Employment Development Department
State of California

Gavin Newsom
Governor

Projected Impact of Modifying the Disability Insurance Waiting Period

A Report to the California Legislature

EMPLOYMENT DEVELOPMENT DEPARTMENT
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The Honorable Members of the California State Legislature
California State Senate and Assembly
State Capitol
Sacramento, CA 95814

Dear Members of the California State Legislature:

Assembly Bill 908 was signed into law in April 2016. This legislation contains a provision requiring the Employment Development Department to issue a report on the costs and benefits of modifying the Disability Insurance (DI) program's mandatory one-week waiting period. The letter is being sent pursuant to Government Code Section 9795(a) that requires each legislative mandated report to include a summary of its contents not to exceed one-page in length, which is distributed to each member of the Legislature.

The DI program provides monetary benefits to covered workers who are unable to work due to an illness, non-work related injury, or pregnancy. State law requires that the first week of a claimant's disability period serves as a mandatory non-compensable waiting period. Pursuant to Assembly Bill 908, the Employment Development Department has prepared a legislative mandated report on the projected costs and potential benefits of modifying or eliminating the non-compensable waiting period. This legislative report includes the following contents:

- An executive summary that highlights key issues including the costs and benefits to workers if the waiting period was modified;
- An explanation on why this report is being issued;
- An overview of the State Disability Insurance program;
- A description of recent legislation impacting the DI program;
- A description of the methodology used to calculate the costs and potential benefits;
- The projected costs and benefits to workers; and
- A summary of the report's findings.

This report will be sent to the Assembly Insurance and Senate Labor, Public Employment and Retirement Committees pursuant to the provisions contained in Assembly Bill 908. Copies of this report are available to any legislative member upon request.

Sincerely,

/s/PATRICK W. HENNING
Director

EXECUTIVE SUMMARY

Assembly Bill 908 (Chapter 5, Statutes of 2016) requires the Employment Development Department (EDD) to report to the Legislature the projected costs and potential benefits associated with options to reduce, modify, or eliminate the seven-day waiting period for the DI program. The waiting period refers to the requirement that Disability Insurance (DI) customers must serve a seven-day non-payable waiting period prior to receiving DI benefits.

Data compiled by the EDD provides insights on the effects of modifying this requirement in calendar years 2018 through 2021. A careful examination of this data included considerations of all possible waiting period variations – from reducing the requirement by one day, to eliminating the waiting period altogether.

It should be noted that these projections do not consider potential future economic downturns or increases in Paid Family Leave (PFL) usage, both of which may significantly impact the DI Fund.

Estimated Costs and Potential Benefits

The EDD's analysis indicates that reducing or eliminating the DI waiting period would increase the duration of benefits for DI customers. For example, under current law a claimant who files a claim for an eight-week duration receives seven weeks of benefits, with the first week being the unpaid waiting period. If the waiting period is eliminated, the claimant would receive eight weeks of benefits. Modifying or eliminating the waiting period would provide claimants between $222.9 million to $1.6 billion in additional benefits.

The estimated costs over a four-year period would range from $720.5 million to $2.2 billion depending on the number of days the waiting period is reduced. The higher costs are attributed to the financing structure that is designed to generate more revenue than what is needed to pay benefits to build a reserve and ensure fund solvency during economic downturns.

In addition, modifying the seven-day waiting period would also require significant changes to the EDD program processes and automated systems. Administrative and technology cost estimates for implementing changes to the waiting period would require a one-time cost of approximately $7 million and a projected 24-36 month implementation time frame.

INTRODUCTION

This report has been submitted to the California Legislature pursuant to the provisions in Assembly Bill 908 (Chapter 5, Statutes of 2016). Assembly Bill 908 was signed into law in April 2016. This legislation contains a provision requiring the EDD to issue a report on the projected costs and potential benefits associated with options to reduce, eliminate, or others modify the DI program's one-week waiting period.

This report fulfills the provisions cited above. Assembly Bill 908 also requires this report to be submitted pursuant to Government Code Section 9795(a) which requires a printed copy be submitted to the Secretary of the Senate and an electronic copy submitted to the Chief Clerk of the Assembly and Legislative Counsel. Furthermore, Government Code Section 9795(a) requires each report to include a summary of its contents not to exceed one page in length, which is distributed to each member of the appropriate house or houses of the Legislature.

