health and human services workforce and deliver on good paying jobs, as an economic driver for low income communities as well as a force for equity for the whole state.

Governor's Budget.

The Governor's budget proposes $110 million in 2022-23, and $120 million in each of 2023-24 and 2024-25, to establish, expand, and improve workforce development programs for health and human service careers.

Use of Funds. According to the Administration, this investment in workforce development, utilizing the High Road approach, will create innovative and accessible opportunities to recruit, train, hire and advance an ethnically and culturally inclusive health and human services workforce, with improved diversity and higher wages. This investment will enhance opportunity and economic mobility across the health and human services sectors for individuals and families, especially young people of color, across California.

The CWDB will contract, using program funds, with the University of California for evaluation work. Metrics tracked will include both quantitative and qualitative elements, including but not limited to participant demographics, employment, wages, education, credentials, and apprenticeship. High Road elements may include understanding partnership development, system alignment, effective models, industry-driven training solutions, worker voice and agency.

Suggested Questions

- How is the department planning to account for differences in skillsets and certification requirements across the fields in healthcare?
- What types of jobs are the focus of this proposal?
- How would this proposal interact with and fit into the Administration's other proposals in the $1.7 Billion Care Economy Workforce package? How is this proposal distinct from those proposals?
- Who is participating in these initiatives? How are you measuring or tracking these participants?
- What kinds of services are they receiving? How are you measuring or tracking the services that will be delivered to program participants?
- What kinds of labor market outcomes are program participants expected to achieve? How are you measuring the success outcomes for these investments with respect to the goals that the Administration has for these investments?
- What is the Administration's expectations for the types of jobs and benefits that participants of these initiatives would receive after completion?
- Are these aforementioned expectations going to be formalized in trailer or budget bill language?

Staff Recommendation. Hold Open

Issue 3: Climate and Clean Energy Economy

Background

The California Global Warming Solutions Act of 2006 requires the reduction of greenhouse gas emissions across California's economy to 1990 levels by 2020 (AB 32, 2006) and to 40% below 1990 levels by 2030 (SB 32, 2016). This Act also requires the CWDB to report to the Legislature on workforce education and training needed for workers, communities, and specific industries to respond to the exigencies of climate change (AB 398, 2017). The report titled, *Putting California on the High Road: A Jobs and Climate Action Plan for 2030*, was delivered to the Legislature in September 2020. The report offers the State of California a vision for integrating economic and workforce development into major climate policies and programs in order to help achieve California’s climate goals, and recommends state investment in the High Road Training Partnerships and High Road Construction Careers initiatives to ensure disadvantaged Californians have access to high-quality employment and training needed for the transition to a carbon-neutral economy. Overall and across various departments and agencies, the Governor’s budget includes $550 million over three years to expand climate workforce strategies.

Port Worker Training Facility. California’s ports are critical to the national supply chain. The Ports of Los Angeles and Long Beach move roughly 35 percent of all containers in the United States, approximately 40 percent of U.S. imports, and 25 percent of U.S. exports through the San Pedro Bay. California’s nationally significant regional supply chains and goods movement networks have been negatively impacted by global disruptions, resulting in port congestion, extended shipping container dwell times, and bottlenecks farther downstream in the supply chain.

The state has taken several actions to reduce the congestion in California’s ports to ensure people in California and across the country and world can access goods and supplies. This request is part of an overall package of $1.38 billion one-time General Fund over two years for port, freight, and goods movement infrastructure and other supply chain investments across various departments and agencies. The requested funding will improve supply chain resiliency and will help the state leverage federal funding.

The Goods Movement Workforce Training Campus will focus on developing the skilled workforce needed across the goods movement system to build long-term system resiliency. The total project cost is $150 million and builds on the successful High Road model lashing training, a partnership among the Port employers, the International Longshore and Warehouse Union (ILWU), and the Los Angeles Port Authority, and funded by the California Workforce Development Board in 2018. The Campus will attract new workers, address skill shortages, and provide opportunities for workforce up-skilling or re-skilling to avoid future workforce shortages and address the rapidly changing needs of the industry.

Importantly, the Campus will also facilitate workforce transition in response to the introduction of zero emission (ZE) technologies. The Port of Los Angeles, in coordination with the Port of Long Beach, has identified a 15-acre site that will be the site for the campus. Benefits of this campus include:

- Zero-emission cargo handling equipment training ground for workers to learn how to operate, maintain and repair equipment that directly supports the industry's transition;
- Replicating goods movement environments, such as marine cargo terminals, while giving workers a safe training space away from the busy activities of the terminals;
- Training that impacts the region and the entire supply chain, coordinated with related High Road training in the Inland Empire;
- Space for other High Road employers seeking to train their workforce on freight equipment including trucks, forklifts, and ship-to-shore cranes.

Low Carbon Economy Program. This High Road Training Partnership model is designed to: 1) address the critical needs emerging as that industry or sector faces the challenges of climate change and environmental sustainability; 2) increase the capacity of firms and workers to adapt and compete in a carbon-constrained economy; and 3) help California communities prosper by creating accessible local pathways into safer, healthier, and more highly skilled jobs.

In 2019, the Legislature approved $165 million in Greenhouse Gas Reduction Fund (GGRF) money over five fiscal years to CWDB for the HRTP and HRCC initiatives (together referred to as the Low Carbon Economy initiative) starting in 2019-20. Only one budget appropriation has been made, for $35 million for FY 2019-20, which was subsequently reduced by the Department of Finance to $25.6 million for local assistance and $4.2 million for operations when subdivision (b) of Control Section 15.14, 2019 Budget Act, was applied due to lower-than-expected revenue to the GGRF.

In June 2021, the CWDB released the $25.6 million in local assistance funds to 22 new and existing HRTPs and expanded the work of the 11 regional HRCC partnerships. New industry sectors include zero-emission bus manufacturing, energy storage, food and agriculture, fossil fuel transition, clean transportation, forestry, utility line tree-trimming, and offshore wind.

The requested $20 million General Fund annually starting 2022-23 and running through 2024-25 will ensure the continuation of the CWDB's Low Carbon Economy Workforce grant program initiated under the Greenhouse Gas Reduction Fund. This funding will support existing and new HRTP and HRCC in industries aligned with the California Air Resources Board's Climate Change Scoping Plan.

With this funding it is proposed that 4,300 participants will be trained and employed, and 10 of the 22 HRTPs will expand or build new apprenticeships. The formal evaluation of this funding will be completed in March 2023. The CWDB will contract, using program funds, with the University of California for evaluation work consistent with CUIC §14014.

The CWDB program metrics include both quantitative and qualitative elements including but not limited to number of participants served, participant demographics, employment, wages, education, credentials, and apprenticeship. High Road elements may include understanding partnership development, system alignment, effective models, industry-driven training solutions, worker voice and agency.

Well Capping Workforce Pilot. California contains over 100,000 oil wells, thousands of which have not produced oil in decades, contribute harmful emissions that negatively affect nearby communities, and have no solvent owner to hold responsible for remediation costs. Properly sealing these wells (called "plugging and abandoning") is critical to protecting the health of Californians and will be increasingly important as more wells cease production in the coming years as the state moves closer to carbon neutrality.

As the state moves toward carbon neutrality, certain regions will require a transitioning of workers in certain impacted industry sectors to high wage jobs. While longer-term economic transition is needed and efforts are underway, immediate investments can be made to recruit and train willing oil and gas industry workers, who are displaced or at-risk of being displaced, to work in quality jobs capping open and abandoned wells.

The CWDB requests $15 million one-time General Fund to develop the Oil and Gas Well Capping Pilot initiative in Kern County to provide training and employment for impacted oil and gas workers. The CWDB will lead this effort using High Road approach which prioritizes industry engagement, job quality, equity, and climate resilience.

This work is being conducted in partnership with the Department of Conservation which has an associated proposal to assist in transitioning displaced workers from the oil and gas industry into the effort to plug orphan or idle wells, decommission attendant facilities, and complete associated environmental remediation.

The CWDB will use five percent of the $15 million allocation to launch and manage this program. Metrics tracked include both quantitative and qualitative elements. They include but are not limited to participant demographics, employment, wages, education, credentials, and apprenticeship. High Road elements may include understanding partnership development, system alignment, effective models, industry-driven training solutions, worker voice and agency.

<u>Governor's Budget.</u>

Port Worker Training Facility. The Governor's budget proposes $30 million in 2022-23, and $40 million in 2023-24 and 2024-25, for a Goods Movement Training Campus in southern California.

Low Carbon Economy Program. The Governor's budget proposes $20 million General Fund annually from 2022-23 through 2024-25, to fund the California Workforce Development Board's Low Carbon Economy Workforce grant program.

Well Capping Workforce Pilot. The Governor's budget proposes $15 million one-time General Fund to develop a well capping workforce training pilot program to provide training for short-term employment for impacted oil and gas workers. These funds will require an extended expenditure period, with the liquidation of encumbrances ending on June 30, 2027.

Suggested Questions

For all climate proposals in this agenda,

- How does the Administration view these proposals in relation to its transportation packages to address the transportation system, related zero-emission vehicle (ZEV) efforts, port infrastructure and supply chain resilience?
- Who is participating in these initiatives? How are you measuring or tracking these participants?
- What kinds of services are they receiving? How are you measuring or tracking the services that will be delivered to program participants?
- What kinds of labor market outcomes are program participants expected to achieve? How are you measuring the success outcomes for these investments with respect to the goals that the Administration has for these investments?
- What is the Administration's expectations for the types of jobs and benefits that participants of these initiatives would receive after completion?
- Are these aforementioned expectations going to be formalized in trailer or budget bill language?

On Low Carbon Economy Program,

- What part of the sector is being targeted?
- What types of jobs are the focus of this proposal?

On Well Capping Workforce Pilot,

- How does the Administration/CWDB plan on rolling out the program for displaced oil and gas workers to cap orphan oil wells?
- How will you ensure these jobs are quality jobs/are these considered public works for the purpose of prevailing wages?

Staff Recommendation. Hold Open

Issue 4: California Youth Leadership Program Language Justice Pathway

Background

The California Youth Leadership Corps (CYLC) is a new statewide partnership among the California Labor and Workforce Development Agency, selected California community colleges, the California Community Colleges Chancellor's Office, the Community Learning Partnership, local nonprofit organizations, the California Endowment, the Hilton Foundation, Haas Jr. Fund, and other community partners. This unique partnership was created to prepare a new generation of young people to become community organizers and change agents in their local communities.

In Fall 2021 and Spring 2022, the CYLC will launch learn-and-earn career pathway programs in the cities of Los Angeles, San Jose, Riverside, and Fresno.

This unique partnership grew out of Governor Newsom's economic recovery task force as a response to the staggering number of unemployed young people, particularly in communities of color and low-income communities across the state. To address this crisis, CYLC was created to prepare the next generation of young people to:

- Become community organizers and change agents in their local communities
- Increase civic engagement and power building among marginalized youth and their communities;
- Scale up community change learn-and-earn career pathways; and
- Strengthen the capacity of social justice organizations.

Today, millions of immigrant families are in great need of a comprehensive and humane immigration reform to adjust their immigration status in the United States and to improve their quality of life. Along with a broad-based and just immigration reform at the federal level, immigrants and their families, including Dreamers, immigrants with temporary legal status, refugees, farm workers, and undocumented children, youth, and adults without any legal protections need greater access to community-based immigration legal services providers who can help them adjust their legal status and educate them of their rights.

The CYLC Language Justice Pathways program will strengthen the workforce pipeline for community-based immigration legal services and other immigrant rights and social and climate justice organizations, by expanding language justice pathways for community college students. Expanding the capacity of community-based immigration legal services would help to bring undocumented immigrants and their families out of the shadows and provide them with a greater understanding of immigration laws that impact their daily lives. It would require, however, that local communities have a greater number of well-trained interpreters, paralegals, advocates, and nonprofit leaders who could strengthen the capacity of these legal services providers and immigrant rights organizations.

CYLC will collaborate with deans, faculty and program staff at CYLC community college partnership sites to prepare community college students to pursue careers in pre-law or paralegal services, translation services and leadership or social change in the community-based immigration legal services and nonprofit sectors.

The participants will be able to receive critical supports and mentoring while enrolled. Students will be offered a postsecondary credential, paid internships with community-based immigration legal services providers and immigrant rights organizations, and a living wage of at least $15 per hour. Funding would will extend programs at Mission College in Los Angeles and Fresno City College, De Anza College in San Jose, Los Angeles Trade Tech College and Riverside Community College, with expansion to other community colleges across the state. This language justice pathway will offer students a postsecondary credential and internships with community-based immigration legal services providers and immigrant rights organizations.

CWDB will execute a direct allocation grant agreement and provide the funding to Emerald Cities Collaborative, the fiscal agent for the California Youth Leadership Corps. The funding will be granted to the CYLC Language Justice Pathways initiative in lump sum one advance payment with grant provision for fiscal and program monitoring conducted as required by statutory language to ensure funds are spent appropriately and program goals are met.

Governor's Budget.

The Governor's budget proposes $10 million one-time General Fund to expand learn-and-earn community change career pathways for community college students.

