Feasibility Study - Unemployment Benefits for Self-Employed Individuals (Senate Bill 1138)

Employment Development Department

2024

Employment Development Department
State of California

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Executive Summary

The purpose of this study is for the Employment Development Department (EDD) to examine the idea of providing Unemployment Insurance (UI) benefits to self-employed individuals as mandated by California Unemployment Insurance Code (CUIC) Section 339.5 per Senate Bill (SB) 1138 (Chapter 836, Statutes of 2022).

Self-employed individuals who are not employers do not generally qualify for the federal-state UI program (regular UI program) for covered employees. Historically, there have been some exceptions, such as the Disaster Unemployment Assistance (DUA) program and the Pandemic Unemployment Assistance (PUA) program. These are federally approved and funded, limited-term programs implemented due to special circumstances.

This Feasibility Study Report evaluates the concept of providing coverage for self-employed individuals by primarily utilizing California's current UI program requirements. This report provides information on the steps that may be considered, including the initial and ongoing costs of implementing a UI program for self-employed individuals. The study is based on a state-run program administered by public employees with state information technology infrastructure.

As described below, a program for self-employed workers would have a high potential for fraud for the same reasons that the PUA program was a target of identity fraud attacks during the pandemic. The traditional UI program mitigates fraud by using a combination of effective, industry leading tools to verify an individual's identity and identify characteristics associated with fraudsters. The UI program also relies on a successful partnership between claimants, employers, and EDD, who work collectively to submit, validate, and process claim information and report potentially fraudulent activity.

While EDD's robust identity verification procedures could be adopted by an unemployment program for self-employed individuals, a new program would be especially vulnerable to fraud due to the inability of EDD to verify the work and earnings of self-employed individuals while they are claiming benefits. For example, it would be very difficult to know when an individual is receiving benefits while continuing self-employment as there is no employer to independently report employee wages to the Department. For regular UI, there are also checks and balances to prevent fraud, which would not be applicable.

This report assumes self-employed individuals would finance the program, in alignment with the existing, optional Disability Insurance Elective Coverage (DIEC) program, which provides similar benefits to self-employed individuals who cannot work due to a serious illness, injury, or pregnancy, or other eligible family-related matter.

This report considers three scenarios under which the state's approximately 1.43 million eligible self-employed individuals could participate in the program, with participation rates of approximately 0.1%, 5%, and 100%. The wide range of estimates recognizes the challenge of predicting interest in a self-financed program of unemployment benefits. The following summarizes the main findings of those scenarios:

- EDD estimates an implementation timeframe of approximately 72 months to create the new administrative and IT systems necessary to operate the program.
- EDD would incur a one-time administrative cost between $279 and $326 million to initially establish the program, most of which is attributable to Information Technology (IT) system development.
- EDD estimates an annual ongoing administrative cost of $29.5 million to $133.5 million.
- Assuming an unemployment rate between 5% and 10%, the program could pay between $0.5 million and $1.0 billion in benefits annually. The wide range of benefits is attributable to the different participation rates of eligible self-employed individuals.

This report is informational only. The content herein is to provide information on aspects of a potential program for future consideration, as required by SB 1138. Any new program would require legislation to grant EDD authority to implement the program by creating a funding structure to collect premiums and establish funds, and a benefit structure to administer the payment of benefits.

Introduction

The federal government established the UI program as part of the Social Security Act (SSA) of 1935 during the Great Depression. It is a federal-state program with minimum requirements established under federal law. The state administers the program with federal funding and based on additional eligibility, benefit and employer contribution requirements that are determined by state law.

The objective of the UI program is to provide temporary partial income replacement when workers become unemployed through no fault of their own in order to stimulate growth during economic downturns and prevent financial hardship resulting from job loss. To be eligible for benefits, individuals must meet all eligibility requirements based on state law and regulations that conform and comply with federal law and guidance. An individual must have work and earnings from a covered employer, which generally does not include the self-employed, be able and available for work, and must be seeking suitable work.

The UI program is funded mostly by taxes levied on employers based on their employees' earnings. Employers pay federal and state UI taxes for each of their employees. In general, the federal UI tax pays for the administration of the UI program, and the state UI tax pays for the monetary benefits. According to federal law (SSA Section 303), the funding to administer the program (administrative grants) and the funding to pay for the benefits (UI Trust Fund) may only be used for the purposes of administering the UI program.

Elective Coverage for Employers and Self-Employed Individuals:

Current state law allows self-employed individuals who are employers to elect for either UI and State Disability Insurance (SDI) or for SDI coverage only for themselves. There is no provision in state law that allows self-employed individuals, who are not employers, to elect for UI coverage. However, self-employed individuals who are not employers may elect for SDI coverage for themselves: California has an optional DIEC program for workers who do not pay into the SDI program but seek to be covered for SDI. Anyone who receives a major part of their income from their self-employment or business may elect to be covered by DIEC.

Coverage for individuals who do not normally qualify for regular UI benefits:

Separate from the regular UI program, the federal government has established special federally-funded programs serving the self-employed, including the permanent DUA program and the temporary PUA program created in response to the pandemic.

The DUA program provides temporary financial assistance to workers and self-employed individuals when they become unemployed as a direct result of a major natural disaster (based on a Presidential declaration) and do not qualify for regular UI benefits. The Department of Homeland Security's (DHS) Federal Emergency Management Agency (FEMA) provides funds to the U.S. Department of Labor (U.S. DOL) for payment of DUA benefits and state administrative costs. U.S. DOL oversees the DUA program in coordination with FEMA. The program is administered through the UI state agencies.

