

**STATE OF CALIFORNIA
OFFICE OF ADMINISTRATIVE LAW**

AGENCY: CalPERS)	
)	
)	DECISION OF DISAPPROVAL
)	OF REGULATORY ACTION
ACTION: Adoption of sections 584, 584.1,)	(Government Code Section 11349.3)
584.2, 584.3, 584.4, 584.5, 584.6, 584.7,)	
584.8, 584.9, and 584.10 of title 2 of the)	OAL File No. 04-0312-05 S
California Code of Regulations)	
_____)	

BACKGROUND

The California Public Employees Retirement System (“CalPERS”) proposed the adoption of regulations that define terms and provide criteria for the assignment of participating agencies to risk pools, the determination of rates, and allocation of assets and liabilities, all for the purpose of equitably reducing the volatility of small employer risk pools. This rulemaking action was submitted for OAL review on March 12, 2004, and was disapproved on April 26, 2004. The following decision explains the reasons for OAL’s action disapproving these regulations.

DECISION

OAL disapproved the proposed regulations because their proper application depends upon other regulatory material that was not adopted by the Board in accordance with the APA. Additionally, a CalPERS study on fund volatility due to demographic events that was relied upon by the Board in the formulation of these rules was omitted from the file.

DISCUSSION

1) OMITTED REGULATORY MATERIAL

(A) In proposed section 584.8, the Board adopts three categories of benefit provisions, designated as Class 1, Class 2, and Class 3. In the regulation, the three classes are distinguished by whether a contracting agency's (employer's) contribution rate must cover the benefit, and if so, for what period of time. This distinction between the 3 classes is clear on the obligation to pay, but the assignment of benefit provisions available to a contracting agency to the appropriate class is to be made by the CalPERS Board in accordance with criteria established by Board policies. The regulation provides:

“The CalPERS Board shall separate, in accordance with *criteria established by Board policies*, the benefit provisions available to a contracting agency into various classifications that will be handled as follows:” (Emphasis added.)

The Board has established criteria for the classification of benefit provisions and they are included in the rulemaking file as Exhibit 1, Attachment III, Resolution No. 03-04-AESD. The resolution provides, in part:

“Upon implementation of the risk pool structure at CalPERS, the Chief actuary shall assign each existing optional benefit to one of the classifications in accordance with the following criteria:

“(a) Class 1 benefits shall be the optional benefits meeting the following criteria:

- Impact the ongoing cost (either total or employer normal cost) of the risk pool by more than 0.25% of payroll; or
- The benefit is not available to all plans participating in the risk pool.

“(b) Class 2 benefits shall be the optional benefits, other than Class 1 benefits, meeting the following criteria:

- No impact on the ongoing cost (normal cost) of the risk pool; and
- Provide a one time increase in benefit with an identifiable increase in accrued liabilities.

“(c) Class 3 benefits shall be the optional benefits meeting the following criteria:

- Impact the ongoing cost (normal cost) of the risk pool by no more than 0.25% of payroll”

These criteria are a regulation because they implement and make specific the provisions of Government Code section 20841, subdivision (b), which authorizes adjustment of contribution rates to “take into account the differences in the benefits provided by each employer to its members in the classification included in the risk pool.” This mention of the criteria serves to identify them generally, but is inadequate to adopt them pursuant to the Administrative Procedure Act (“APA”). The criteria must be included within the text of the proposed regulations or properly incorporated by reference in the text, in accordance with the provisions of CCR, title 1, section 20. Such identification would assure a full opportunity for public comment on the criteria, a complete record, and OAL review of the entire regulation for compliance with APA standards.

Section 584.8 also provides, in its final sentence:

“The CalPERS Board reserves the right to modify the classification of benefits.”

We are unable to determine whether this has been included to simply remind those subject to the regulation that the Board may amend the regulation in the future, or to advise them that the Board may modify its classification of a particular benefit by reassigning it to a different class. If it refers to modification of the regulation (including the classification criteria), then it should also note that the amendment would be made in accordance with the APA. If instead, it refers to reconsidering application of the rule in order to properly classify a particular benefit, this intention should be clarified.

(B) Government Code section 20840, subdivision (a) provides:

“Notwithstanding Sections 20616, 20618, and 20815, the board may create, combine, or eliminate risk pools for local miscellaneous members and local safety members.”

Proposed section 584.1 of the regulations refers to the creation of risk pools pursuant to section 20840 of the Government Code. The new Article 7.5 heading, and indeed, all of the proposed regulations have a title identifying the subject as one relating to risk pools. In the rulemaking record, the Board has included a copy of Resolution No. 03-03-AESD, which shows that it has created nine risk pools (Exhibit 1, Attachment II). The Board’s exercise of its discretion to create and define these classifications is rulemaking, and must be done in accordance with the APA. The risk pools should be identified in one of the proposed regulations, or properly incorporated by reference in a regulation.

(C) Proposed section 584.5 entitled “Risk Pools – Amortization of Side Funds” provides, in part, as follows:

“The side fund shall be amortized at the actuarially assumed investment return pursuant to CalPERS Board policies.”

These CalPERS Board policies for amortization have not been clearly identified in the regulations. OAL is unable to determine from the available information what the relevant policies are, and whether the policies the Board has in mind are exempt from the APA or are “regulations” as defined in Government Code section 11342.600.” The policies should be clearly identified and, to the extent the referenced policies are regulations, they must be adopted pursuant to the APA, unless an exception applies.

2) OMITTED DOCUMENTS: The Board’s Initial Statement of Reasons (“ISR”) prepared for the adoption of these regulations discusses the need for its creation of risk pools, and in particular, the need for mandating participation by small employers. In this context, the ISR provides:

“A study performed by CalPERS actuaries demonstrated that liability losses due to demographic events cause 2 to 6 times more volatility in the employer rates of small employers than larger employers. The highest volatility was seen for plans with less than 20 active members. However, the study also showed that plans with as many as 50 active members are subject to volatility that could cause large swings in employer contribution rate. As a result of this study and to ensure the viability of risk pools, the proposed regulations mandate participation in a risk pool for all existing and future rate plans at CalPERS with less than 100 active participants.”

The record also includes Board correspondence replying to several commenters that mentions this study for the purpose of emphasizing the importance of participation by small employers to help reduce rate fluctuations caused by unexpected demographic

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events. Clearly, the Board relied upon the study of rate volatility in adopting these regulations. The APA requires any study relied upon by an agency in the adoption of a regulation to be included in the rulemaking file [see Government Code section 11347.3, subdivision (b), paragraph (7)]. Please also note that the addition of the study would require notice as described in Government Code sections 11346.8, subdivision (d), and 11347.1.

For these reasons, OAL disapproved the CalPERS Board's proposed adoption of sections 584 through 584.10 of Title 2 of the CCR.

Date: May 3, 2004

David Potter
Senior Counsel

for: Edward G. Heidig
Director

Original: Fred Buenrostro, Chief Executive Officer
cc: Joe Parilo, Regulations Coordinator
Nathan Schmidt, Counsel