Suggested Questions

- Why does this proposal only focus on immigrant legal services?
- How is this "Learn and Earn" program proposed to be set up and structured? Is this programs providing wage subsidies, stipends, paid internships to participants?
- Are there expectations for employers that use labor from these investments to contribute and help labor? In other words, what's the Administration's position on a "match requirement" for employers— do you expect employers making use of "learn and earn" labor be required to pay some portion of the wages/stipends?
- After participation in these programs, what types of jobs and benefits do the Administration expect for participants? What is the Administration's position on rewarding earn and learn programs that lead to or support full time employment of program participants once the subsidy goes away?
- Are supportive services also provided to the students? If so, what types?

Staff Recommendation. Hold Open

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7100 EMPLOYMENT DEVELOPMENT DEPARTMENT

The Employment Development Department (EDD) connects employers with job seekers, administers the Unemployment Insurance, Disability Insurance, and Paid Family Leave programs, and provides employment and training programs under the federal Workforce Innovation and Opportunity Act. Additionally, EDD collects various employment payroll taxes including the personal income tax, and collects and provides comprehensive economic, occupational, and socio-demographic labor market information concerning California's workforce.

3-YEAR EXPENDITURES AND POSITIONS †

		Positions			Expenditures		
		2020-21	2021-22	2022-23	2020-21*	2021-22*	2022-23*
5900	Employment and Employment Related Services	1,331.7	1,332.6	1,382.4	$224,134	$825,509	$322,203
5915	California Unemployment Insurance Appeals Board	509.3	658.3	571.0	92,830	116,821	100,166
5920	Unemployment Insurance Program	9,286.2	5,765.3	4,239.8	139,940,888	34,359,842	8,927,370
5925	Disability Insurance Program	1,575.9	1,513.5	1,506.5	10,151,749	10,507,068	10,512,846
5930	Tax Program	1,728.3	1,589.4	1,519.4	455,522	374,629	350,395
5935	Employment Training Panel	85.1	159.8	227.7	103,760	154,701	216,825
5940	Workforce Innovation and Opportunity Act	202.2	202.2	202.2	404,833	417,723	408,261
5945	National Dislocated Worker Grants	1.5	1.5	1.5	45,000	45,000	45,000
9900100	Administration	701.0	701.0	701.0	400	400	400
TOTALS, POSITIONS AND EXPENDITURES (All Programs)		**15,421.2**	**11,923.6**	**10,351.5**	**$151,419,116**	**$46,801,693**	**$20,883,466**

Issue 5: Addressing Unemployment Insurance (UI) Debt

Background

UI Program Assists Unemployed Workers. Overseen by the Employment Development Department (EDD), the UI program provides weekly benefits to workers who have lost their jobs through no fault of their own. The federal government oversees state UI programs but the state has significant discretion to set benefit and employer contribution levels. Under current state law, weekly UI benefit amounts are intended to replace up to 50 percent of a worker's prior earnings, up to a maximum of $450 per week, for up to 26 weeks. In 2019, the average benefit amount was $330 per week.

UI Program Is Financed With State And Federal UI Payroll Taxes Paid by Employers. State UI tax revenues are deposited into the state's UI trust fund to pay benefits to unemployed workers. Each individual employer's state UI tax rate is calculated annually using an experience rating system based in part on the usage of the UI system by the employer's former employees. The tax rates on an employer range from a low of 1.5 percent to a high of 6.2 percent. Due to longstanding solvency issues, the state's UI tax rate has been at the maximum amount since 2004.

The federal UI tax, known as the Federal Unemployment Tax Act (FUTA) is typically used to pay for state UI program administration costs. The tax rate assigned to each employer is then applied to a taxable wage base to determine the amount the employer owes in UI taxes for a particular employee. Since 1984 and the taxable wage base used to calculate California employers' UI state taxes is the lowest allowed under federal law. The taxable wage base is currently $7,000, and only Arizona, Florida, Tennessee, and Puerto Rico currently use the same wage base. For California, the maximum tax is $434 per employee per year. In 2019, the state collected $5.9 billion in UI taxes from employers and issued about $5.5 billion in total UI benefits.

States May Borrow From Federal Government During Economic Downturns. During recessions, the state's UI trust fund can become insolvent as the cost of benefits exceeds employer tax contributions and trust fund reserves are exhausted. Federal law allows states, when they exhaust their state UI trust funds, to receive loans from the federal government to continue paying benefits. These loans must be repaid, with interest (currently 2.3 percent annually), at a later time. The loan principal is repaid by automatic increases in the federal UI tax rate that are set out in federal law. The loan interest typically has been paid from states' General Funds.

Under Federal Repayment Plan, Businesses Repay Federal UI Loans Over Time. Under federal law, for states with federal UI loans outstanding, the federal UI tax rate on employers increases by 0.3 percentage points. The additional revenues generated from the tax increase go to paying down the state's federal loan. The federal UI tax rate continues to increase by increments of 0.3 percentage points each year until the loans are fully repaid, at which point the federal tax returns to its usual rate of 0.6 percent. In effect, these federally required tax increases make it so that employers pay for UI benefit costs that were covered by federal loans when the state UI trust fund exhausted its reserves.

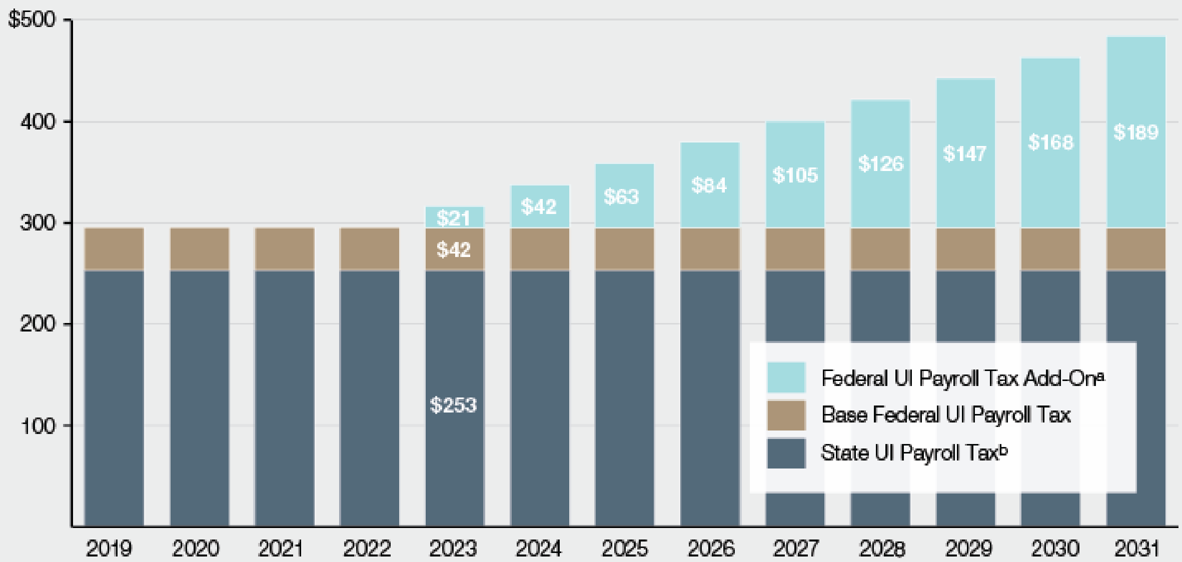
Since Pandemic Began, State Has Received $20 Billion in Federal UI Loans. Prior to the pandemic, at the start of 2020, the state's UI trust fund held $3.3 billion in reserves. Despite these reserves, the state's UI trust fund became insolvent during the summer of 2020, a few months following the start of the pandemic and associated job losses. California, like many other states, used federal loans to continue paying benefits during the pandemic. In total, the state needed to borrow about $20 billion from the federal government, roughly twice the amount the state borrowed for UI benefits during the Great Recession.

Businesses Set to Pay Add-On Federal UI Tax Beginning in 2023. To repay the federal loans, the federal UI payroll tax rate on employers will increase by 0.3 percent for tax year 2022. However, employers will not pay this higher rate until 2023 when employers remit their 2022 federal UI payroll taxes. To give some context to the size of increased federal UI taxes that employers will pay to repay the loans, Figure 1 from the LAO shows a hypothetical employer's combined state and federal UI tax liability for a single employee over the next several years.

Figure 1

Federal Tax Increases to Repay UI Loans in Context

Example of Employers' Annual UI Payroll Taxes Per Employee



[a] For states that have outstanding federal UI loans, federal law requires the federal UI tax rate paid by employers to increase by 0.3 percentage point increments until the loans are repaid.

[b] State UI tax rates vary by employer and by year. For this figure, we display the average state UI tax rate of 3.62 percent.

UI = Unemployment Insurance.

LAO

Recent Fraud Concentrated in Federal UI Benefits That Do Not Affect Loan Repayment. Figure 2 shows the Administration's estimate of possible UI benefit fraud that occurred during the pandemic. Almost all pandemic-era fraud occurred in the temporary federal programs that now have ended. The federal government, not the state UI trust fund, paid these benefits. As a result, the state did not use federal UI loans to pay these fraudulent benefits, meaning California employers are not required to repay any of the fraudulent federal benefits.

Figure 2

Temporary Federal Benefits, Not State Benefits, Were the Primary Target of Fraud

State UI Fraud Does Not Appear to Be Major Factor in Size of UI Loans to Be Repaid. Although the figure shows the Administration's estimate of possible state fraud during the pandemic, a more reliable estimate of likely fraud in state UI benefits comes from an audit of claims in 2020. This review suggests about $100 million of $35 billion in state benefits paid during the pandemic were fraudulent. This estimate of likely fraud is much smaller than the $1.3 billion a separate EDD analysis flagged as possible fraud, but this $1.3 billion estimate likely is overstated. To arrive at the estimate of $1.3 billion, EDD counts state UI claims as fraudulent if a worker did not respond to a request for additional identity documents after they had started receiving benefits. There are several reasons why workers with legitimate claims may not have followed up with EDD. Many of the suspected claimants had already run out of benefits and thus had little reason to log in to confirm their identity. Other claimants may have given up in frustration after trying unsuccessfully to send requested documentation to EDD. Since state UI fraud was less widespread than fraud in the temporary federal programs, state UI fraud does not appear to have notably increased the amount of federal UI loans that the state and employers are to repay.

Governor's Budget.

The Governor's budget proposes to make a $1 billion General Fund payment in 2022-23 and an additional $2 billion General Fund payment in 2023-24 toward repaying the outstanding balance on the state's federal UI loans. The proposed supplemental payment would reduce the state's outstanding loan balance by about 15 percent.

LAO Assessment

Looking Ahead

Updated Forecasts Under Two Economic Scenarios—Low Cost and High Cost. To illustrate state and employer costs to repay the federal UI loans, the LAO's analysis updates their earlier low- and high-costs forecast scenarios for the state's UI system based on different underlying economic scenarios. Under the low-cost scenario, employment quickly returns to pre-pandemic levels and interest rates remain historically low for the entire period. Under the high-cost scenario, the state's full economic recovery is delayed several years, and interest rates paid on the UI loans increase gradually over the next several years.

Loan Will Take Many Years to Repay Under Either Scenario. Under the LAO's low-cost scenario, the state and employers pay off the federal loan in 2030. Under our high-cost scenario, the payoff occurs in 2032. Neither of these scenarios capture the possibility of another recession sometime this decade. Should that occur, payoff of the federal loan would extend well beyond 2032.

Larger State Interest Payments Begin This Year. Figure 3 shows the LAO's projections for upcoming state interest payments under two interest rate scenarios. Under the LAO's low interest rate scenario, the federal interest rate charged on outstanding federal UI loans rises slightly from its current low and remains near 2.5 percent. Under the LAO's high interest rate scenario, the federal interest rate increases from 2.2 percent to 4.5 percent over the next several years and remains at that level.

Figure 3

Looking Ahead at State Costs to Repay the Federal UI Loan

LAO Projections (In Millions)

	Estimated State Interest Payment	
Fiscal Year	**Low-Cost Scenario**	**High-Cost Scenario**
2021-22	$36	$36
2022-23	460	630
2023-24	520	890
2024-25	480	1,030
2025-26	440	1,020

2026-27	380	970
2027-28	300	880
2028-29	210	750
2029-30	110	600
2030-31	20	430
2031-32	—	240
2032-33	—	50
Totals	**$3,000**	**$7,200**

Note: low-cost scenario assumes 2.5 percent interest rate, whereas high-cost scenario assumes 4.5 percent interest rate.

UI = Unemployment Insurance.

$3 Billion Repayment Would Lower State Interest Costs and Employer Costs... According to the LAO, the Governor's proposal would reduce the amount of outstanding federal UI loans. As a result, the proposal would reduce state interest costs immediately. The state also would face lower interest payments each year the loan remains outstanding. The LAO estimates that the Governor's proposed $3 billion payment likely would reduce General Fund interest costs over the repayment period by a total of $550 million to $1.1 billion.

…But Provide No Near-Term Economic Relief to Employers or Workers. The proposed state payment also would reduce employer costs in the future. In general, the $3 billion deposit would reduce the amount employers must repay by $3 billion. However, employers would not benefit from these lower costs for many years. This is because the federal tax increases remain in place until the loan is fully repaid, which would still take several years even with the $3 billion payment. Further, although the state payment could shorten the number of years that employers pay the increased federal tax rates, employers may see no direct benefit if the payment is too small to reduce the repayment schedule by a full year. (In this case, employers would nevertheless pay the higher federal UI tax rates, but the carryover revenue would instead be deposited into the state UI trust fund. These funds would be available to pay UI benefits in future years.)