The PUA program provided temporary benefits to workers (including self-employed workers and independent contractors) who lost work for certain COVID-19-related reasons and did not qualify for regular UI. The PUA program was a *one-time emergency unemployment assistance program* authorized under the federal Coronavirus Aid, Relief, and Economic Security (CARES) Act of 2020, which initially provided up to 39 weeks of benefits and expanded to up to 86 weeks at the height of the program. The program, which provided benefits from February 2, 2020, to September 4, 2021, was fully funded by the federal government. U.S. DOL provided oversight of the PUA program, however it was administered by the UI state agencies. U.S. DOL reimbursed states for all program administration and benefit payment costs.

Background

SB 1138 (Chapter 836, Statutes of 2022) was signed into law by Governor Newsom on September 29, 2022. This legislation adds Section 339.5 to the CUIC and requires EDD to conduct a feasibility study to examine the idea of extending the UI program to include benefits for self-employed individuals.

Feasibility Study Objective and Scope

The objective of the study is to evaluate the idea of providing UI benefits to self-employed individuals who do not normally qualify for UI benefits outside a federal disaster declaration (DUA program). The intended population is similar to the population of individuals who qualified for PUA benefits. The scope considers the feasibility of expanding the current federal-state UI program and integrating benefits for self-employed individuals, if possible, or creating a separate UI program for the self-employed as an alternative. These individuals include business owners, independent contractors, and self-employed people who are not employers and are excluded from UI and SDI elective coverage, or who have not elected for SDI coverage under the DIEC program.

Assumptions

EDD administers the UI program in California, and built its IT system, which includes the financing and benefits structures, mostly from funding appropriated as part of the special UI federal-state partnership. The federal UI administrative funding also supports the ongoing maintenance of the UI system. As previously mentioned, EDD cannot utilize its federal UI funding for any purpose other than the administration of the federally approved UI program.

Any UI program for the self-employed is not currently a federally approved program, thus EDD cannot expand its existing UI administrative system to include state-run coverage for self-employed individuals unless granted approval by U.S. DOL. To obtain U.S. DOL's authorization, EDD would need to negotiate, and, if approved, create a cost-sharing agreement that tracks and accounts for all non-UI related costs to be funded by the state, as well as satisfy other conditions under federal UI law, which, to come into compliance, would require significant resources. Historically, U.S. DOL has not allowed the use of the UI system for other programs. As such, for this feasibility study, EDD assumes U.S. DOL would not approve a cost-sharing agreement, and therefore focuses this report on the creation of a separate UI program for the self-employed that mirrors the programmatic requirements of the regular UI program, while adopting the financing structure of the DIEC program. The following assumptions, which are discussed in more detail throughout this document, were used to develop this feasibility study.

<u>Statutory Authority</u>: This report provides an analysis of the information that lawmakers may want to consider, and the associated costs attributed to the creation of a new UI program on the state level for the self-employed. However, a new program would require legislation to grant EDD authority to implement the program by creating a funding structure to collect premiums and establish funds, and a benefit structure to administer the payment of benefits.

<u>Funding</u>: This study assumes the program, which includes benefits and administrative costs, would be funded by participants who would elect for coverage and pay an insurance premium, similar to the DIEC program. While the ongoing costs of the program, once established, could be paid by participant premiums, EDD would also require an initial General Fund appropriation to finance the initial costs to establish the program, including developing the necessary IT infrastructure.

<u>Participation</u>: This study assumes coverage would be optional, thus self-employed individuals could elect to participate in the program and contribute the required premiums. Within this report, this new UI program for the self-employed will be referred to as UI Elective Coverage or UIEC, mirroring the DIEC program already in place. The participant application, registration, collection of premiums, and ensuring that usable income is collected in the Base Wage Database, could be similar to the DIEC program.

<u>New Staff Positions</u>: Lawmakers wishing to pursue a UIEC program would likely need to provide EDD an appropriation of funds to establish additional state-funded staff positions to administer the program. The new staff positions would be responsible for the benefit administration such as claim filing, determination of eligibility, identity verification, payment of benefits, and formulation of policies and procedures, including the training of employees.

<u>Eligibility</u>: This study assumes the monetary eligibility would be based on the same income level and requirements as the regular UI program. Lawmakers may wish to use the same base periods (regular base period and alternate base period, discussed later in this report), providing the same weekly benefit amount (WBA) calculation range of $40-$450, and the same maximum benefit amount calculation that provides up to a maximum of $11,700, as in the regular UI program.

Wage investigation and accounting activities performed for the new UIEC program could be completed by EDD as additional workload activities but would have to be administered and funded from a separate UIEC fund.

Non-monetary eligibility could be based on the same regular UI eligibility requirements but would require modifications to consider the individual's self-employment status. For example, individuals receiving regular UI benefits are required to actively look for work, be able and available for work, and must not refuse suitable work as a condition of eligibility. The DUA program applies these eligibility provisions to the unique circumstances of self-employment who qualify for disaster benefits. Rather than requiring self-employed individuals to actively look for work with an employer, DUA allows the individual to perform services or activities which are solely for the purposes of enabling them to resume self-employment. Separately, individuals may also be eligible for benefits if they are working less than full time. Earnings could be deducted from the WBA.

Appeals could be handled by the California Unemployment Insurance Appeals Board (CUIAB), and could be similar to the current UI process, thus creating an additional workload for CUIAB. Per federal law, funding for the UIEC program appeals cannot come from regular UI funds.