STATE DISABILITY INSURANCE PROGRAM OVERVIEW

The DI program was created in 1946 to provide benefits to workers experiencing wage loss due to a non-work related injury or illness, or due to pregnancy or childbirth. In 2004, California was the first state in the nation to implement a PFL program that provides benefits to workers who need to take time off to care for a seriously ill family member, or to bond with a new child either from birth, adoption, or foster care placement. The SDI program encompasses both DI and PFL benefits.

Financing Structure

The SDI program is financed solely by workers who have contributions withheld from their pay checks. The financing structure includes a number of different components that are discussed below.

One component is the taxable wage ceiling. The taxable wage ceiling is the maximum amount of wages earned by a worker that are subject to SDI contributions. State law sets the taxable wage ceiling by a formula. One of the factors in the formula is the maximum weekly benefit amount, which is adjusted annually to match the Workers' Compensation benefit level. The formula automatically triggers an increase to the taxable wage ceiling when the maximum weekly benefit amount increases. In calendar year 2019, all wages earned up to $118,371 are subject to SDI contributions.

A second component is the contribution rate, which is also determined by a statutory formula. The rate is applied to all wages up to the taxable wage ceiling to determine the amount of contributions a worker owes. State law also provides that the contribution rate shall not be less than 0.1 percent and shall not exceed 1.5 percent. Depending on the condition of the DI Fund, the EDD Director has the statutory authority to raise or lower the contribution rate by 0.1 percent. For calendar year 2019, the contribution rate is set at 1.0 percent. Based on the current taxable wage ceiling and contribution rate, the maximum amount of contributions a worker could make annually to the DI Fund is $1,183.71.

It should also be recognized that the financing structure was designed to ensure the year-end fund balance meets a specified adequacy rate. Currently, a year-end fund balance that is between 25 and 50 percent of the previous year's total disbursements for the fund is considered an adequate reserve rate. With a projected year-end fund balance in 2019 of $3.4 billion, the adequacy rate is estimated to be 43.0 percent. The following chart, derived from the October 2018 DI Fund Forecast, provides key financial data for three calendar years, 2018 through 2020.

Employment Development Department

SDI Financing Data - Calendar Years 2018-2020

Table 1

Year	Contribution Rate	Taxable Wage Ceiling	Net Worker Contributions	Year-End Fund Balance	Adequacy Rate
2018 (f)	1.0%	$114,967	$7,366,300,000	$3,358,700,000	46.5%
2019 (f)	1.0%	$118,371	$7,809,300,000	$3,398,600,000	43.0%
2020 (f)	1.1%	$125,462	$9,439,400,000	$4,568,200,000	54.2%

(f) = Forecast. Data for the entire 2018 calendar year was not available at the time of this publication.

Additional details about the SDI financing structure can be found in the October 2016 DI Fund Forecast located in the appendix section of this report.

Program Details

The SDI program pays weekly benefits in amounts ranging from $50 to $1,252 depending on the worker's earnings. The average weekly benefit payment is currently $618 for DI and $685 for PFL benefits. In addition, the DI program pays benefits for a maximum duration of 52 weeks, while the maximum duration for the PFL program is six weeks (Appendix B – Net Benefits 2015-2018). The following chart, derived from the October 2018 DI Fund Forecast, provides key claims data for three calendar years, 2018 through 2020.

SDI Claims Data - Calendar Years 2018-2020

Table 2

Year	DI Claims Paid	PFL Claims Paid	Max. Weekly Benefit Amount	Total DI Benefits Paid	Total PFL Benefits Paid
2018 (f)	651,000	279,000	$1,216	$6,221,762,000	$1,007,396,000
2019 (f)	671,000	292,000	$1,252	$6,818,193,000	$1,109,471,000
2020 (f)	680,000	296,000	$1,327	$7,283,673,000	$1,186,451,000

(f) = Forecast. Data for the entire 2018 calendar year was not available at the time of this publication.