To Provide Immediate Benefit, Legislature Could Instead Provide UI Tax Credits to Businesses. Should the Legislature instead wish to provide immediate tax relief to employers while the economic effects of the pandemic linger, one option to consider would be to provide employers state UI tax credits to offset the upcoming federal UI tax increase. Tax credits could be designed in various ways to meet the Legislature's policy objectives and priorities.

<u>Suggested Questions</u>

- What is the Administration's projected date for repaying the UI debt to the federal government?

- How will the $3 billion payment benefit small businesses? Will it reduce the amount that they have to pay?

Staff Recommendation. Hold Open.

Issue 6: Addressing and Preventing Fraud

Background

Since the surge in pandemic-related California unemployment claims began in March 2020, individuals, news organizations, and law enforcement officials have reported many cases of potential and actual UI fraud. Not surprisingly, the pandemic conditions increased EDD's UI workloads and also resulted in changes to federal UI benefit programs, both of which have created a greater risk of fraud.

UI Program Procedures. The EDD administers the UI program, which provides benefits to workers who lose their job due to no fault of their own. The UI program is administered through a combination of federal and state laws and regulations. When completing an initial application, claimants provide basic information regarding their employment history, including the reason they separated from their most recent employer. The EDD uses this information to determine if the claimant lost their job due to no fault of their own and meets other eligibility criteria. Concurrently, the EDD also contacts the claimant's employer to verify the information provided on the application. The UI program is funded by employers, and employers are therefore incentivized to dispute illegitimate claims made by former employees or individuals claiming to be former employees.

The most commonly identified false statement occurs when a claimant fails to report or underreports wages they earned during the duration of the claim. As a result, the claimant receives benefits to which they are not entitled. The EDD identifies these potential false statements through multiple processes, including claim processing, anonymous tips, and most commonly, Benefit Audit Cross-matches. The cross-match process uses wages and new hire information reported by employers quarterly to identify claimants who may have received wages, but did not report them while collecting UI benefits. In the event the EDD identifies a claimant meeting this criteria, the Department may contact the appropriate employer to gather additional information regarding the wages paid to the claimant. If, after reviewing the information provided by the employer, it is found the claimant may have been overpaid, the EDD will issue the claimant a Notice of Potential Overpayment.

COVID-19 and Unemployment Assistance. Due to the COVID-19 pandemic lockdown, California's unemployment rate jumped from 4.3 percent in February 2020 to 16.2 percent in April of 2020. By March of 2021, EDD processed more than 22 million claims, including Pandemic Unemployment Assistance (PUA) claims. This equates to more than $140 billion in unemployment insurance benefits. The scale, scope, and speed of the COVID-19 pandemic is simply unprecedented, and it caught EDD unprepared, as it did nearly all governmental entities.

Time Line of Key Events During the Pandemic

2020

March
Governor declares state of emergency due to COVID-19 pandemic.
Widespread business closures, layoffs, furloughs, and hours reductions.

March through July
UI application workload 15 to 25 times higher than normal levels.

April
Following USDOL guidance, state begins to fast-track UI claims by issuing payment before confirming final eligibility.

July
Governor forms strike team to address delays at EDD. Benefit delays ranged from four weeks to several months.

July and August
EDD identifies high level of suspected fraud in federal PUA program.

September
- EDD takes steps to limit fraud exposure, including not automatically backdating claims or allowing multiple claims at same address.
- Strike team issues exhaustive, critical assessment of delays at EDD.
- EDD begins implementing key strike team recommendations: two-week reset and setting up a new identity verification tool—ID.me.
- Backlog of delayed UI claims peaks at 1.7 million delayed claims.

October
EDD begins implementing other recommendations from strike team, including recommendation to revisit its approach to fraud prevention

December
- EDD hires Thompson-Reuters to assign "fraud score" to pre-ID.me claims. Based on fraud scores, EDD suspends 1.1 million claims with no advanced notice. At least 600,000 of the 1.1 million claims were real.
- California State Auditor releases two EDD audits, pointing out that EDD must redetermine eligibility for claims that were fast-tracked early the pandemic.

2021

July
Due to long delays for scheduling eligibility interviews, EDD begins paying benefits while awaiting eligibility interviews rather than delaying benefits until after interview.

September
Temporary federal benefits for self-employed workers and add-on UI payments for all recipients end.

UI = Unemployment Insurance; USDOL = United States Department of Labor; EDD = Employment Development Department; and PUA = Pandemic Unemployment Assistance.

LAO

Timeline of Events.

EDD faced unique challenges in implementing the federal government's response to the COVID-19 pandemic. On March 27, 2020, the former administration signed the Coronavirus Aid, Relief, and Economic Security (CARES) Act, which extended unemployment insurance benefits to independent contractors through the PUA program. This extension of wage replacement benefits to independent contractors and business owners, which is 100 percent federally funded, was an unprecedented and untried program, and it represented an attempt to provide wage replacement benefits to the broadest range of workers impacted by COVID-19.

Unfortunately, as structured by the federal government, the PUA program did not have sufficient anti-fraud protections in place. Unlike with traditional unemployment insurance benefits, where employer payroll reports to EDD serve as a verification tool of continued unemployment, the PUA program operated entirely on self-attestations. During the Great Recession, the federal government extended no comparable benefit program, and therefore fraud remained negligible.

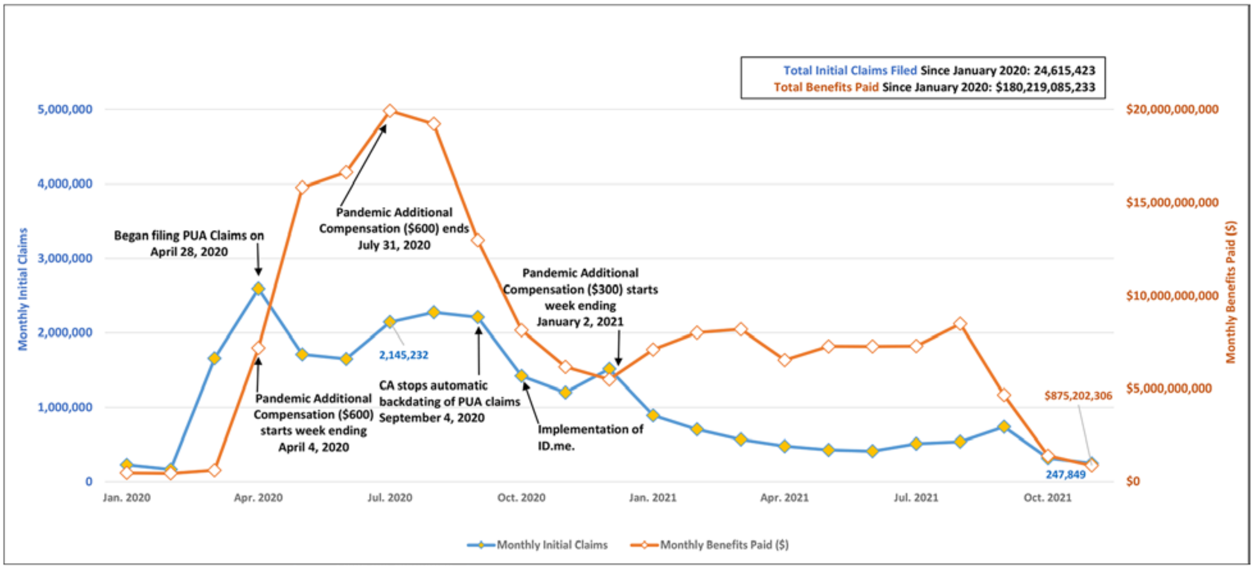
Strike Team. In July 2020, Governor Gavin Newsom created the EDD Strike Team to assess and recommend improvements at EDD. The Strike Team was given 45 days to review the EDD and was led by the Government Operations Secretary Yolanda Richardson and Code for America founder and former U.S. Deputy Chief Technology Officer Jennifer Pahlka. On Saturday, September 19, 2020, the Administration released Recommendations to Set Path for Reform at the Employment Development Department. These recommendations were based off a more comprehensive report titled Employment Development Department Strike Team Detailed Assessment and Recommendations (dated September 16, 2020).

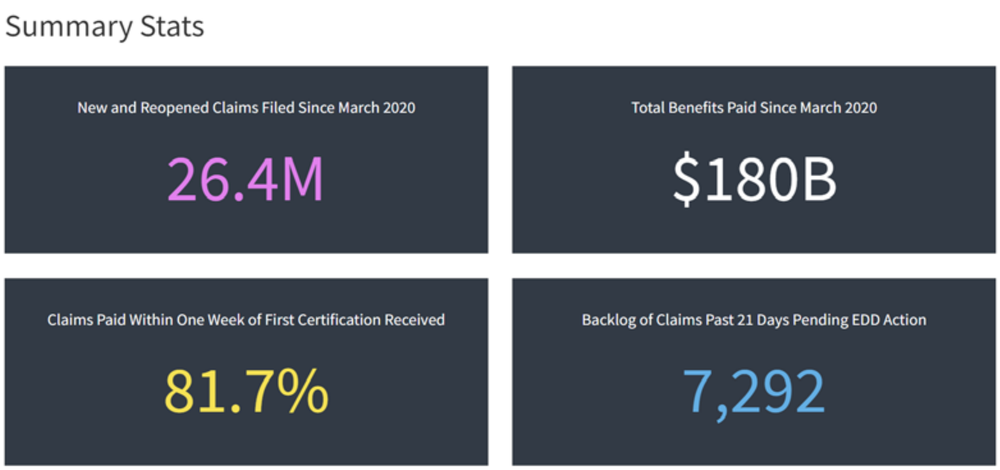
Curbing Fraud. In January 2021, the EDD began an analysis of 1.48 million suspicious claims that were suspended until identity or eligibility could be verified. Of those who needed to verify their identity, approximately 37 percent did so and were then cleared to resume obtaining benefits if otherwise eligible, while the others were disqualified and were provided appeal rights. EDD notes that further details will be provided when the full analysis is complete.

The EDD's investigations unit also works with local, state and federal investigators and prosecutors. At the end of April 2021, the Governor's Office of Emergency Services announced the state Task Force on Pandemic Unemployment Assistance Fraud has led to the arrest of 68 suspects and the opening of 1,641 additional investigations. In addition, EDD notes that they have taken the following steps to help curb and address fraud:

- Established partnerships with law enforcement and other states to share data with other jurisdictions to help catch multi-state fraudsters,
- Cross referencing data against law enforcement records,
- Suspending payment to investigate suspicious multiple claims from single addresses,
- Implementing State Auditor recommendations to convene a fraud unit that coordinates fraud prevention and detection, and
- No longer automatically backdating federal PUA claims, a program that was vulnerable to fraud.
- Contracted with Accenture to conduct an evaluation of fraud detection and prevention operations.

Figure: Claims Filed and Benefits Paid by Month





California State Auditor (CSA) Recommendations and Progress. In January 2021, the CSA released two audit reports about EDD's ability to deliver unemployment benefits while preventing fraud and maintaining privacy. As noted in the February 2021 Subcommittee No. 5 hearing, the State Auditor issued 14 recommendations to EDD regarding its operations, all of which EDD agreed to implement.