Multiple Benefit Eligibility: Lawmakers wishing to pursue a UIEC program may consider that individuals could potentially qualify for the new UIEC if they do not otherwise qualify for regular UI benefits or SDI. Workers could not be eligible for UIEC benefits if they are eligible to receive UI (e.g., they have sufficient employment wages to qualify), or SDI benefits. This is in alignment with other federal programs, which only provide unemployment benefits to individuals if they are not otherwise eligible for regular UI benefits. Lawmakers could also consider an alternative approach that provides a different benefit structure for workers who receive a mixture of earnings through employment and self-employment.

Payment: Benefit payments could be made via check, direct deposit when available by EDD, or Electronic Benefit Payment (EBP), similar to the regular UI and SDI programs.

Reporting: While SB 1138 does not require this report to include specific documentation and tracking mechanisms, EDD assumes a new UIEC program could generate similar internal reports and data tracking as the current regular UI program for workload management and oversight purposes.

Approach

The approach for this feasibility study was partially informed by the existing DUA program. The DUA program provides benefits to self-employed individuals who do not otherwise qualify for regular UI benefits, which was also the model for the PUA program. DUA is a special program that is fully funded by the federal government and temporarily activated during a Presidential declared major disaster. Programming modifications to the current UI system and updated policies and procedures are generally employed to implement the DUA program to ensure payment to those who do not qualify for regular UI benefits. Given federal restrictions, to implement a UI program for the self-employed or UIEC, California would need to create an identical but separate system with updated programming, including updated policies and procedures to serve the specific needs of the new program for the self-employed. Other programs served as models as well. The financing structure of the UIEC discussed in this report could mirror the current DIEC program to allow for individuals to elect to participate and pay into the program, while the benefit structure could be similar to the regular UI program in terms of claim filing, eligibility determinations, and payment of benefits.

Considerations of self-funding a UI program for the self-employed. The regular UI program is funded entirely by employers while the DUA program is entirely funded by the federal government. Workers do not pay for their UI or DUA coverage. Self-employed individuals may choose not to participate if they must pay for their own UI premium, which could potentially result in a very low participation rate.

Including the Self-Employed in Unemployment Insurance

Defining *Self-Employed Individual*

The U.S. Bureau of Labor Statistics classifies self-employed individuals as either incorporated or unincorporated. Incorporated individuals, such as small-business owners, typically have established a legal corporation and employ others. Unincorporated individuals, such as independent contractors and freelancers, have not established a corporation and often operate alone.

In California, incorporated self-employed individuals who are employers currently have the option to elect for UI and SDI coverage for themselves, while the unincorporated self-employed who are not employers do not have that option. For this study, the target population is the unincorporated self-employed individuals.

Population Estimates of Self-Employed Individuals

The following table shows the number of unincorporated and incorporated self-employed individuals in California.

	California: Total Number of Self-Employed Persons (July 2023)*
Self-employed, Unincorporated	1,427,900
Self-employed, Incorporated	683,000

**Source: U.S. Census Bureau, Current Population Survey of Households, 12-month moving average*.

Existing Law and Regulations

The UI program is based on federal law and administered through state law. The federal requirements for the operation of a state UI program are found in the SSA and in the Federal Unemployment Tax Act (FUTA). States must conform and comply with the requirements in these statutes to receive federal funding for the administration of the UI program. The federal government has the authority to withhold funding for non-conformity and/or non-compliance. In addition to the federal requirements, EDD administers the UI program according to state law – the CUIC, and regulations – the California Code of Regulations (CCR), Title 22.

The current federal funds used to administer the regular UI program cannot be used to fund a UI program for the self-employed, as it is not authorized under the federal unemployment compensation program.

If lawmakers create a UI program for unincorporated self-employed individuals in California, it would require a review of state law and regulations to determine, at a minimum, the need to amend the CUIC and CCR Title 22 or create new sections. Statutory authority would also need to be established for EDD to implement a separate UI program for the self-employed and establish the financing structure, including fully funding the program's benefits (e.g., source of funding, enroll individuals, collect premiums, etc.) as well as the program's administration (e.g., claim filing, benefit determination, benefit payments, accounting, etc.).

Financing Structure

EDD offers an optional DIEC program for individuals who do not pay into the SDI program but seek to be covered. Individuals who receive a major part of their income from their self-employment or business may elect to be covered by DIEC. Limited partners and corporate officers are not eligible, as they are considered to be employees subject to the mandatory provisions of state law. CUIC Section 708.5 details the eligibility framework for the DIEC program, and CUIC Section 984.5 details the contribution rate calculation. As of 2023, 1,509 self-employed individuals (unincorporated) were paying into the DIEC program under CUIC Section 708.5 and may participate if they meet the eligibility requirements.

To extend unemployment benefits to self-employed individuals, this report discusses creating an optional UIEC program, leveraging fundamental guidance from the DIEC program, for people who do not contribute to UI as employers, but elect to receive UI coverage.

The following sections discuss the different components lawmakers may wish to consider to develop the UIEC program's financing structure in greater detail. These components include the:

- Contribution rate formula and its statutory requirements
- Taxable wage ceiling formula
- Fund solvency adequacy rate

The UIEC program's financing structure could utilize a statutory formula that sets an annual contribution rate to determine the amount of premiums a participant would be required to pay. The annual UIEC premiums could be based on participants' net profit as reported on their Internal Revenue Service (IRS) Form 1040 Schedule SE or other appropriate tax form.

For example, if the UIEC rate is set at 2.1% of the first $42,545 of reportable earnings for the year, and a worker earned $40,000 in annual self-employment income, the participant would be required to pay an annual premium of $840. The premium could be paid in four equal quarterly installments. The 2023 DIEC rate is 6.93% on the first $153,164 and the average annual income of the self-employed unincorporated individuals enrolled in the DIEC program was $28,316 for the 2022 filing year.