Most PFL claims were filed to bond with a new born or adopted child, or with a foster placement. Additional program details can be found online at the following web site: http://www.edd.ca.gov/About_EDD/Quick_Statistics.htm

Waiting Period

The California Unemployment Insurance Code Section 2627(b)(1) requires an individual to serve a one-week non-compensable waiting period before DI benefits are payable. Specifically, this section states that a disabled individual is eligible to receive DI benefits only if the Director finds that:

> *"He or she has been unemployed and disabled for a waiting period of seven consecutive days during each disability benefit period with respect to which waiting period no disability benefits are payable."*

The mandatory one-week non-compensable waiting period has been a statutory requirement since 1993. This report discusses the projected cost and potential benefits if the mandatory waiting period was reduced to less than one-week or eliminated.

Function of the Waiting Period

The SDI program is an employee-paid benefit program intended to partially compensate disabled workers for a wage loss due to a non-work-related injury, illness, or pregnancy. It is intended to provide benefits to cover a loss of wages due to more lengthy disabilities. Eligible workers are compensated beginning with the eighth day after serving a seven-day nonpaid waiting period, pursuant to Section 2627(b) of the California Unemployment Insurance Code.

As with other types of insurance, it should also be noted that the waiting period acts like a deductible which limits an insurer's costs. In this case, workers are the insurers, as they fund the DI program. This requirement was instituted to discourage individuals from filing claims for less than eight days of disability due to short-term common health conditions such as the cold and flu. In addition, establishment of the seven-day non-waivable and non-payable waiting period in 1994 was done to help preserve long-term DI Fund solvency.

KEY LEGISLATION IMPACTING THE PROGRAM

Recently chaptered legislation has had a significant impact on California's SDI program. Five bills, highlighted below, continue to influence SDI operations and should be considered in the analysis of modifying or eliminating the DI program waiting period.

Assembly Bill 1522– Paid Sick Days

Assembly Bill 1522 (Chapter 317, Statutes of 2014) mandated paid sick leave protections for California workers. Assembly Bill 1522 entitles employees who work seven or more days in a calendar year up to three days of paid sick leave. At the time the bill was proposed, approximately 40 percent of all workers in California did not have access to paid sick days through their employer.

Assembly Bill 304 – Paid Sick Days

Assembly Bill 304 (Chapter 67, Statutes of 2015) amended language codified by Assembly Bill 1522 to clarify the state's sick leave laws. Among other things, the bill provides employers alternative methods for calculating an employee's accrued paid sick leave.

Both Assembly Bill 1522 and Assembly Bill 304 were of particular interest for the SDI program because workers have the option to integrate their sick leave with their SDI benefits in order to receive their full pay. Workers may also use sick leave during the waiting period.

Assembly Bill 908 – State Disability Insurance Benefit Increase

Assembly Bill 908 modified the SDI program by increasing the wage replacement rate to 60 percent for middle and high income workers, and to 70 percent for low income workers. This increase took effect in January 2018 and will sunset in January 2022, unless otherwise extended. The bill also repealed the unpaid one-week waiting period for PFL benefits. From 2018 to 2021, the bill's provisions will increase DI and PFL benefits paid by a total of approximately $1.9 billion. To cover these additional costs, eligible employees will be required to contribute an additional $2.1 billion, or approximately $115 per employee over the four year period. The fund balance would be increased by approximately $349 million. It should be noted that not all of the increase in the fund balance is attributed to this bill, but other factors that can increase the fund balance.

Senate Bill 3 – Minimum Wage Increase

Senate Bill 3 (Chapter 4, Statutes of 2016) increased the California minimum wage, beginning in 2017. For employers that have 26 or more employees the minimum wage increased to $10.50 per hour beginning January 1, 2017. The minimum wage will increase incrementally for these employers until 2022 when it is set to $15.00 per hour. Smaller employers will be required to follow the same procedures, but on a delayed schedule. Because the SDI program provides temporary, wage replacement benefits based on a claimant's earnings, an increase in eligible wages results in a complementary increase in the benefits lower-paid employees are eligible to receive. The EDD estimates that the net result from 2017 to 2023 is an increase in benefits paid of approximately $1.0 billion and an increase in contributions of $600 million.

Senate Bill 1123 – Exigency Leave

Senate Bill 1123 (Chapter 849, Statutes of 2018) expanded the scope of the PFL program by adding a new claim type to cover paid leave when an individual's spouse, domestic partner, child, or parent needs to assist them in preparing for military deployment. Exigency leave would be limited to military personnel ordered to foreign deployments. The bill includes a number of administrative provisions to support this expansion. Senate Bill 1123 goes into effect on January 1, 2021.