Audit Recommendations
Operations Audit Recommendations

Recommendation	Status	Resources
To provide a more transparent picture of claims in its backlog, by March 2021 EDD should revise its public dashboards to clearly indicate the number of claims that have waited longer than 21 days for payment because EDD has not yet resolved pending work on the claim.	Fully Implemented	Unemployment Benefits Data Dashboard
To ensure that its identity verification processes are as robust as possible, EDD should determine by June 2021 the reasons why claimants cannot successfully complete their identity verification through ID.me and work with its vendor to resolve these problems. EDD should thereafter regularly monitor the rate of successful identity verifications to ensure that it consistently minimizes unnecessary staff intervention.	In final clearance	
To retain as much automation in initial claims processing as possible, by June 2021 EDD should determine the automation modifications achieved through its emergency processing tool that it can retain and by September 2021 it should make those a permanent feature of its UI Online application.	In final clearance	
To ensure that it does not delay needed improvements to its IT systems, EDD should, by June 2021, identify the elements of the Benefit Systems Modernization project that can assist it in making timely payments and that it can implement incrementally. It should then prioritize implementing the elements most likely to benefit Californians.	In final clearance	
To ensure its ability to respond in a timely fashion to fluctuations in its workload, EDD should immediately begin modeling workload projections that account for possible scenarios that would cause a spike in Unemployment Insurance (UI) claims. EDD should plan its staffing around the likelihood of those scenarios, including having a contingency plan for less likely scenarios that would have a significant impact on its workload.	In progress	

To continue providing timely payment of benefits to Californians in need while also effectively responding to the Department of Labor's directive regarding immediately resuming all eligibility determinations and resolving all suspended determinations, EDD should do the following: Perform a risk assessment of its deferred workloads, including deferred eligibility determinations and retroactive certifications. EDD's assessment should take into account the relative likelihood that it issued payments to ineligible claimants by considering historic overpayment trends as well as the new or altered eligibility requirements the federal government adopted in response to the pandemic. If necessary, EDD should either partner with another state agency or contract for assistance in performing the analysis in support of this assessment.	In progress	
To continue providing timely payment of benefits to Californians in need while also effectively responding to the Department of Labor's directive regarding immediately resuming all eligibility determinations and resolving all suspended determinations, EDD should do the following: Develop a workload plan that prioritizes its deferred workloads based on the risk assessment and determine the staffing and IT resources needed to accomplish the work within expected time frames.	In progress	
To continue providing timely payment of benefits to Californians in need while also effectively responding to the Department of Labor's directive regarding immediately resuming all eligibility determinations and resolving all suspended determinations, EDD should do the following: Hire and train staff as necessary in order to carry out the workload plan.	In progress	
To continue providing timely payment of benefits to Californians in need while also effectively responding to the Department of Labor's directive regarding immediately resuming all eligibility determinations and resolving all suspended determinations, EDD should do the following: 1. The need to pay timely benefits to new or continued claimants. 2. Federal expectations about the urgency of the deferred work. 3. Any deadlines by which EDD may no longer be allowed to recoup inappropriately paid benefits.	In progress	

To ensure that it is able to take informed steps to provide better customer service through improved call center performance, EDD should implement a formal policy by no later than May 2021 that establishes a process for tracking and periodically analyzing the reasons why UI claimants call for assistance. By no later than October 2021, and every six months thereafter, EDD should analyze these data to improve its call center by doing the following: Identifying and resolving weaknesses or problems with the ways in which it provides assistance to UI claimants through self-service and noncall-center options.	In progress	
To ensure that it is able to take informed steps to provide better customer service through improved call center performance, EDD should implement a formal policy by no later than May 2021 that establishes a process for tracking and periodically analyzing the reasons why UI claimants call for assistance. By no later than October 2021, and every six months thereafter, EDD should analyze these data to improve its call center by doing the following: Developing specialized training modules to quickly train its call-center staff on the most commonly requested items with which callers want assistance.	In progress	
To assess the effectiveness of its call center, by May 2021 EDD should implement a policy for tracking and monitoring its rate of first-call resolution. EDD should review first-call resolution data at least monthly to evaluate whether it is providing effective assistance to callers.	In final clearance	
To maximize the number of calls that its staff are able to answer, as soon as possible EDD should add the prerecorded message functionality to its new phone system to advise claimants of their rights and responsibilities after they file their claim with an agent	Fully implemented	
To provide a more convenient customer experience, as soon as possible EDD should implement those features of its new phone system that allow callers to request a callback from an agent instead of waiting on hold for assistance.	In final clearance	

The State Auditor also issued seven recommendations for EDD to implement regarding anti-fraud.

Anti-Fraud Audit Recommendations
Anti-Fraud Audit Recommendations, as listed in CSA Report 2020-628.2

Recommendation	Status	Resources
To prepare to respond to victims of identity theft who receive incorrect tax forms, EDD should, by mid-February 2021, provide information on its website and set up a separate email box for such individuals to contact EDD and receive prompt resolution.	Fully implemented	Form 1099G Information Center
To ensure that it reviews each account that Bank of America reports to it as suspicious or potentially fraudulent, by February 2021, EDD should establish a centralized tracking tool that allows it to review and stop payment on claims, as appropriate. EDD should use this tool to monitor its own internal decisions and track whether the claimant responds to its requests for identity information and should, therefore, have their account unfrozen.	Submitted to State Auditor	
To ensure that its recession planning encompasses its fraud prevention efforts, EDD should identify the fraud prevention and detection efforts it can adjust during periods of high demand for UI benefits. It should ensure that it accounts for all probable consequences of the adjustments and design procedures that appropriately balance the need to provide prompt payment during a recession with the need to guard against fraud in the UI program.	In progress	
To ensure that it provides appropriate assistance to victims of identity theft who report fraud through its online fraud reporting portal, EDD should, by March 2021, establish a working group to coordinate the work needed to resolve each complaint of identity theft, make decisions about staffing levels necessary, and add staffing to accomplish the work.	Fully implemented	
To ensure that it provides legitimate claimants with benefits but does not pay benefits related to fraudulent claims, EDD should immediately obtain from Bank of America a comprehensive list of claimants' accounts that are frozen. EDD should immediately thereafter evaluate the list—including considering using ID.me to verify claimants' identities—to identify accounts that should be unfrozen. By March 2021, it should direct Bank of America to take action to freeze or unfreeze accounts as appropriate.	Fully implemented	
To ensure that it maintains a robust set of safeguards against fraud, EDD should, by March 2021, designate a unit as responsible for coordinating all UI fraud prevention and detection. EDD should assign that unit sufficient authority to carry out its responsibilities and align the unit's duties with the US Government Accountability Office's framework for fraud prevention.	Submitted to State Auditor	
To ensure that it maintains a robust set of safeguards against fraud, EDD should, by May 2021, develop a plan for how it will assess the effectiveness of its fraud prevention and detection tools.	In final clearance	

With the demand of customer needs for online services and making systems available 24 x 7 as well as the need to work remotely and recommendations from the Strike Team and CSA for implementing digital technologies, the EDD expanded its reliance on IT and automation. In addition to the cybersecurity risk that must be managed, the EDD experienced an unprecedented scale of cyber-attacks and fraud against the EDD systems.

Benefits System Modernization (BSM) Project. The 2020 Budget Act included $46 million and 147.5 positions funding equally by the General Fund and Unemployment Disability Fund, and a redirection of $3.1 million and 19 positions in 2020-21 for the BSM project. These resources began the multi-year implementation of an integrated and secure benefits system for unemployment, disability or paid family leave benefits. The BSM solution was intended to modernize the EDD's benefit systems by implementing a single, integrated benefit system that provides customers and staff a consistent, single portal into the EDD's services while being more agile and responsive for deployment of enhancements and lowering overall maintenance costs.

Pursuant to the September 2020 Strike Team report recommendations, EDD placed the BSM project temporarily on hold. On May 4, 2021, EDD announced a redesigning of the BSM, which would take into account lessons learned from the pandemic as well as new software technology that has since become available. For example, EDD notes that the BSM project was first designed based on demand levels from the Great Recession, which peaked at 3.8 million claims in a year, compared to 20 million claims during the pandemic. EDD notes that they will leverage work already done on the BSM, including an inventory of business rules and processes in the state unemployment insurance, disability insurance and paid family leave programs, and incorporate the information in a new project moving forward. EDD notes that they are working with the Department of Technology and the Office of Digital Innovation to help modernize the claimant process. The 2021 Budget Act included $11.8 million one-time to refocus and review project.

Vendor Contracts. According to EDD, based on the findings of the report, the EDD took immediate action to implement the recommendations by contracting with vendors to shore up the vulnerabilities within the IT systems with a focus on more efficient claim processing, fraud risk mitigation and detection and identity management. This included contracts that provide critical services for the benefit payments process such as:

- Fraud Prevention and Detection
- Identity Management
- Security Services for IT Systems
- Support for Pandemic Programs
- Customer Experience
- Parallel Modernization for IT Systems
- License Maintenance for Legislative Tracking, Workshare, and AskEDD
- Document Upload Functionality
- Reporting Tool Software
- Testing Consultants
- Disaster Recovery Solution

UI Command Center Division (UICCD). In an effort to optimize program performance and enhance the customer experience, the EDD established the UICCD in January 2021 in a limited capacity to begin centralizing and providing oversight of the workload planning and staff resource allocations for the Unemployment Insurance (UI) Branch. The UICCD's primary functions are forecasting future UI workload volumes, quality assurance management, enhance customer experience, and staffing levels needed to meet performance objectives. Prior to the establishment of the UICCD, workload management activities and the management of the contact centers were fragmented across the four divisions within the UI Branch, resulting in workload oversight inefficiencies, impacting timely communication to staff and managers, delaying workload distribution, and overall, drastically impacting the UI program's performance. Managers and supervisors who provide workload management and resource management did not have the bandwidth to strategically assess workload distribution and anticipate workload at a holistic and centralized branch level. The distribution of workload at the field office level is granular and often impacts workload assignments made by other offices, therefore, creating inefficient utilization of UI resources.

Information Technology Branch (ITB). The ITB provides leadership and direction to its internal and external customers in the use of technology, and ensures a secure technology infrastructure for the EDD. This includes project planning, policy development, system maintenance, support, operations, and oversight of automated solutions within EDD. The ITB focuses on the identification, development, and deployment of new technologies in an enterprise architecture that leverages technology to meet these needs. In partnership with EDD's UI Branch, the ITB is responsible for providing EDD customers the technology and systems to file benefit claims and access other services through online systems like Unemployment Insurance Online.

Assembly Bill (AB) 110 (Petrie-Norris), Chapter 511, Statues of 2021. AB 110 requires the Department of Corrections and Rehabilitation (CDCR) to provide the names, known aliases, birth dates, Social Security Numbers, and the booking date and expected release date, if known, of current incarcerated individuals to the EDD for the purposes of preventing payments on fraudulent UI claims. AB 110 requires EDD to complete any necessary system programming or automation to monitor CDCR's inmate data and prevent payments on fraudulent UI claims by the earliest feasible date, but not later than September 1, 2023.

To implement AB 110, EDD would establish an automated system to identify an individual's incarceration status to prevent and deter fraud. Deploying an automated solution would require a one-time cost of approximately $3.0 million to document business requirements, complete development, conduct testing, and comply with California Department of Technology Project Approval Lifecycle requirements.

EDD will use existing funds for deployment activities that occur in 2021-22. This new technical solution would require an ongoing cost of approximately $720,000 annually for maintenance and support. The EDD would also incur administrative costs to support this effort.

In the event an individual is disqualified and appeals the EDD's decision, staff would process the appeal and represent the Department at an appeals hearing, as appropriate. The costs to process and administer appeals would depend on the number of appeals filed, however, they are expected to be minimal.

Assembly Bill (AB) 397 (Mayes and Chiu) Chapter 516, Statutes of 2021. AB 397 is regarding the disqualification notice for unemployment insurance (UI) benefits. An individual may be disqualified from receiving UI benefits if they are found to have knowingly provided false information or withheld information in the pursuit of those benefits. Prior to disqualifying an individual from receiving benefits due to a false statement, AB 397 requires the EDD to provide notice and allow a claimant to dispute the potential disqualification. The claimant has 3 to 10 days to respond, as applicable. AB 397 requires EDD to make the necessary changes to its forms and information technology systems by September 1, 2022.

Currently, claimants can contact the EDD by phone to clarify an issue on their claim forms, and EDD's online benefit portal also includes a dedicated option to notify the EDD of potential mistakes. If an issue is not corrected before EDD identifies an eligibility issue, claimants can also respond to the Notice of Potential Overpayment or provide information as part of the eligibility determination interview process, as appropriate. These opportunities are available prior to a formal eligibility determination and disqualification. In addition to those avenues, the EDD can reverse a decision as part of the pre-appeal review process if the claimant provides contrary evidence of the unknown facts.

By requiring a more explicit notice for any applicable potential disqualification, and identifying a specific response timeframe, this law will result in a more robust eligibility determination process. An explicit notice would raise further awareness of the potential eligibility issue identified and encourage claimants to respond with information that could clarify the claim record.

To implement AB 397, the EDD would revise its notices to provide more information related to the false statement or misrepresentation, and provide claimants with an opportunity to respond. The Department would develop business requirements, complete development, conduct testing, comply with California Department of Technology Project Approval Lifecycle requirements and deploy new programming to its legacy information technology systems to accept, store, and utilize information provided by claimants. The EDD estimates requiring approximately $1,029,000 to implement AB 397. The Department will use existing funds for implementation activities that occur in 2021-22. AB 397 provides EDD until September 1, 2022 to make these revisions. In addition to these one-time costs, the Department would also incur ongoing costs to mail forms and process claimant responses as appropriate, which would depend on the associated workload volumes.

EDD Information Security. EDD is continuously audited by control agencies such as Department of Labor (DOL), Internal Revenue Services (IRS), CA State Auditors, CA Department of Military, CA Department of Technology (CDT), and other internal/external required audits. Prior to the COVID-19 pandemic, the EDD had audit findings that dated as far back to 2016 that were not remediated. Most recently, EDD has accrued over 40 additional findings including business operational issues as a result of an independent security assessment and audit in 2020. According to EDD, the inability to address audit findings timely is due to the lack of resources, ineffectiveness of the current ITB structure of siloed security lines of business and lack of appropriate tools.

Governor's Budget.