If lawmakers established a UIEC program, EDD would closely monitor the fund's solvency during state or national disasters, pandemics, and recessions to ensure eligible Californians continue to receive benefit payments.

Contribution Rate Formula and Statutory Requirements

The existing statutory formula and limitation for the DIEC program are cited in CUIC Section 984.5. Lawmakers may wish to consider a similar statutory formula and limitations for the UIEC program. This could require EDD to prepare a statement on or before November 30 of each calendar year, which would be a public record, declaring the rate of contributions of the succeeding calendar year for all employers and self-employed individuals and would notify promptly the employers and self-employed individuals of the rate.

The formula could be attributed to several fund conditions that occurred over the previous 12-month period beginning October 1 and ending September 30. The formula, as stated in CUIC Section 984.5, is as follows:

$$\frac{\text{Current Year's Rate} \times (1.10 \times \text{Current Year's Disbursements})}{\text{Contributions for the Same Period}}$$

The 1.10 variable is a key factor for ensuring the UIEC fund retains a year-end reserve in the range of 25% to 50% of the prior year's disbursements. The term *disbursements* includes benefits paid to eligible self-employed workers, administrative costs to operate the program, and any other minor changes to the fund.

Different variables in the financing formula consider increases and decreases in the disbursements and changes in the fund balance that establish an appropriate contribution rate to cover the program's costs without accumulating excess funds. For example, if there are significant increases in disbursements from the prior year resulting in a much lower fund balance, those two fund conditions could likely result in a higher contribution rate. A higher contribution rate may also be caused by significantly lower contributions due to a decrease in the number of active participants in a program. Conversely, if disbursements decrease, causing the fund balance to increase, then the contribution rate could likely decrease when compared to the prior year's rate. For example, the DIEC contribution rate increased in 2024 from 2023 because a reduced number of participants lowered the amount of contributions paid into the fund.

Taxable Wage Ceiling Formula

As with the contribution rate, this report assumes the maximum amount of earnings subject to the UIEC contribution rate would be adjusted annually by a statutory formula. This component of the financing structure is referred to as the taxable wage ceiling, or, in the case of the DIEC program in which self-employed individuals do not earn wages, net profit. To participate in the DIEC program, self-employed individuals must have a minimum net profit of $4,600 annually. For consistency, EDD assumes this $4,600 threshold could also apply for the UIEC program. Prior to January 1, 2024, contributions to the DIEC program were based on the DIEC participant's net profit up to the taxable wage (net profit) ceiling, in accordance with CUIC Section 985. SB 951 (Chapter 878, Statutes of 2022) repealed Section 985 and the taxable wage ceiling. Lawmakers, however, may still wish to consider the former statutory formula for the DIEC program to determine the taxable wage (net profit) ceiling for the UIEC program:

$$\underline{(4 \times \text{the Maximum Weekly Benefit Amount} \times 13) / 0.55}$$

This report assumes the maximum weekly benefit amount would not change. However, should lawmakers choose to increase the maximum weekly benefit amount, the increase could automatically trigger an increase in the taxable wage (net profit) ceiling. This trigger could allow the UIEC program to generate additional revenue to issue benefits at the higher maximum weekly benefit amount. Both the contribution rate and taxable wage (net profit) ceiling could work in tandem to generate revenue to operate the UIEC program. The formulas and triggers serve to automatically adjust the financing structure to keep pace with increased benefits, fund balance changes, etc.

Fund Solvency Adequacy Rate

Many insurance programs use different methods to measure solvency and ensure there is sufficient revenue to meet the obligations to pay claims. The proposed method lawmakers may wish to adopt for the UIEC program is defined as the "Adequacy Rate." Simply stated, a UIEC fund balance that equals 25% to 50% of the prior 12 months of disbursements could be considered adequate for the fund to remain solvent through different economic conditions and fluctuations in revenue and benefit volume, which is also the same solvency standard used by the DIEC program.

If the Adequacy Rate falls below 25% during a typical year, concerns could arise that the fund could become insolvent. Conversely, if the Adequacy Rate was above 50%, concerns may be that the fund has accumulated excessive reserves paid by covered workers. It is in these circumstances the Director may be given the authority, similar to the UI and DI programs, to increase the contribution rate by 0.1%, therefore allowing additional revenue to be generated and bringing the Adequacy Rate above 25% or decreasing the contribution rate by 0.1% to bring the Adequacy Rate at or below 50% and reduce costs for covered workers.

Benefit Details

While *contributions* could be collected in alignment with DIEC, lawmakers may wish to administer *benefits* for a UIEC program like the regular UI program. The regular UI program pays weekly benefits in amounts ranging from $40 to $450, depending on the worker's earnings. As described later in this report, EDD estimates an implementation timeframe of 72 months or 6 years. While EDD does not have a forecasted average weekly benefit amount for this time period, the average weekly benefit payment for 2025, the latest available, is $377 for regular UI. Additionally, the UI program pays benefits for a maximum duration of 26 weeks, and the average duration forecasted for 2025 is 19.1 weeks.

Based on information from EDD's Labor Market Information Division, EDD estimates the total UIEC participant population to be approximately 1.43 million individuals (i.e., self-employed, unincorporated population). Cost estimates in this report are calculated based on three potential enrollment scenarios:

- 100% participation rate
- 5% participation rate
- Approximately 0.1057% participation rate (the current program participation rate in the DIEC program).

Assuming 100% of the approximately 1.43 million eligible workers enroll in the program, and the state experiences a 5-10% unemployment rate, the number of annual claimants is estimated to be between 71,395 and 142,790 individuals.