METHODOLOGY TO CALCULATE PROJECTED COSTS AND POTENTIAL BENEFITS

This report uses the Department's October 2016 DI Fund Forecast as a baseline to project the impact of modifying the DI waiting period for calendar years 2018 through 2021. The projections included in this report consider the increased wage replacement rate for DI benefits, as specified in Assembly Bill 908, and the state's minimum wage increases, as prescribed in Senate Bill 3.

A careful examination of this data considers all possible waiting period variations – from reducing the waiting period by one day to eliminating the waiting period altogether. To approximate the waiting period modifications' impact to the DI Fund and benefits to claimants, several elements were considered for each waiting period reduction scenario over four calendar years, 2018 through 2021 (Appendix A – Additional Total Net Benefits Paid and Additional Contributions Chart).

PROJECTED COSTS AND POTENTIAL BENEFITS

The following chart provides the projected costs for reducing the current seven-day waiting period by one-day intervals until the waiting period is eliminated. In addition, the chart also provides the total amount of benefits claimants are projected to receive under each of the seven different scenarios. Cost and benefits data are also reported as percent increases in both total contributions and benefits paid.

Projected Costs to Workers

Based on the data below, eliminating the waiting period would increase workers' contributions between $720.5 million to $2.2 billion over the four year period depending on the number of days the waiting period is reduced. The increase in contributions is caused whenever there is an increase in benefits paid, and the increase impacts two components in the statutory formula used to set the contribution rate annually. Those components include total disbursements (e.g., benefit and administrative costs) and the DI Fund balance.

Initially, when more disbursements are made, it results in a lower fund balance, which triggers a higher contribution rate to generate revenue. However, if that contribution rate generates more revenue than what is needed to pay benefits, it is likely that the additional revenue amounts will stabilize as shown in the last four scenarios below. Another characteristic with the DI financing structure, particularly the contribution rate formula, is that it was designed to generate more revenue that what is needed to pay benefits. This feature ensures whenever there is a benefit increase, enough revenue is generated to pay those benefits and build a reserve to ensure solvency during economic downturns. As shown below, in all scenarios more revenue is generated than the amount of benefits paid.

Projected Costs vs. Potential Benefits - Calendar Years 2018-2021

Table 3

Waiting Period Scenarios	Additional Total Net Receipts	Percent Increase In Contributions	Additional Total Net Benefits Paid	Percent Increase In Benefits Paid
6-day	$720,453,000	2.33%	$222,988,000	0.88%
5-day	$720,185,000	2.33%	$445,975,000	1.76%
4-day	$1,425,052,000	4.61%	$668,965,000	2.65%
3-day	$2,157,665,000	6.89%	$891,952,000	3.53%
2-day	$2,157,398,000	6.98%	$1,114,940,000	4.41%
1-day	$2,157,129,000	6.94%	$1,337,927,000	5.29%
No waiting period	$2,156,863,000	6.97%	$1,560,916,000	6.18%

Potential Benefits for Workers

By comparison, reducing the waiting period would provide claimants with $222.9 million to $1.6 billion in additional benefits over the four-year period depending on the number of days the waiting period is reduced.

It should be recognized that Assembly Bill 908 provided a benefit increase beginning January 1, 2018. This increase will sunset on January 1, 2022. In addition, Senate Bill 3 raises the minimum wage which would also result in an increase in benefits for low wage workers since benefit amounts are based on a worker's wages. These bills will also have an impact to the DI program resulting in higher benefits and contributions.

Administrative Costs

Finally, if the Legislature chooses to pursue legislation to modify the existing waiting period it will require significant modifications to program processes and the multiple automated systems used to administer the DI program according to the statutory requirements. These changes could take up to 24 to 36 months to fully implement and test at a one-time cost of approximately $7 million.

SUMMARY OF THE REPORT'S FINDINGS

The waiting period serves as a deductible so that the DI program is not used for short-term and common health issues. For each day the waiting period is reduced, the additional annual benefit payments increases by approximately $222.9 million to $1.6 billion during the four-year period 2018-2022. These additional benefits equate to approximately $51 to $59 million in additional benefits per year for each day the waiting period is reduced. Lastly, modifying the waiting period would increase worker contributions from approximately $720.5 million to $2.2 billion over the four-year period.

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