The Governor's budget proposes $133.9 million ($121.2 million General Fund) in limited-term resources to continue supporting EDD's development of IT systems, improve service for claimants, and protect the state from fraud, while EDD identifies longer-term plans. These expenditures include the following proposals:

- **Continuing Vendor Contracts**. The Governor's budget proposes $96.3 million ($86 million General Fund) in 2022-23 and $45.1 million ($36.8 million General Fund) for 2023-24 and 2024-25 to continue benefit service contracts that include essential document upload services, claims review, testing consultants for EDD products, as well as fraud prevention services. The six fraud-related contracts are:

    - ***Automated Batch Review.*** Thompson Reuters software tool used to flag potentially fraudulent claims. Same tool used in January 2021 to suspend 1.1 million claims.
    - ***Identity Risk Analytics.*** Thompson Reuters software contract to allow EDD to review new UI claims daily instead of weekly. Aim of more frequent review is to stop fraud.
    - ***Identity Verification.*** Extension of state's existing contract with ID.me.
    - ***Website Managed Security Services.*** Expanding an existing statewide partnership with Akamai to detect and prevent organized, automated cyber-attacks—known as "bot attacks"—that could disrupt or disable EDD's benefit application website.
    - ***Business Intelligence Competency Center Consulting.*** Consulting contract with Executive Information Systems to improve reporting of potentially fraudulent activity and cross-matching that data with Department of State Hospitals patient data or California Department of Corrections and Rehabilitation records.
    - ***Fraud Services.*** Rehiring Accenture to continue advising EDD on how to identify and prevent future fraud.

- **Information Technology Branch Technology Modernization**. The Governor's budget proposes $23.5 million General Fund and 122 positions for three years to maintain and improve benefit system usability to better serve claimants and remain hardened against fraud.

- **Cyber Security Resilience and Instrumentation**. The Governor's budget proposes an increase $10.2 million General Fund in 2022-23, and $6.1 million General Fund in 2023-24 and 2024-25, and 29.0 positions, for cybersecurity resources to assist with fraud mitigation and to improve cybersecurity and suspicious event monitoring, response, and resiliency. This proposal includes funding for cybersecurity, enhancements, suspicious activity monitoring tools, and staff training and is necessary to proactively address cybersecurity vulnerabilities, threats and security findings, implement technology to mitigate benefit fraud, meet the increasing need in cyber risk management, and strengthen the EDD cybersecurity posture.

- **UI Command Center Division (UICCD)**. The Governor's budget proposes $2.1 million General Fund and 10 positions for three years for a UI Command Center that centralizes UI branch management, supports UI data analytics, and enhances training to improve customer service.

- **AB 110-Fraudulent Claims for Unemployment Compensation Benefits: Inmates.** $2,199,000 EDD Contingent Fund and 4.6 positions in 2022-23, $934,000 and 3.6 positions in 2023-24, and $720,000 and 3.5 positions in 2024-25. These resources will be used to administer provisions of AB 110 that was recently chaptered.

- **AB 397-Unemployment Insurance: Benefits: Disqualification: Notice.** The budget includes $241,000 EDD Contingent Fund and one position in 2022-23. These resources will be used to administer provisions of AB 397 that was recently chaptered.

Legislative Analyst's Office Assessment and Recommendations on Assessing Proposals to Address Unemployment Insurance Fraud

Striking a Balance Between Fraud Prevention and Program Access. State employment insurance programs must balance the need to prevent fraud with the priority to delivery payments in a timely and straightforward manner. State agencies also have a responsibility to protect the privacy of the constituents they serve. Eliminating all fraud is infeasible. Moreover, attempting to eliminate all fraud necessitates onerous eligibility standards and a lengthy, time-consuming application process. On the other hand, although a program without fraud controls would be quick and simple, such a system would expose the state and employers to substantial financial risk. Given the importance of UI payments to workers, the economy, and the state during economic downturns, EDD's policies and practices should be regularly reviewed by the Legislature and administration to be sure the state is striking a workable balance that manages fraud while providing prompt and straightforward payments to eligible workers.

State Already Set up ID.me, Providing Substantial Protection Against Fraud… EDD's implementation of ID.me during the pandemic has had two major benefits: (1) with ID.me in place, the department now can automate more claims so fewer are redirected to the time-consuming manual review process; and (2) fraudulent actors using stolen identity information are no longer able to successfully claim benefits. With ID.me now in place, EDD has taken steps to substantially limit opportunities for fraud while also addressing the manual review bottleneck that caused the backlog during pandemic.

…But ID.me Has Come Under Scrutiny in Recent Days. The state hired ID.me to confirm workers' identities using so-called "one-to-one" face matching; that is, when a computer algorithm matches the photo or video submitted by the worker to the worker's identification card. In February 2022, the company CEO admitted to misleading ID.me clients: Although ID.me uses one-to-one matching to confirm identity, the company also made so-called "one-to-many" matches without their client's knowledge. One-to-many matches scan one person's face against large databases and therefore could help identify fraudulent actors who claim multiple benefits. However, privacy experts warn that these matching systems are prone to error, suffer from systematic racial bias, and have the potential to be misused. In light of this scrutiny, the Internal Revenue Service recently called off its planned adoption of ID.me for tax filing.

New Anti-Fraud Proposals No Longer Needed and Run Counter to Strike Team Recommendations. Moving forward at this time with additional layers of fraud protection is not necessary because (1) recent fraud was concentrated in temporary federal benefit programs that have now ended, (2) recent fraud in the state's regular UI program appears to have been minimal, and (3) adopting additional fraud protection now runs counter to the strike team recommendations.

- ***Recent Fraud Concentrated in Temporary Federal Benefits That Have Ended.*** Figure 3 shows the administration's estimate of suspicious or confirmed UI benefit fraud that occurred during the pandemic. The vast majority of fraud occurred in the temporary federal programs that now have ended. According to the Administration, $18.7 billion (94 percent) of UI benefit fraud may have occurred in the federally funded PUA program, while EDD suspects $1.3 billion (6 percent) in state UI benefits fraud.
- ***Administration's Estimates of Fraud in State UI Benefits Likely Significantly Overstated.*** The $1.3 billion estimate of fraud in the state UI benefits program likely is overstated. EDD counts state UI claims as fraudulent if a worker did not confirm their identity when EDD requested additional documentation or verification. Yet there are several reasons why workers with legitimate claims may not have followed up with EDD. Many of the suspected fraudulent claimants already had run out of benefits, meaning legitimate claimants would have had little reason to log in to confirm their identity. Other claimants may have given up in frustration after trying unsuccessfully to send requested documentation to EDD. While widespread frustration and an inability to contact EDD are problematic for other reasons, the claims from this group of workers did not represent fraudulent activity so including them contributes to the overstatement. Another estimate of likely fraud in the state's program (based on findings in the administration's strike team report) suggests that state UI fraud during the pandemic could be much smaller—just $100 million in fraud out of $35 billion in benefits paid. (The small red area represents this smaller likely fraud estimate.) Given that relatively little fraud seems to have targeted the state's regular UI program, new, additional layers of fraud prevention are not needed.
- ***Runs Counter to Key Strike Team Recommendation.*** Moving forward at this time with new, additional layers of fraud protection also would move the department further out of balance by again prioritizing fraud elimination at the expense of prompt and straightforward payments. To ensure that an anti-fraud emphasis does not come at the expense of prompt and straightforward payments, the strike team recommended that new anti-fraud proposals must be supported by data and take into consideration how the new protocols might impact legitimate claimants. The department's use of the Thompson Reuters software to suspend 1.1 million claims, of which at least 600,000 were legitimate, raises concerns that EDD has not internalized the strike team's fraud-related recommendations. Moving forward with this contract and others therefore runs counter to the administration's own assessment and recommendations and would move the department further out of balance.

Figure 3

Temporary Federal Benefits, Not State Benefits, Were the Primary Target of Fraud

<u>LAO Recommendation:</u> Approve Contract to Prevent Website Disruptions. The LAO suggests that the Legislature approve the Administration's contract with Akamai to prevent coordinated bot attacks that could disrupt or shut down EDD's website at critical times.

<u>LAO Recommendation:</u> Withhold Action on ID.Me. Setting up automated identity verification substantially sped up EDD processes so benefits could be paid promptly during the pandemic. The software likely also reduced fraud in the temporary federal programs. In hindsight, the strike team's recommendation to set up ID.me was warranted during the pandemic, when the magnitude of the claims backlog called for prompt and decisive action. Now that this critical period has passed, the LAO recommends that the Legislature pause and carefully consider the implications of requiring third-party biometric scanning—in this case, facial recognition performed by artificial intelligence.

<u>LAO Recommendation:</u> Direct Administration to Gather More Information, Assess Alternatives. As the Legislature considers the ongoing use of facial recognition software for the state's UI system, the LAO recommends that the Legislature directs the Administration to follow through on the strike team recommendation to assess the trade-offs and potential unintended consequences of anti-fraud measures, in this case for ID.me. The Legislature also may wish to task the administration with presenting alternatives to biometric scanning that achieve the same (or similar) level of automated security but that pose fewer potential privacy risks and equity concerns.

<u>LAO Recommendation:</u> Reject Proposals to Make Pandemic Era Anti-Fraud Tools Permanent. The LAO recommends the Legislature reject the pandemic era anti-fraud contracts with Thompson Reuters for *automated batch review* and *identity risk analytics* because the state's use of these programs adversely impacted the experience of several hundred thousand unemployed workers with legitimate claims and are not likely to be useful now that automated identity verification is in place. The Legislature may wish to ask the Administration whether these software tools could be useful in more targeted, special circumstances.

<u>LAO Recommendation:</u> Reject Anti-Fraud Consulting Contracts, Require EDD to Outline Benefits and Consider Trade-Offs First. The LAO also recommends that the Legislature reject the Business Intelligence Competency Center Consulting and Fraud Services contracts until the Administration reports on the "the effectiveness, but also the trade-offs and unintended consequences of these practices" as recommended by the strike team.

<u>Suggested Questions</u>

- How many vacancies exist at the department? What is EDD's recruitment and retention strategy overall?
- To date, where is EDD in terms of implementing the Strike Team's recommendations? How/Do these proposals reflect implementation of the Strike Team's recommendations?
- Is cybersecurity a prevailing challenge that EDD currently faces? Are there large ongoing threats?
- How do these proposals interact with the Benefits System Modernization Project that has been placed on hold?
- What security elements of ID.Me does EDD use in its verification processes? What key security element does EDD lose if they "downgrade" ID.me identity verification to do everything but facial recognition?
- We ask for the Administration's/EDD's response to the LAO recommendations.

Staff Recommendation: Hold Open

Issue 7: Workforce Education, Development, and Training Proposals

<u>Background</u>

Employment Training Panel Expansion for Health and Social Work. The COVID-19 pandemic has highlighted the need for more skilled workers in all areas of the healthcare industry, and for better training programs, higher wages, increased diversity, and career pathways for workers in the healthcare industry. The healthcare fields often have high barriers to entry (high costs for long training programs), and entry-level positions are often low paid. Increased accessibility, wage progression, and career ladders are needed in order to fill the gaps that are negatively impacting the healthcare industry.

This investment in the Employment Training Panel will support job entry and career advancement for entry-level and other workers in care, healthcare, and human service social work settings. Funding may go directly to employers to provide their own training, and thereby creating career pathways. Funding may also go to organized labor, community based organizations (nonprofits), or trade associations -training organizations that provide training to workers in multiple employer settings. Training providers that are upskilling existing employees will be required to demonstrate wage increases after training completion in order to receive the funds.

Additionally, these funds will need an extended encumbrance period, using 3 years to encumber the funds and an additional two years to expend and liquidate the funds (for a 5 year period, total). For funds encumbered on the third year, this would allow ETP to utilize its traditional performance based model, thereby allowing the funds to be expended and liquidated in the two following years.

Workforce Literacy. California is home to millions of immigrants and limited English proficient individuals. These individuals are also often lacking in digital and technical skills. Many of these individuals work in low paying jobs without opportunities for advancement. The high poverty and low skill levels of these populations not only causes hardships for these individuals and their families, but also adds to higher unemployment and underemployment figures in California, as well as causing a loss in tax revenue and higher costs for supportive-type services for the state. Therefore, a systems-change approach is needed that removes barriers to licensure and certification, substantially broadens access to skills training, expands evidence-based practices that accelerate learning for English language learners and engages employers in building the skills of their workers to build their business competitiveness.

These funds will support the Employment Training Panel in creating the Workforce Literacy Pilot Program, expanding workplace literacy in contextualized English, digital skills, and technical skills training for incumbent and newly hired workers, as well as for unemployed individuals, who are limited English proficient. This pilot program will enable participating single employers, organized labor, community based organizations (nonprofits), or trade associations-training organizations, to build skilled workforces and increase employee retention, and to provide pathways to higher wages and better jobs for immigrants, refugees, and other limited English proficient individuals.

Displaced Worker Fund for Oil and Gas Workers. Since 1985, California's in-state oil production has declined an average of 65.2 percent per year. As in-state production continues to decline and California moves closer towards carbon neutrality, the Administration is committed to supporting workers on the front-lines of this transition and specifically workers in California's oil and gas industry.

This pilot investment is designed to provide financial awards that would complement the State's existing Workforce Innovation and Opportunity Act (WIOA) Dislocated Worker (DW) program, in an effort to minimize disruptions to the livelihoods of impacted workers and their families. Impacted workers will have access to transitional jobs, career counseling, employment and training services to help them prepare for new careers in growing industries. Additionally, grant awards will provide broad support for impacted Dislocated Workers such as immediate financial support for housing, groceries, utilities, and childcare.

In an effort to maximize the reach of the pilot program, the EDD will collaborate with existing partners to identify existing impacted workers. The EDD will collaborate with partners such as the California Workforce Development Board, the Department of Rehabilitation, the Department of Social Services, and existing workforce initiatives. The goal of the EDD is to reinforce the collaborative efforts to align the pilot with new and existing economic development and displaced worker programs. The EDD will use the information collected during the pilot program to inform discussions regarding the need for future investments in this area.