If only 5% of that approximately 1.43 million population opt into the program (71,395 individuals), the estimated number of applicants that may claim benefits annually is between 3,569 and 7,139 individuals if the state experiences a 5-10% unemployment rate.

If the same number of individuals opt into the program as currently opt into the DIEC program (1,509 individuals or approximately 0.1057% of that approximately 1.43 million population) then the estimated number of applicants that may claim benefits annually is between 75 and 151 individuals if the state experiences a 5-10% unemployment rate.

The following chart provides key claims data representing the estimated benefits paid based on the estimated number of applications. As discussed later in this report, EDD estimates an implementation timeframe of approximately 72 months to create a UIEC program. Therefore, EDD used the most current estimates of average weekly benefit amount and duration currently available.

Number of Enrolled Participants	Unemployment Rate	Number of Applicants	Avg. Weekly Benefit Amount	Avg. Duration (weeks)	Total UIEC Benefits Paid
1,427,900 (100%)	5% Unemployment Rate	71,395	$377	19.1	$514,093,977
	10% Unemployment Rate	142,790	$377	19.1	$1,028,187,953
71,395 (5%)	5% Unemployment Rate	3,569	$377	19.1	$25,699,298
	10% Unemployment Rate	7,139	$377	19.1	$51,405,797
1,509* (0.1057%)	5% Unemployment Rate	75	$377	19.1	$540,053
	10% Unemployment Rate	151	$377	19.1	$1,087,306

*The current number of participants in the DIEC program

To ensure a sustainable financing structure, lawmakers may wish to delay eligibility for benefits from the UIEC program for at least 24 months from the approved start date of the individual's plan. Adopting a 24-month waiting period as an ongoing requirement while the individual is paying the required premiums would not only allow the first two years of contributions to fund ongoing costs but collect adequate funds to pay benefits into the future. After the third year, for the financing structure to be adequate, the individual's contributions could be adjusted based on the disbursements (e.g., benefits paid to participants, administrative costs to operate the program, and any other minor changes to the fund). As indicated above, a year-end fund balance between 25% and 50% of the previous year's total disbursements is considered an adequate reserve rate.

Alternatively, lawmakers may wish to adopt an approach similar to the DIEC program, where the individual's coverage must remain in effect for two complete calendar years (unless the individual meets the criteria for early termination under CUIC Section 704.1). As such, EDD could adopt the DIEC program model, and initiate an overpayment process for unpaid premiums should the participant collect UIEC benefits and not pay premiums, when due, for the remainder of the two complete calendar years.

The following chart provides the estimated year-end fund balance and adequacy rate based on the estimated number of applicants and assumes applicants have an annual net profit of $39,156, the average annual salary needed to qualify for a weekly benefit amount of $377. The chart also shows the contribution rate, based on three participation levels, needed to maintain an adequate fund solvency balance. This chart also displays the maximum possible exposure to the program, assuming a 10% unemployment level.

Number of Program Participants		Contribution Rate	Total Contributions	Total Disbursements*	Year-End Fund Balance	Adequacy Rate
1,427,900 (100%)	First Year	1.1 %	$615,019,379	$133,500,000	$481,519,376	361%
	Second Year	1.1%	$615,019,379	$133,500,000	$963,038,753	721%
	Third Year	1.1%	$615,019,379	$1,161,687,953	$416,370,176	36%
71,395 (5%)	First Year	2.3%	$64,297,480	$39,300,000	$24,997,480	64%
	Second Year	2.3%	$64,297,480	$39,300,000	$49,994,961	127%
	Third Year	2.3%	$64,297,480	$90,705,797	$23,586,644	26%

1,509 (0.1057 %)	First Year	68.0%	$40,178,755	$34,800,000	$5,378,755	15%
	Second Year	68.0%	$40,178,755	$34,800,000	$10,757,509	31%
	Third Year	68.0%	$40,178,755	$35,887,306	$15,048,958	42%

*Total disbursements include the estimated ongoing administrative costs for the first and second years. Year three includes the estimated ongoing costs and projected benefit payments.

The table above includes the following conclusions.

- Assuming 100% of potential participants enroll in the program this report estimates a projected year-end fund balance of $416.4 million in the third year, with an adequacy rate of 36%.
- If only 5% of the approximately 1.43 million population enroll in the program (71,395 individuals), there is a projected year-end fund balance of $23.6 million in the third year, with the adequacy rate estimated to be 26%.
- If the same number of individuals opt into the program as currently opt into the DIEC program (1,509 individuals), there is a projected year-end fund balance of $15.1 million in the third year, with the adequacy rate estimated to be 42%.

As such, the type of financing structure outlined above could be appropriate for self-employed individuals and adequate for the fund to remain solvent. However, it should be noted that in the third scenario with only 1,509 participants, and ongoing administrative costs of $34.8 million, a contribution rate of 68% could be necessary. This could require participants to contribute an annual premium of up to $26,626.08.

Benefits Determination Structure

Definition of Benefits

The current California UI benefit provisions have been utilized for this UIEC study. Lawmakers may consider limiting UIEC benefits to individuals who are unemployed through no fault of their own, are able and available for work, are seeking suitable work, and do not qualify for benefit programs such as regular UI, or SDI.

This study assumes monetary benefit eligibility would be determined by leveraging the existing regular UI program criteria, which includes a minimum earnings or income amount within a specified timeframe, defined as the base period. Self-employment income could be utilized to satisfy the earnings test. Once the monetary eligibility criteria is satisfied, the WBA an individual may receive could be based on a 50% replacement rate and capped at a maximum amount ($40 to $450). This is reflected in the existing UI Benefit Table. The maximum benefit amount calculation could be the lesser of 26 times the WBA or one-half of the base period earnings.