These funds will need an extended expenditure period using three years to encumber the funds and an additional two years to expend and liquidate the funds. The EDD will use the extended encumbrance period to reinforce existing partnerships, identify new partners and develop further guidance. The liquidation period will allow the grantees to include a start-up period for their pilot programs. The liquidation of encumbrances shall end on June 30, 2027.

Integrated Education and Training. English language learners face cultural, language, educational and other barriers that limit their access to services and opportunities to gain skills and experience leading to family-sustaining jobs. California is investing Workforce Innovation and Opportunity Act (WIOA) funds to expand and enhance workforce development services for English language learners (ELLs).

The training and services offered through the IET for ELL program will help to prepare individuals with limited English skills for good quality jobs and careers in growing local industries. The Immigrants Build Back a California for All Initiative seeks to expand successful ELL pilots to sites across the state. The program will tap the skills and expertise of new immigrants and create pathways out of poverty for immigrants trapped in low wage jobs and precarious employment.

The Workforce Services Branch at EDD will coordinate state efforts across multiple agencies and departments, including adult education partners, for skills training and support services Community-based organizations and workers' centers that have a demonstrated history of assisting immigrants and refugees in successfully completing education and training programs will provide wrap-around and follow-up services, such as child care, mental health, health, financial literacy, support for documentation and citizenship applications, and other supportive services.

In partnership with the State's adult education providers such as the California Department of Education, the EDD will also assist in creating on-ramps to training for undocumented and other immigrants by working with workers' rights centers across the state. These on-ramps could accelerate training by offering contextualized English language instruction for vocational skills training for in-demand occupations.

The funding will support a comprehensive evaluation of the pilot projects to demonstrate results, as well as, coordinated program development, technical assistance and community of practice. Additionally, the Workforce Services Branch of the EDD will create the Immigrant Integration Workgroup which will focus on items such as, the full implementation of AB 2098, guiding the IET expansion and the development of the California Best program.

Targeted Training for Emergency Medical Technicians. This Targeted EMT Training targets youth and those who may have barriers to employment for roles as Emergency Medical Technicians. These will be developed, in partnership with local public health systems and their contracted emergency medical providers, building on the Emergency Medical Services Corps

Alameda County model, with replication in 5-10 counties throughout the State.

The program, developed and tested in Alameda County, includes 380 hours of classroom instruction following a pre-course in medical terminology. Students will also participate in 20 hours of direct medical treatment and job shadowing, and receive intensive wrap-around support, including case management, mentoring, life coaching and job readiness. A training stipend of $1,000 a month will allow participants to focus on their training program without part-time or full-time employment.

The initial planning process will identify program sites best suited for success: those at the intersection of high need and administrative capacity and willingness, informed by stakeholder meetings, a scan of the health care workforce, an assessment of each county's population of underserved youth, as well as the partnership potential. The full partnership and commitment of the county health department will be a critical component. Site selection would be followed by program development and capacity building, to include the identification of key partners, staff hiring, mentor recruitment and initial outreach for program participants.

In addition to the projects, the funding will support a comprehensive evaluation of the pilot programs to demonstrate results, as well as, coordinated program development, technical assistance and community of practice.

Each of the appropriations will follow an extended expenditure and liquidation timeline, allowing three years to expend and encumber, with an additional two years to liquidate obligations. This will allow enough time to properly set up, administer and evaluate this new program.

<u>Governor's Budget.</u>

- **Employment Training Panel Expansion for Health and Social Work.** The Governor's Budget proposes $90 million one-time General Fund to provide training for incumbent health and social workers.

- **Workforce Literacy.** The Governor's Budget proposes $20 million one-time General Fund to expand workplace literacy training.

- **Displaced Worker Fund for Oil and Gas Workers.** The Governor's Budget proposes $50 million one-time General Fund to establish a fund to provide assistance for oil and gas workers facing unanticipated displacement.

- **Integrated Education and Training.** The Governor's Budget proposes $30 million one-time General Fund to the Employment Development Department's Workforce Services Branch to expand the English Language Learner (ELL) pilots in Integrated Education and Training (IET) programs.

- **Targeted Training for Emergency Medical Technicians.** The Governor's Budget proposes $20 million General Fund from 2022-23 through 2024-25 to provide targeted training for Emergency Medical Technicians.

Suggested Questions

- DOF: Can you explain why the training proposals are housed under EDD as opposed to other departments/entities under the LWDA? How do these proposals relate to the Administration's broader workforce initiatives in the budget?
- Are interagency agreements imagined for these initiatives?
- EDD: What is your capacity to carry out these initiatives?
- How were these proposed amounts determined?
- Who is participating in these initiatives? How are you measuring or tracking these participants?
- What kinds of services are they receiving? How are you measuring or tracking the services that will be delivered to program participants?
- What kinds of labor market outcomes are program participants expected to achieve? How are you measuring the success outcomes for these investments with respect to the goals that the Administration has for these investments?
- What is the Administration's expectations for the types of jobs and benefits that participants of these initiatives would receive after completion?
- Are these aforementioned expectations going to be formalized in additional trailer bill or budget bill language? Will we see some of these formalized expectations by the May Revise?

Regarding the ETP proposals, in addition to the above questions,

- Is ETP requiring job and wage commitments upfront?
- What information is ETP requiring contractors to submit and is this information available to the public?

On ETP expansion for health and social work,

- Why are incumbent health and social workers targeted as part of this investment?
- How would this proposal interact with and fit into the Administration's other proposals in the $1.7 Billion Care Economy Workforce package? How is this proposal distinct from those proposals?

On Workforce Literacy,

- Please elaborate on the types of workforce literacy efforts that will be provided and why these strategies were identified as the best practices to fund? What are the outcomes expected from this proposal?
- How is this proposal expected to interact with the integrated education and training proposal? Is there overlap between the intent and target population of these two proposals?

On Displaced Worker Fund for Oil and Gas Workers,

- How was this amount determined? How many workers are expected to receive grants from these funds? What is the minimum and maximum award amounts? Will you track outcomes? If so, what outcomes will you track?
- Given the potential coordination between this and other proposals, how does the Administration view this proposal in relation to other Administration workforce climate proposals, including the well-capping efforts mentioned under CWDB in Issue 3? Is this seen as complimentary or separate from these proposals? Does the Administration intend to incorporate these displaced workers into those proposals?
- How does this proposal ensure that displaced workers will find employment with earnings approximate to their former earnings?
- What is the Administration's plan for sector partnerships with employers, industry associations, and worker associations that helps these workers find employment and makes use of their existing skill set?
- What is the Administration's plan for a transition of these oil and gas workers, when appropriate, onto public works projects, other workforce climate proposals, and apprenticeship programs? Will these workers receive prioritization in these processes?

On Targeted Training for EMTs,

- How would this proposal interact with and fit into the Administration's other proposals in the $1.7 Billion Care Economy Workforce package? How is this proposal distinct from those proposals?
- DOF: Why is EDD the appropriate implementation entity for this proposal?

Staff Recommendation: Hold Open

7350 DEPARTMENT OF INDUSTRIAL RELATIONS

The Department of Industrial Relations is responsible for enforcing the sections of the Labor Code that protect the health and safety of workers; promulgating regulations and enforcing laws relating to wages, hours, and workers' compensation insurance laws; adjudicating workers' compensation claims, and working to prevent industrial injuries and deaths. The Department also promotes apprenticeship and other on-the-job training, as well as analyzes and disseminates statistics measuring the condition of labor in the state.

3-YEAR EXPENDITURES AND POSITIONS †

		Positions			Expenditures		
		2020-21	**2021-22**	**2022-23**	**2020-21***	**2021-22***	**2022-23***
6080	Self-Insurance Plans	22.8	26.1	26.1	$6,440	$6,835	$6,842
6090	Division of Workers' Compensation	991.0	1,147.0	1,158.0	248,524	270,304	273,740
6095	Commission on Health and Safety and Workers' Compensation	4.8	9.1	9.1	4,053	4,091	3,796
6100	Division of Occupational Safety and Health	738.7	858.9	893.9	172,772	214,245	199,882
6105	Division of Labor Standards Enforcement	658.9	753.4	816.9	139,939	154,717	145,502
6110	Division of Apprenticeship Standards	92.9	94.3	94.3	17,462	47,737	18,526
6120	Claims, Wages, and Contingencies	-	-	-	245,182	238,712	238,712
9900100	Administration	488.7	558.0	565.0	104,620	145,187	100,548
9900200	Administration - Distributed	-	-	-	-104,620	-145,187	-100,548
TOTALS, POSITIONS AND EXPENDITURES (All Programs)		**2,997.8**	**3,446.8**	**3,563.3**	**$834,372**	**$936,641**	**$887,000**

Issue 8: Enhanced Enforcement and Compliance

Background

SB 62. Before Jan 1, 2022 law (Part 11 of Division 2 commencing with section 2670 of the Labor Code) established a system of registration, penalties, and misdemeanors for violations of laws and regulations applicable to the employment of workers in the garment industry.

SB 62 updates these laws to close existing loopholes that have allowed retailers and manufacturers to circumvent the laws that seek to ensure that workers are fully paid legal minimum and overtime wages for their labor. This legislation, among other things, makes the common practice of "payment by the piece" prohibited except as an incentive bonus, creates a new category of entities called "brand guarantors" (any person contracting for the performance of garment manufacturing as defined), and introduces joint and several liability for payment of wages, reimbursement for expenses, and other compensation due, including interest, between manufacturers and brand guarantors. The bill also establishes joint liability for damages, and penalties between garment manufacturers and contractors.

SB 62 also provides the Division of Labor Standards Enforcement with the authority to issue citations for garment violations, including against upstream defendants along with stop order authority, which can provide strong leverage against the worst violators. The staffing package is as follows:

- Total of 1.5 positions requested for Wage Claim Adjudication Unit. Due to the nature of the changes to law enacted by SB 62 the Division expects an increase in appeals of the Division's administrative decisions increasing the workload of the Divisions hearing officers.
- Total of one position requested for Bureau of Field Enforcement (BOFE). SB 62 would grant citation and stop order authority to the Division's BOFE Unit. The Division conservatively estimates an increase in inspections by 20 percent due to the new stop order authority as well as SB 62's addition of liability for brand guarantors.
- Given the anticipated increase in wage claims and BOFE inspections, the Division's Legal Unit would need 1.5 additional attorneys. Half an attorney position is needed to aid and advise deputies of full enforcement of the new stop order authority citation issuance. The second attorney would be involved in multiple aspects of enforcement, including advising and working with the deputies who are doing the inspections and adjudicating wage claims, advising on (or prosecuting) any appeal by the employer of a garment stop order or citation, and any work involving registration fees and determinations of payments to be made from the Garment Manufacturers Special Account, or representing the Labor Commissioner in any writs (or other actions) filed by the employer in superior court.

SB 606. In the past, CalOSHA has limited the scope of its inspections to individual workplaces, even if CalOSHA has received complaints alleging similar hazards at more than one work site operated by the same "chain" employer. Prior to SB 606, CalOSHA has lacked authority to issue "enterprise-wide" citations to address occupational safety and health violations committed by employers who implement the same noncompliant written policies and practices at more than one of their workplaces. This law created a rebuttable presumption that a violation committed by an employer that has multiple worksites is enterprise-wide if the employer has a written policy or procedure that violates these provisions, except as specified, or the division has evidence of a pattern or practice of the same violation committed by that employer involving more than one of the employer's worksites. The law authorized the Division of Occupational Safety and Health (CalOSHA) to issue an enterprise-wide citation requiring enterprise-wide abatement if the employer fails to rebut such a presumption. The law imposed specified requirements for a stay of abatement pending appeal of an enterprise-wide citation. The law subjects an enterprise-wide violation to the same penalty provision as willful or repeated violations. The staffing package is as follows:

- One Attorney III position within the Legal Unit who will be able to undertake the necessary rulemaking to implement SB 606. CalOSHA must promulgate regulations on behalf of the Director in order to implement Section 2 of SB 606. Among other provisions, CalOSHA must amend the Director's penalty regulations (Title 8, CCR §336 et seq.) to codify the calculation for civil penalties for egregious violations. CalOSHA will also need to promulgate a regulation to further develop some of the statutory "characteristics" for finding an egregious violation. The list of characteristics set forth in Labor Code section 6317.8(b)(1-7) includes a number of unquantified terms. In order to allow for consistent application of this section across all of CalOSHA's Enforcement offices, these terms should be further defined in regulation.
- One Attorney IV position to allow CalOSHA to be staffed to review egregious and enterprise-wide citation packages to ensure legal and evidentiary sufficiency. The changes in the Labor Code codified under SB 606 will further increase the complexity of CalOSHA's litigation caseload, even if it does not increase the number of citations CalOSHA issues. CalOSHA estimates, conservatively, that it will issue citations for at least 30 egregious of employer-wide citations in 2022. CalOSHA estimates that it will go to hearing in at least 20 of those cases, and is unable to absorb that additional caseload of complex litigation. The Legal Unit will also be able to assign more-experienced attorneys to litigate these novel and complex citations.