Process Components

Administrative and System Structure

As previously mentioned, based on federal law, UI funds may not be utilized for any purpose other than the administration of the federally approved UI program. As a result, EDD may be required to allocate additional positions within the Department by way of a state appropriation to administer the UIEC program. The newly funded state positions could support the UIEC program operational needs such as claim filing, eligibility determination, payment of benefits, appeals, and all activities associated with the benefit administration such as policy and procedures, automation, workload management, accounting, and data management. EDD could train the new staff to administer this program.

Lawmakers wishing to pursue a UIEC program would also need to establish a UIEC benefit system infrastructure to support the benefit program operational needs cited above. The program must entail a separate system from the regular UI program. The new infrastructure could mirror the current UI system to effectively handle all aspects of the benefit program administration, from collecting and storing data to generating payments and reports. The data must be safe and secured.

Filing of Benefits

This report assumes the UIEC program could utilize the same methods used to file for regular UI benefits. Individuals could have the option to complete an online or paper application or seek to contact EDD via telephone to file a new claim or reopen an existing claim. Lawmakers may wish for the new UIEC system to include a front-end application to collect data from customers (similar to the UI Online platform) and a back-end database to capture benefit claim and customer information. An Interactive Voice Response (IVR) system could be considered to route callers seeking assistance with their UIEC claim. To ensure that the UIEC serves California's diverse population, the EDD could provide multilingual interpreter and translation services similar to the multilingual services that govern the regular UI program.

Title 22 Section 1326-2 of the CCR details the requirements for individuals to file new claims or reopen existing claims. Similar regulations would need to be created (or amended) to grant statutory authority for the UIEC program to request claim filing information from potential claimants.

Benefit Certification and Continued Eligibility

This study assumes individuals would be required to certify every two weeks to their continued eligibility of the program. As described above, lawmakers may wish to have the eligibility criteria be based on the same regular UI eligibility requirements but would require modifications to consider the individual's self-employment status, similar to the DUA program. Certification could be completed online, by phone, or mail. If eligibility issues are detected, the claimant could be scheduled for an interview or issued an eligibility questionnaire. While receiving benefits, the individual may need to remain available for suitable work and report any income earned.

Benefit Payments

The Legislature could authorize benefit payments to be made via check, direct deposit when available by EDD, or EBP, as currently done for the regular UI and SDI programs. EDD would incur administrative costs to issue additional payments to these customers. For example, EDD might need to purchase additional check stock to issue checks timely to UIEC claimants.

Appeal

This study assumes an individual would have the right to appeal EDD's decision resulting in the reduction or denial of benefits. Appeal requirements could leverage the existing UI program requirements and could be administered by the CUIAB. The CUIAB is a quasi-judicial administrative entity independent of EDD. The funding currently supporting CUIAB's operations is almost entirely from federal UI funds, and therefore CUIAB would also require dedicated UIEC funding to support UIEC appeals workload..

Program Components

If desired by lawmakers, the UIEC program could have similar components as the regular UI program. New state law and regulations would need to be created or amended to grant the statutory authority for EDD to run this program and implement the components listed below:

Benefit Year

This study assumes a UIEC claim would be established effective the Sunday date of which the application is received, which establishes the benefit year of the claim. CUIC Section 1276 defines *benefit year* as the 52-week period beginning with the first day of the week with respect to which the individual first files a valid claim for benefits. EDD assumes the UIEC program for the self-employed would leverage the same benefit year. However, the law would need to be amended or new legislation created to define the UIEC benefit year definition.

Base Period

This study assumes benefit eligibility would be established using the base period. Under the current UI program the base period is a 12-month period, with four quarters (each quarter is three months). The base period is established when the claim is filed. EDD is aware of the claimant's base period earnings as a product of EDD's quarterly wage reporting process, which requires employers to report their employees' quarterly earnings. The UI program utilizes the Standard Base Period (SBP) to establish a claim. The SBP is the first four of the last five completed calendar quarters from the time a claim is filed. To determine monetary eligibility during the base period, EDD looks at the SBP to determine if there are qualifying earnings. If a claimant is not eligible for a standard base period, EDD considers more recently earned income through the use of an alternate base period.

To establish a monetarily valid UI claim, an individual is required to have earnings of at least $1,300 in one-quarter of the base period, or at least $900 in the highest quarter, and a total base period earnings of 1.25 times the high quarter earnings.

The quarter with the highest earnings determines the weekly benefit amount that the individual is eligible to receive. The maximum award is 26 times the weekly benefit amount or one-half of the total base period earnings, whichever is less. Earnings that are not available in the system may be provided by the customer and in those cases, EDD performs a wage investigation to add earnings, if applicable, for the benefit determination.

Unlike employees, self-employed individuals do not have traditional wages to include in their base period, which are reported to EDD by their employer each quarter. To address this, the DIEC program could use the individual's prior year's annual net income to establish their base period earnings. Their annual net income could be divided by four and attributed to four calendar quarters. For example, a self-employed individual with a net income of $20,000 would have $5,000, or 25% of that amount, attributed to each of the four calendar quarters in their base period. DIEC then calculates the claimant's benefit amount using those earnings. This approach was also used to determine the weekly benefit amount of self-employed individuals receiving PUA benefits. EDD assumes the UIEC program would adopt the same methodology.