SB 727. SB 727 expands existing direct contractor liability to include liquidated damages and penalties in circumstances where the direct contractor fails to meet payroll monitoring and corrective action requirements, as specified. The law also requires the Labor Commissioner to notify the direct contractor and any subcontractor on a private works project at least 30 days prior to holding a hearing, issuing a citation, or filing a civil action for the failure of a subcontractor to pay specified wage, fringe or other benefits due to workers. This notice need only describe the general nature of the claim, the project name or address, and the name of the employer.

- Total of six positions requested for Wage Claim Adjudication Unit. The bill would impact WCA workload on claims of wages owed to workers employed by subcontractors who fail to pay their employees. Additional staff time would be required to determine who is a "direct contractor" for one or more projects a claimant worked on, to add defendants, provide statutorily required notice, obtain documents, and to prepare subpoenas seeking information held by direct contractors and subcontractors. It would also require additional hearing officer time to hear and determine contractor liability under the proposed statute with particular attention to the factors limiting liability, draft Order, Decision, or Awards construing proposed statute and evidence of relevant factors, and process additional appeals under Labor Code section 98.2 on the issue of knowledge, if liquidated damages and penalties are assessed. Additionally, the bill has the potential to give rise to litigation regarding the Labor Commissioner's ability to proceed with a claim against a direct contractor if the required notice deadline is not met and will require 0.5 additional staff attorney to address this workload. The additional attorney workload will also include hours assisting deputies in adjudicating wage claims to answer questions regarding points of law and lawful procedure.

- Two positions at BOFE. Given that BOFE citations are of a wider scope than Labor Code section 98 claims (which typically are individual worker claims), they require longer investigations to determine who the contractor is and to determine whether they were given notice of unpaid wages as required. Additional staff time would be required to determine who the direct contractor is on one or more projects a worker worked on and prepare the special notice(s) to the direct contractor(s), to process the notice to direct contractors, prepare subpoenas for workers seeking the information held by the direct contractor and subcontractors, to conduct worker interviews, to hear and determine contractor liability under the new statute with particular attention to the factors limiting liability, and draft Order, Decision, or Awards.

***AB 701*.** AB 701 requires warehouse distribution center employers, as defined, to provide upon hire (or within 30 days of the legislation's effective date) employees with a written description of each quota employees are subject to, including any potential adverse employment action that could result from failure to meet the quota. The law provides that an employee shall not be required to meet a quota that prevents compliance with meal or rest periods or other occupational health and safety laws as specified. AB 701 also prohibits an employer from taking adverse action against an employee for failure to meet a quota that has not been disclosed or that does not allow a worker to comply with meal or rest periods or occupational health and safety laws. If an employee believes that meeting a quota caused a violation of their right to meal or rest period or health and safety laws, they have a right to request a written description of each quota and a copy of the most recent 90 days of the employee's personal work speed data (if it was being monitored).

AB 701 requires the Labor Commissioner to enforce these provisions by engaging in coordinated and strategic enforcement efforts. In an effort to increase compliance, DLSE is also required to collaborate with stakeholders to educate workers and employers about their rights and obligations under AB 701. Additionally, the bill requires Cal/OSHA to notify DLSE if a particular worksite or employer is found to have an annual employee injury rate of at least 1.5 times higher than the warehousing industry's average annual injury rate, so the Labor Commissioner can determine whether an investigation is appropriate.

- Claims related to AB 701 will need to be investigated by the Occupational Safety & Health (OSH) section of Retaliation Complaints Investigation, given the nature of the claims. Due to the complexity of these complaints, they will require more deputy time then other complaint investigations. While the amount of time required to investigate a single OSH RCI case varies depending on its factual complexity, RCI estimates it would require an average of 48 hours total staff time per case, which breaks down as follows: Attorney III [5 hours], Deputy Labor Commissioner (DLC) III [2 hours], DLC I [37 hours] and Office Technician-Typing (OT) [4 hours]. In total, this proposal requests four positions for RCI.

- Enforcement of the new law will require a targeted enforcement unit comprised of deputies specifically trained to determine what constitutes an unlawful quota system per this bill and the resulting remedies, whether there was a failure to disclose required information; and reporting to the Legislature. The Division estimates that one inspection of a warehouse employer would require 92.5 hours to complete on average and includes pre-inspection activities, on-site inspection (including travel time), post inspection activities including records audits, employer/employee follow-up, determination of violations and citation issuance. The Division estimates that a staff of 2 DLC I, 1 Auditor l, 1 OT, and 1 Attorney III will allow BOFE to inspect 40 warehouse employers per year. In addition, the DLSE will require one Associate Governmental Program Analyst to address the reporting and education requirements along with one DLC III supervisory position.
- In order to monitor warehouse inspections; ensure enforcement staff gather relevant data to calculate the annual employee injury rate; analyze whether it is greater than the industry average injury rate; and coordinate reporting with DLSE, Cal/OSHA requests one Research Data Specialist I.

AB 1023. AB 1023 allows the Labor Commissioner (LC) to impose a penalty on a contractor or subcontractor on a public works project if they fail to furnish payroll records to the LC, as specified. The law revises the requirement to furnish records monthly to instead require that the contractor or subcontractor furnish those records at least once every 30 days while work is being performed on the project, and within 30 days after the final day of work performed on the project. The law also require that the contractor or subcontractor furnish these records in an electronic format, in a manner prescribed by the LC, on the DIR's internet site.

- AB 1023 is projected to have a significant impact on the workload of DLSE's Public Works unit. Approximately 25,000 contractors register with DLSE each year, and of those, approximately 15,000 are required to submit payroll records to DLSE. At present, 10,000 contractors are delinquent in their compliance with this requirement and would be subject to the penalty prescribed by the bill. DLSE estimates that levying the penalty on 50 percent of those delinquent contractors would result in 5,000 penalties levied per year. The time to investigate and process each penalty would vary depending on the complexity of the case, but the Division estimates each penalty would require an average of approximately 8 hours per penalty requiring 22.5 positions in DLSE: 11 Deputy Labor Commissioner (DLC) Is, 2 DLC IIIs, 5.5 Attorney IIIs, 2 Legal Secretaries and 2 Office Technicians.
- If DLSE were to levy 5,000 penalties, then the workload of hearing officers within Office of the Director, Legal Unit would also be increased to handle the increase in appeals. Based on DLSE's estimates of additional cases, Office of the Director, Legal Unit estimates 12 percent (or 600) of the 5,000 penalties levied each year would be appealed, requiring additional legal support from Office of the Director, Legal Unit. To handle the estimated influx of appeals, Office of the Director, Legal Unit would require one Attorney III and one Legal Secretary.
- To implement AB 1023, there will be increased demands on the Division of Administration (Admin) to provide general support in areas such as Human Resources, Business Management, Fiscal Management and Information Services. Currently, there is ratio of approximately 1:12 Admin staff to total Department staff. With an increase of 24.5 positions in DLSE and Office of the Director, Legal Unit, DIR requests 3 Staff Services Analyst positions to provide essential administrative support.

Governor's Budget.

The Governor's budget proposes $10.4 million and 53.5 positions in 2022-23, decreasing to $2.7 million and 13 positions by 2025-26, and ongoing, to implement various chaptered legislation. These include the following:

- Senate Bill 62 (Durazo), Chapter 329, Statutes of 2021: Employment: Garment Manufacturing
- SB 606 (Gonzalez), Chapter 336, Statutes of 2021: Workplace Safety: Violations of Statutes: Enterprise-Wide Violations: Egregious Violations
- SB 727 (Leyva), Chapter 338, Statutes of 2021: Labor-Related Liabilities: Direct Contractor
- AB 701 (Lorena Gonzalez), Chapter 197, Statutes of 2021: Warehouse Distribution Centers
- AB 1023 (Flora), Chapter 326, Statutes of 2021: Contractors and Subcontractors – Records: Penalties

Bill	BY FY 2022-23	BY + 1 FY 2023-24	BY + 2 FY 2024-25	BY + 3 FY 2025-26	BY + 4 FY 2026-27
	Pos	Pos	Pos	Pos	Pos
AB 701 (Chapter 197, 2021)	12.0	12.0	12.0	-	-
AB 1023 (Chapter 326, 2021)	27.5	27.5	27.5	-	-
SB 62 (Chapter 329, 2021)	4.0	4.0	4.0	4.0	4.0
SB 606 (Chapter 336, 2021)	2.0	2.0	1.0	1.0	1.0
SB 727 (Chapter 338, 2021)	8.0	8.0	8.0	8.0	8.0
Total	53.5	53.5	52.5	13.0	13.0

Suggested Questions

- The state has enacted many laws to improve conditions for workers but staffing for enforcement and compliance has not kept pace with the growth of our state. Why do we think the need for enforcement staff will be reduced in years 2025-26? What are the underlying assumptions that went into this estimate?
- How many vacancies exist at the department? What is DIR's recruitment and retention strategy overall and specific to these positions?

Regarding implementation of SB 62,

- How many new wage claim cases are estimated for 2022?

Staff Recommendation. Hold Open

7900 California Public Employees' Retirement System
7920 California State Teachers' Retirement System
Various Departments

Issue 9: State Retirement Liabilities

Background

Three Primary Types of Debts and Liabilities. California's debts and liabilities fit into three broad categories:

- ***Retirement Liabilities.*** As discussed below, California has unfunded liabilities associated with pension benefits for judges and state employees, retiree health benefits, and the state's share of pension benefits for the state's teachers and school administrators.
- ***Bond Debt.*** These liabilities include the principal and interest amount of outstanding general obligation and lease revenue bonds issued by the state to finance capital infrastructure.
- ***Budgetary Borrowing.*** For the purposes of this report, these are the debts the state has incurred in the past to address its budget problems. These include loans from other state funds to the General Fund and outstanding obligations to other entities, like cities, counties, and school and community college districts.

In recent years, the state has enacted reforms to public pension law under the Public Employees' Pension Reform Act of 2013, developed and implemented a funding strategy to pay down CalSTRS' unfunded liability, and made numerous supplemental pension payments to CalPERS and CalSTRS to further eliminate the state's share of unfunded liability. In addition to the state's required annual contributions, from 2017-18 through 2021-22, the state has made supplemental pension payments of $12.7 billion to CalPERS and CalSTRS, with the goal of improving the funded status of both systems and reducing the state's long-term retirement obligations.

Proposition 2. Proposition 2 was added to the November 2014 ballot in a special legislative session under ACAX2 1 (Pérez) and subsequently was approved by voters. The measure made significant changes to the state constitution concerning budgeting practices. In particular, in addition to requiring annual deposits into the state's rainy day fund, it requires the state to make additional debt payments each year until 2030. The intent of Proposition 2 was to improve the state's fiscal situation—for example, by "repay[ing] state debts and protect[ing] the state from the negative effects of economic downturns." Among the requirements established by Proposition 2, the law requires that the state spend a minimum amount each year to pay down specified debts though 2029-30.

When Proposition 2 was passed by the voters, there were two major categories of liabilities eligible for repayment using these monies: certain budgetary liabilities and retirement liabilities. Proposition 2 contains a formula that requires the state to spend a minimum amount each year to pay down specified debts. The formula has two parts. First, the state must set aside 1.5 percent of General Fund revenues. Second, the state must set aside a portion of capital gains revenues that exceed a specified threshold. The state combines these two amounts and then allocates half of the total to pay down eligible debts and the other half to increase the level of the rainy-day fund (the Budget Stabilization Account). Since Proposition 2 passed, the state has repaid all of the eligible budgetary debts, meaning the remaining eligible uses of Proposition 2 are related to unfunded liabilities for pensions and retiree health benefits.

Retirement Liabilities

State Employee Pensions. The California Public Employees' Retirement System (CalPERS) administers pension benefits for state employees, state judges, certain elected state officials, and employees of local governments that contract with CalPERS (and their beneficiaries). Under the Constitution, CalPERS has "full rate setting authority," which means the board has authority to require employers to contribute an amount of money that the board determines is necessary to fund the system. With full rate setting authority, contribution requirements might change year over year in response to actuarial changes. This rate setting authority is important because it allows the system to (1) make up for losses that occur when actuaries determine that more funds are necessary to pay for benefits than what has already been set aside (that is, to address an unfunded liability over time) and (2) not charge employers more than is necessary for the system to become fully funded.

Teacher's Pensions. The California State Teachers' Retirement System (CalSTRS) administers pension and other retirement programs for current, former, and retired K-12 and community college teachers and administrators, as well as their beneficiaries. Under state law, currently about one-third of these liabilities are the responsibility of the state ($33 billion) and about two-thirds are the responsibility of school districts.

Prior to 2014, base contribution rates paid by districts, teachers, and the state were established in statute, and the CalSTRS board had limited authority to set a supplemental contribution rate for the state. Given its constraints, CalSTRS projected those losses would result in the system running out of assets in the mid-2040s. In 2014, the Legislature approved a plan AB 1469 (Bonta), Chapter 46, Statutes of 2014, to fully fund the CalSTRS defined benefit program by 2046. The funding plan scheduled increases to the contribution rates paid by districts, teachers, and the state to the system for several years and—after that point—granted the CalSTRS board limited rate setting authority. Specifically, the funding plan phased in increases to the state's contribution rates until 2016-17, after which the funding plan gave the CalSTRS board limited authority to adjust those rates. In particular, the board may increase the state's rate by 0.5 percent of pay each year.