Waiting Period

A mandatory, one-week, unpaid waiting period (WP) could be assessed on UIEC claims similar to the regular UI program, per CUIC Section 1253. The waiting period week is effective on the first eligible week of a claim prior to the payment of benefits. The purpose of the waiting period is to preserve funding for individuals experiencing longer periods of unemployment by preventing payment for unemployment of a very short duration. Under special circumstances, the waiting period may be served at a later time or may be served on a prior claim similar to the UI WP week as outlined in CUIC Section 1254. In the event of an emergency, the Governor may also waive the waiting period in accordance with Government Code Section 8571.

Requalification Requirements

Under the current UI program, per CUIC Section 1277.1, to requalify for a subsequent new claim, an individual must perform work and earn at least $1,300 in a quarter or at least $ 900 in the highest quarter and a total of 1.25 times the high quarter earnings during the benefit year of the original claim This is to protect the integrity and fiscal sustainability of the UI program. Unlike employees, self-employed individuals do not have traditional wages to include in their base period, which are reported to EDD by their employer each quarter. To address this, the UIEC program could require the individual to provide a copy of their annual net income of the preceding year to establish their base period earnings for the subsequent claim.

Overpayments

This study assumes the UIEC system created would have the ability to establish overpayments, including recovery of overpaid benefits, similar to the regular UI and SDI programs.

A benefit overpayment occurs when an individual collects unemployment benefits that they are not eligible to receive. EDD classifies overpayments into two categories: non-fraud or fraud.

For non-fraud overpayments, the individual received benefits for which they were not entitled to through no fault of the individual. In some cases, the overpayment may be waived.

For fraud overpayments, the individual knowingly provided EDD false information or withheld information and received benefits that they were not entitled to receive. Overpayments attributed to fraud under the regular UI program include a 30% penalty assessed and a false statement disqualification ranging from five to 23 weeks.

If the overpayment is not repaid by the individual, EDD will deduct the benefits from future UI or SDI benefits until the overpayment is satisfied. EDD may reduce or completely withhold state income tax refunds, lottery winnings, or any other money owed to the individual by the state to repay and satisfy the overpayment.

For UIEC, legislation would need to be created or amended to establish similar overpayment requirements and grant authority to recover overpayments.

Notices

This study assumes various notices would be issued after a claim is filed and may be utilized throughout the life of the claim. Notices leveraged from the regular UI program may need to be created. In some cases, new forms may need to be composed depending on the specific needs of the UIEC program.

EDD Public Facing Website and Outreach

This study assumes EDD's public facing website would be updated to include information about benefits available for the self-employed. The Department interfaces would need to be programmed to accept UIEC claims and provide access to claim information. EDD could also conduct outreach and an education campaign to communities that would benefit from the UIEC, that would otherwise be ineligible for UI benefits.

Fraud Mitigation

As described below, a program of unemployment benefits for self-employed people would have a high potential for fraud for the same reasons that the PUA program was a target of identity fraud attacks during the pandemic.

EDD has a multi-tiered, comprehensive approach to identify, detect, and deter fraud beginning at the first point of claim filing, throughout the life of the claim, and after benefits have been exhausted. Several branches and divisions within EDD play a role in the efforts to detect UI fraud and respond to fraud allegations. Through the Department's Fraud Hotline, EDD captures fraud reports submitted by the public, law enforcement, and state and federal agencies, pursuing criminal charges against fraudsters.

EDD requires individuals to supply personal identifiers that assist in verifying the individual's identity when applying for benefits. If the personal identifiers are not met, the individual will be required to submit additional documents to verify their identity. The next section provides an overview of the fraud mitigation process currently used on UI claims.

While EDD's robust identity verification procedures could be adopted by the UIEC program, it is important to point out that this program still has a high potential for fraud due to the inability of EDD to check the work and earnings of self-employed individuals while they are claiming benefits. It would be very difficult to know when an individual is receiving UIEC while continuing self-employment as there is no employer to independently report employee wages to the Department. For the DIEC program, claimants must be certified as unable to work by a qualified medical provider during the claim period, which provides a check and balance to prevent fraud.

For regular UI, there are also checks and balances to prevent fraud, which would not be applicable to the UIEC program. These checks and balances include the National Directory of New Hires crossmatch, which enables EDD to use new hire information provided by employers nationwide to identify claimants who improperly continue to receive benefits after they have returned to work; the New Employee Registry Benefit Crossmatch for California Employers, which enables EDD to use new hire information from California employers to identify claimants who improperly continue to receive benefits after they have returned to work; the Benefit Audit Quarterly Wage Records Crossmatch, which is an automated process that matches quarterly earnings, reported by employers, with claimants that have certified for and received unemployment insurance benefits during the same calendar quarter; and the Interstate Crossmatch, which crossmatches wages reported quarterly by employers outside of California to UI benefits paid within the same period, helping EDD to detect when claimants have been fraudulently collecting benefits while working outside of California.

While the Independent Contractor Registry requires the reporting of hired independent contractors meeting specific criteria, individuals operating a brick-and-mortar business are not subject to these requirements. Without establishing a state-wide, regular income reporting requirement for all business owners, individuals could collect UIEC benefits while continuing to operate their businesses. A check and balance could come a year later, when the self-employment income from the Franchise Tax Board (FTB) is reported, and EDD conducts a wages audit. However, income from self-employment is reported to the FTB after the fact and cannot be tied to a certain quarter, or to a period worked—only to a year, making fraud prevention for this population difficult.

Program Components

Lawmakers may wish for EDD to use the fraud mitigation processes mentioned below for the UIEC program to provide monetary benefits from the UIEC program to the intended individuals and to prevent and deter the attempts of identity thieves, fraudsters, or organized crime rings to defraud the program.

Online Verification

EDD has partnered with ID.*me* to create a secure identity verification process when individuals apply for benefits online. The process requires the individual to create an account with ID.*me* and upload acceptable documents to complete the verification process. If the individual requires additional assistance to complete the process, they can contact an ID.*me* team member to assist with the verification process. EDD is also adopting additional identity verification tools to complement ID.*me*, including Socure, that will provide a "frictionless" option that will not require document submissions for approximately 95% of customers.

Telephone/Mail Verification

Individuals that apply for benefits through telephone or mail are required to supply their Social Security Number which is then verified with the Social Security Administration. In addition, a California driver's license or identification number is verified with the California Department of Motor Vehicles (DMV).

Thomson Reuters

EDD partners with Pondera, a business unit within the Thomson Reuters (TR) Government Division, to cross-check new UI claims filed against fraud detection tools allowing for the earliest possible detection of fraud prior to issuing benefits.

Biweekly Certification Verification

EDD requires individuals to certify bi-weekly and provide earnings made for the weeks on the certification.

Overpayments

EDD can establish overpayments when benefits were issued to ineligible individuals, including recovery of overpaid benefits.

Reporting Fraud

EDD receives fraud tips online or from the EDD Fraud Hotline. Information can come from individuals that report claims filed under their name, address, or SSN but indicate that they themselves did not file a claim.

Documentation and Tracking

Data Retention and Internal Reporting

Internal validation and performance reports help to ensure the new system is working as designed to efficiently deliver benefits. These reports could assist in maintaining program integrity, expanding improvements, and providing transparency.

Lawmakers may wish for the new UIEC system to collect and save information similar to the regular UI program and to produce similar internal reports that are generated for the UI program, such as, but not limited to, claim and payment activities, disqualification and appeals, overpayments and recovery efforts, and demographic information. Additionally, employees could have the ability to query information, as needed, such as customer information, employee access information, and actions taken by employees. The UIEC system could also generate records and information to be responsive to audit requests.

Summary and Estimated Program Costs

For program administration, California's UI program is funded primarily through federal grants, and a benefit program for the unincorporated self-employed is generally excluded. To provide benefits for the unincorporated self-employed population, EDD assumes it would need to create a separate benefit program (UIEC).

This study assumes EDD would leverage the existing DIEC model to develop the financing structure (program funding and participation) and leverage the regular UI program as a template for the benefit administration (e.g., claim filing, eligibility determinations, payments, etc.). If lawmakers established a new UIEC program, EDD would be required to establish a new exclusive IT system capable of accepting applications, determining eligibility, issuing payments, working on appeals, and conducting evaluations and audits. This report uses the known costs of EDD's existing IT infrastructure to estimate the potential costs for a UIEC program. The report does not consider using any new technologies the Department may adopt as part of its modernization effort, EDDNext, as the relevant costs of those technologies required to create the UIEC program and their attributes were not known at the time this report was drafted.

To establish a separate UIEC program in California, EDD estimates it will take a timeframe of at least 72 months to implement. However, the one-time cost would be dependent on the program participants. The population of potential participants is identified as approximately 1.43 million individuals based on data from the U.S. Census Bureau, Current Population Survey of Households, 12-month moving average for July 2023. The EDD calculates a one-time administrative cost of $326 million for the 100% program participation rate, $281 million for the 5% program participation rate, or $279 million for the 0.1% program participation rate. While the majority of the cost is associated with the creation of an IT system, the estimate also includes the creation of an insurance premium collection system, contact center infrastructure and payment system, creation of policies and procedures including forms and notices, employee training and onboarding, fraud prevention and detection, and report generating activities.

EDD's annual ongoing cost estimate to administer the UIEC program largely depends on the number of applications received, in addition to the cost associated with the maintenance and operation of the new IT system. As mentioned above, the population of potential participants is identified as approximately 1.43 million individuals. Using a 5% and 10% rate of applicants from a 100% program participation rate, EDD estimates annual ongoing costs of $116 - $133.5 million. Using a 5% and 10% rate of applicants from a 5% program participation rate, EDD estimates annual ongoing costs of $33 - $39.3 million. Using a 5% and 10% rate of applicants from a 0.1057% program participation rate, EDD estimates annual ongoing costs of $29.5 - $34.8 million. The majority of the ongoing costs for the UIEC program, even if the program participation rate is low, will be driven by the need to establish and maintain an exclusive IT system to process UIEC claims, as California's UI program is funded primarily through federal grants, which exclude unincorporated self-employed individuals. Administering a complex IT infrastructure to support an ongoing benefit program requires significant resources to maintain system integrity; resources must also be made available for IT support.

The UIEC program could not use federal UI funds to pay for the one-time or ongoing administrative costs. For comparison, California is expected to receive approximately $790 million of federal funds to administer the regular UI program in State Fiscal Year 2023-24. This amounts to approximately 63% of the total resources available for UI administration.

The one-time and ongoing cost estimates cited above do not include the dollar amount of benefits that may be paid to claimants. The benefit amount is difficult to predict due to a varying number of factors, such as the WBA that ranges between $40 and $450, which may be reduced due to part-time earnings, and the number of weeks customers may receive benefits ranging between 13 and 26 weeks. Assuming an unemployment rate between 5% and 10%, the program could pay between $0.5 million and $1.0 billion in benefits annually. The wide range in benefits is attributable to the different participation rates of eligible self-employed individuals.

Conclusion

This study finds that to provide UI benefits for the unincorporated self-employed, lawmakers would have to create a separate program outside of the regular UI program. Based on federal law, no funding from California's UI Trust Fund or California's UI administrative funds may go towards a UI program for the unincorporated self-employed or UIEC. This UIEC program would have to be implemented separately from the UI program to ensure conformity and compliance with federal UI laws and regulations.