Over the past few years, the state has made supplemental payments toward the state's share of CalSTRS' Unfunded Actuarial Obligation (UAO) using Proposition 2 debt payment funding. These supplemental payments have helped offset the gap that has existed between the contribution rate that would be actuarially required if CalSTRS had full rate setting authority and the state's actual rate within the limits of the CalSTRS Funding Plan. Specifically, the supplemental payments the state made in 2019-20, 2020-21, and 2021-22 in aggregate fully offset the gap in those years—which was around $1.8 billion in sum.

Supplemental and Supplanting Payments. Over the last few years, the Legislature has made over $7 billion General Fund, Proposition 2, and loan from the Surplus Money Investment Fund (SMIF) in supplemental pension payments CalPERS state plans and the state share of the CalSTRS unfunded liability.

State Does Not Regularly Make Contributions to School Pool. School and community college district employees who earn pension benefits as part of their compensation but are not members of the CalSTRS receive their pension benefits through the CalPERS School Pool. These CalPERS pension benefits are funded through a combination of contributions from district employers and employees as well as investment returns on those contributions. Unlike CalSTRS, the state does not regularly make contributions to the CalPERS School Pool.

State Made Supplanting Contributions in Recent Years. Across the three years between 2019-20 and 2021-22, the state contributed $904 million to the CalPERS School Pool. These contributions *supplanted* school district contributions, meaning that they reduced the contributions that school districts otherwise would have been required to make. The figure below from the LAO displays the effect on contribution rates that supplanting payments have provided for CalPERS school employers over the past few years.

CalPERS School Pool Employer Required Contribution Rates

Percent of Creditable Compensation

	2019-20	2020-21	2021-22	2022-23 Proposed
Total employer rate collected by CalPERS	20.733%	23.6%	25.07%	25.4%
Offsetting rate paid by state on behalf of employers	-1.012	-2.9	-2.16	—
Effective Rate Paid by Employers	**19.721%**	**20.7%**	**22.91%**	**25.4%**

State Retiree Health. The state provides health benefits to retired state employees. Prior to 2015, the state essentially put no money aside to pay for this benefit while the eventual retiree was still working. As a result, the state accrued a significant unfunded liability associated with retiree health. In 2015-16 the state began a policy to prefund this benefit by setting aside funds annually. Over the last few years, the state's General Fund costs of prefunding have been paid using Proposition 2. Under the new policy to prefund retiree health, the state and employees each pay a percent of pay intended to equal one-half of the normal cost so that the entire normal cost is paid each year. Normal cost is the amount that actuaries estimate is necessary to be invested today to pay for the benefit in the future.

Through the collective bargaining process, the state's 21 employee bargaining units and related excluded and exempt employees have agreed to prefund retiree health benefits. Based on the most recent actuarial valuation, as of June 30, 2020, the state and employees had set aside $2.7 billion.

State Has Large Unfunded Retirement Liabilities. The state has significant unfunded liabilities associated with retirement benefits for state employees and teachers. An unfunded liability occurs when the assets that have been set aside during a retiree's working years are insufficient to pay their future benefits.

- The most recent actuarial valuation (as of June 30, 2020) estimates that the state's unfunded CalPERS pension liabilities are $63 billion. This estimate does not take into consideration the higher-than-assumed investment returns in 2020-21 or the new discount rate assumption. CalPERS should release a new initial estimate of the state's unfunded liability (as of June 30, 2021) in the spring.

- As of CalSTRS' most recent actuarial valuation (for the period ending June 30, 2020), CalSTRS' total UAO is $105.9 billion, with $31.5 billion assigned to the state and $74.0 billion assigned to employers, based on the CalSTRS Funding Plan (AB 1469 (Bonta) Chapter 46, Statutes of 2014).

- The state's retiree health unfunded liability is $95.2 billion.

Governor's Budget Proposals

Proposition 2 Debt Payments

Under the Administration's revenue estimates, the state's required debt payments under Proposition 2 total $3.9 billion in 2022-23. Of that, the Administration proposes dedicating:

- $3.5 billion to make a supplemental pension payment to CalPERS,
- $365 million to pay for the state's portion of normal cost to prefund state retiree health benefits, and
- $56 million to repay the Surplus Money Investment Fund for a loan the state took in 2017-18 to make a one-time $6 billion supplemental pension payment to CalPERS.

CalPERS

State's Required Contributions to CalPERS Assumed to be $8.4 Billion ($4.8 Billion General Fund) in 2022-23. The Governor's budget assumes that the state will contribute $8.4 billion ($4.8 billion General Fund) in 2022-23 to pay for state employee pension benefits (including CSU employees). This assumed contribution level takes into consideration the phased-in effects of (1) higher-than-assumed investment returns in 2020-21, which will reduce pension costs, and (2) a lower discount rate assumption, which will increase pension costs. On net, the full effects of both of these factors will reduce state contributions to CalPERS over time. The Administration's multiyear projection assumes that the state's CalPERS costs will decrease by $838 million by 2026-27. Compared with the Administration's multiyear projection from May 2021, this represents about a five percent reduction from what the administration expected state CalPERS contributions would have been before the 2020-21 investment returns and change in discount rate assumption.

As Noted Above, The Administration Proposes $3.5 Billion Supplemental Payment to CalPERS in 2022-23. The Administration proposes using $3.5 billion of the total $3.9 billion in Proposition 2 debt payment requirements as a supplemental pension payment to reduce the state's CalPERS unfunded liabilities. As a supplemental pension payment, this contribution is in addition to what the state is required to contribute to CalPERS. The Administration proposes that the supplemental payment would be apportioned across the state's pension plans in proportion to the amount of General Fund contributions to those plans.

No Proposal for State to Make Contribution to School Pool in 2022-23. The Governor does not propose any state resources be used to offset district employer contributions to the CalPERS School Pool in 2022-23.

CalSTRS

State's Required Contribution to CalSTRS is $3.7 Billion. The Governor's 2022-23 budget proposal includes $3.7 billion General Fund in required contributions to CalSTRS. This reflects an estimated contribution rate for the state of 8.328 percent of creditable compensation to the Defined Benefit program (the final rate will be determined by CalSTRS' board at its spring meeting), as well as the state's required annual contribution rate of 2.5 percent of creditable compensation (less $72 million) to the Supplemental Benefit Maintenance Account.

No Supplemental Payments to CalSTRS Proposed in 2022-23, in Contrast to Past Few Years. In 2022-23, the Administration does not propose to direct any Proposition 2 debt payment funding to CalSTRS. In addition, the Administration no longer proposes to provide an additional General Fund payment—equivalent to 0.5 percent of CalSTRS creditable compensation—in the budget year. The state made such a payment in 2021-22—and the Administration's multiyear forecast submitted to the Legislature at the time assumed the state would do so again in 2022-23—to offset a 2020-21 budget action to hold the state's contribution rate flat on a one-time basis rather than allowing it to increase by 0.5 percent of creditable compensation as recommended by the CalSTRS board.

No Supplanting or Supplemental Payments Proposed for Employers. Between 2019-20 and 2021-22, the state has provided more than $2 billion in supplanting payments to CalSTRS on behalf of employers, offsetting the effective contribution rate that employers have been required to pay. These payments were made using General Fund resources—not Proposition 2 debt payment requirements. The Administration does not propose to continue these payments in 2022-23. The figure from the LAO displays the effect on contribution rates that supplanting payments have provided for employers over the past few years.

CalSTRS Employer Required Contribution Rates

Percent of Creditable Compensation

	2019-20	2020-21	2021-22	2022-23 Proposed
Total employer rate collected by CalSTRS	18.13%	19.10%	19.10%	19.1%
Offsetting rate paid by state on behalf of employers	-1.03	-2.95	-2.18	—
Effective Rate Paid by Employers	**17.10%**	**16.15%**	**16.92%**	**19.1%**

Retiree Health

In 2022-23, the Governor's budget assumes that the state will pay $3 billion (General Fund) to pay for benefits received by retired state and California State University (CSU) employees and, as noted above, dedicates $365 million in Proposition 2 requirements to prefund state employee benefits.

Legislative Analyst's Office Assessment of Proposition 2 Proposals

Framework for Proposition 2 Payments. In the past, the LAO recommended the state focus on using Proposition 2 to keep funding plans on track for CalSTRS and retiree health—that is, to use the requirements to support the state's plans to fully fund these systems by the mid-2040s. Given recent investment returns, it does not appear that additional payments are needed this year to accomplish this goal. That being said, investment returns in the future might fall short of actuarial assumptions, warranting supplemental payments to CalSTRS or retiree health to put these funding plans back on track. In such a case, the LAO recommends that the state look to addressing unfunded liabilities with an eye toward budgetary benefit and reducing total UAO. As explained by the LAO previously, additional payments to CalPERS would have more budgetary benefit—because the system has a higher discount rate—while additional payments to retiree health could *eventually* result in the state's total unfunded liabilities declining by more—because with enough prefunding, actuaries will eventually grant the state a higher discount rate for that system.

Administration's Proposal Reasonable, but Other Options Available. The state continues to have significant unfunded liabilities attributed to state employee CalPERS pensions. The Administration's proposal to use $3.5 billion of Proposition 2 funding to make a supplemental payment to CalPERS is reasonable. There are also other reasonable options, however. For example, the Legislature could consider using these funds to make an additional contribution toward the retiree health unfunded liability. While this would have less budgetary benefit compared to a supplemental CalPERS payment, it could eventually have a much larger impact on the state's total unfunded liabilities.

Legislative Analyst's Office Assessment and Recommendations for CalSTRS Proposals

State's Share of UAO Projected to Be Eliminated Within a Few Years. No supplemental payments are proposed for CalSTRS in 2022-23 because the state's share of CalSTRS' UAO is projected to be eliminated in the next few years. This is a result of the extremely high investment returns (27.2 percent) CalSTRS experienced in 2020-21 and the effect that investment return volatility has on the state's share of UAO under the funding plan. According to current law, if the state's share of UAO is eliminated, the state's required contribution rate to CalSTRS' Defined Benefit program would drop to the base rate of 2.017 percent of creditable compensation. As such, assuming no new significant actuarial losses occur over the next few years, the state's Defined Benefit program contribution would decrease from the estimated rate of 8.328 percent in 2022-23 to 2.017 percent in the next few years (around 2024-25). This rate decrease would result in a reduction in required contribution to CalSTRS of more than $2 billion annually. (Notably, the Administration's multiyear forecast does not currently account for the potential rate drop should the state's share of UAO in fact be fully eliminated. Rather, the administration's estimate holds the state's contribution rate constant at 8.328 percent throughout the multiyear period.)

Counterintuitively, Projected Elimination of State's UAO Could Make Addressing Future Losses More Challenging. As described above, the state's required contribution rate is projected to fall to 2.017 percent in a few years, assuming the state's share of UAO is eliminated in that time frame. However, between then and the end of the funding plan in 2046, CalSTRS may experience lower-than-assumed investment returns in any number of years, resulting in new losses and the accrual of new UAO. Responsibility for paying down that UAO would fall to the state, though under statute, its contribution rate would be only 2.017 percent. Due to the limitations that the funding plan places on CalSTRS' ability to increase the state's contribution rate (allowing a maximum increase of 0.5 percent annually), once the state's rate drops down to the base, it could take many years to increase the state's rate to required levels to pay down any new UAO that is accrued in future years.

Employers' Share of UAO Projected to Increase, Requiring Higher Long-Term Contribution Rate Relative to What Had Been Projected Previously. In contrast to the projected elimination of the state's share of UAO, the school and community college districts' share of UAO is projected to increase. This is a result of the 2020-21 27.2 percent investment returns and the counterintuitive effect of higher-than-assumed investment returns on the employers' share of UAO. CalSTRS actuaries project employers' UAO will continue growing over the next few years, reaching around $80 billion before beginning to decrease. To successfully pay down the employers' share of UAO, CalSTRS estimates employers' required contribution rate will need to remain around 19 percent of creditable compensation over the next few decades. Prior to the very high investment returns of 2020-21, CalSTRS had been projecting employers' long-term required contribution rate would have been around 18 percent.

Recent LAO Recommendation:* *Allow CalSTRS to Increase the State's Rate by More Than 0.5 Percent Annually. This change would help ensure CalSTRS could more successfully address future UAO and eliminate the state's portion by 2046, especially if the state's rate drops to 2.017 percent in the next few years.

Recent LAO Recommendation:* *Specify a Fixed Proportional Division of UAO Between the State and Employers. The exceedingly complex theoretical calculations employed by CalSTRS result in an ever-changing proportional division of UAO between the state and employers, extra sensitivity to investment returns in terms of the state's contribution rate, and counterintuitive (but less significant) impacts on the employers' contribution rate. CalSTRS' 27.2 percent investment returns in 2020-21 provide an extreme example of the complex and counterintuitive effects of these calculations. By eschewing the current complex UAO calculations and adopting a fixed proportional division of UAO between the state and employers, the Legislature would be able to lessen the volatile effects of investment returns on the state's actuarially required contribution rate, and align impacts of investment returns across the state's and employers' actuarially required contribution rates.

Staff Recommendation. Hold Open