

California State Disability Insurance: Privatization Is the Answer to Employee Woes

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WITH THE WORLD'S fifth-largest economy, California's labor force consists of almost eighteen million workers.¹ California workers rely on their income to pay for shelter, food, and to support their families.² As a result, the ability of a person to earn a living is one of her most important assets.³ An off-the-job injury can ruin a person financially if it prevents her from working.⁴ Therefore, the wage-replacement system that a state chooses and whether the system works are of critical importance.

California's current wage-replacement system, known as the State Disability Insurance ("SDI") program, provides benefits for workers injured off-the-job. Despite its importance to the State, the SDI program has been the subject of negative press and calls for reform due to improper claim processing that costs the program millions of dollars in cost overruns.⁵ The administrative problems inherent in the current system are not only costly to the program but also to those

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1. See Cal. Employment Dev. Dep't, California Profile, <http://www.labormarketinfo.edd.ca.gov/cgi/databrowsing/localAreaProfileQSResults.asp?selectedarea=California&selectedindex=0&menuChoice=localAreaPro&state=true&geogArea=0601000000&countyName=> (last visited Feb. 2, 2005).

2. See generally Peter G. Gosselin, *The New Deal: If America Is Richer, Why Are Its Families So Much Less Secure?*, L.A. TIMES, Oct. 10, 2004, at A1.

3. See Paul Silverman, *Protect Your Ability to Earn a Living*, SANTA FE NEW MEXICAN, Jan. 28, 1996, at F-4.

4. See generally Gosselin, *supra* note 2.

5. See Robert Sallady, *Disability Plan Loses Millions; State Insurance Program's Costs Skyrocket Through Errors, Abuse*, S.F. CHRON., Jan. 26, 2003, at A1 [hereinafter *Disability Plan Loses Millions*].

eligible claimants who never receive benefits due to processing mistakes.

Additionally, limits on the duration for which workers can collect SDI may potentially cause workers who suffer off-the-job injuries financial hardship.⁶ These limits affect workers who suffer long term injuries as they may be left with no wage-replacement options if they do not have private disability insurance.⁷

The program also caps payment amounts at a low income level causing high income earners to suffer disproportionate wage losses.⁸ A hypothetical example of an injured worker illustrates the problem. Sam is a thirty-five year old systems analyst working in Silicon Valley and earning \$75,000 per year. He recently bought a home and spends most weekends working on improving it. Due to high home prices in the Bay Area, Sam is stretched to the limit to make his mortgage payment, and between the house and his other regular expenses, Sam spends his entire paycheck each month.

One Saturday, Sam is trimming trees in his yard and falls off of a ladder. He injures his back and is unable to return to work for five months. Sam has no money in his savings account as it all went towards the down payment on his house. How will Sam afford to make his mortgage payment and pay the monthly bills he owes while he is unable to work? He does not qualify for workers' compensation because he was not injured on-the-job.⁹

Sam does have options to supplement at least part of the wages he will lose for the five months that he is unable to work. First, he qualifies for SDI.¹⁰ Second, if he has purchased private disability insurance, this will also supplement his lost income.¹¹ These options, however, do not solve Sam's problem. Because of payment limits, SDI will

6. See generally CAL. UNEMP. INS. CODE § 2653 (West 1986 & Supp. 2005).

7. See Fred Cook, *Selling Disability in California: Finding Plans that Bridge the Gaps in State Coverage*, CAL. BROKER MAG., May 2005, available at <http://www.calbroker.com/Magazine/story/may/Disability-Cook.htm> (last visited Sept. 24, 2005).

8. See CAL. EMPLOYMENT DEV. DEP'T, STATE DISABILITY INSURANCE (SDI) AND PAID FAMILY LEAVE (PFL) WEEKLY BENEFIT AMOUNTS 1 (2005), available at <http://www.edd.ca.gov/direp/de2588.pdf> (last visited Jan. 22, 2006) [hereinafter SDI WEEKLY BENEFIT AMOUNTS].

9. See CAL. LAB. CODE § 3208 (West 2003). This Comment does not consider workers' compensation as it only deals with off-the-job injuries that affect an employee's ability to work and earn income, not on-the-job injuries.

10. See CAL. UNEMP. INS. CODE § 2606 (West 1986 & Supp. 2005); Cal. Employment Dev. Dep't, About the DI Program, <http://www.edd.cahwnet.gov/direp/diindx.htm> (last visited Oct. 3, 2004) [hereinafter About the DI Program].

11. See Insure.com, The Basics of Short Term Disability Insurance, <http://info.insure.com/disability/shorttermdisability.html> (last visited Feb. 5, 2005) [hereinafter Basics of Short Term Disability Insurance]; see also Insure.com, The Basics of Long Term Disability

not pay Sam nearly enough to cover his mortgage payment and bills. In addition, in order to qualify for private disability insurance, Sam must have purchased it prior to his injury. Individual rates for these plans are very expensive,¹² which discourages many who would be interested in purchasing private insurance from actually doing so.

Sam's situation is not unique. The probability of a thirty-five year old suffering a disability for more than three months during his working life is 24%.¹³ Replacing wages lost because of a disability is an issue that concerns all workers. SDI, however, currently leaves Sam with inadequate protection.

Moreover, as SDI is a state-mandated program, almost all California workers must pay for SDI.¹⁴ Yet most workers may never use these benefits due to the relatively low probability that a worker will sustain a debilitating injury.¹⁵ These workers are forced to supplement other workers' incomes who suffer disabling injuries. This is an unfair burden California places on too many workers.

In short, California's current wage-replacement system for workers injured off-the-job is ineffective and must be changed. The SDI program is outdated: it is fraught with administrative problems, does not adequately protect workers who are injured, and forces many workers to pay for a benefit they will never use. Therefore, the State must eliminate its flawed SDI program and mandate that employers offer private disability insurance to their employees.

Eliminating the SDI program and mandating that employers offer private insurance to their employees is an easy solution that is cost effective to the State, employers, and employees. In addition, it will provide added protection to injured workers so that they are not in financial jeopardy.

Part I of this Comment provides background information on the SDI and private disability systems currently in place in California. This includes a discussion of the history of the SDI program and a comparison of the structure and costs of SDI and private disability insurance. Part II examines the problems inherent in the current structure that make privatization desirable. These include administrative problems,

Insurance, <http://info.insure.com/disability/longtermdisability.html> (last visited Feb. 4, 2005) [hereinafter *Basics of Long Term Disability Insurance*].

12. See *Basics of Short Term Disability Insurance*, *supra* note 11.

13. See Press Release, Consumer Fed'n of Am. et al., Large Majority of Workers Risk Financial Exposure in Event of Disability, Survey Finds 2 (Apr. 23, 2001), available at <http://www.consumerfed.org/ltdisability.pdf> (last visited Feb. 5, 2005).

14. See CAL. UNEMP. INS. CODE § 2901 (West 1986 & Supp. 2005).

15. See Press Release, Consumer Fed'n of Am. et al., *supra* note 13, at 2.

disability payment caps, accessibility, and use. Part III reasons that the elimination of the SDI program and a state mandate requiring employers to offer private disability insurance is the best plan for California workers and employers.

I. California's Current Partial-Wage Replacement System

Employees in California generally have two options for wage-replacement if they are injured off-the-job and are unable to work:¹⁶ employees can collect SDI, or they can obtain private disability insurance.¹⁷

A. State Disability Insurance

California, along with only five states and one commonwealth, offers short term disability benefits to employees.¹⁸ SDI is a state-mandated, partial-wage replacement insurance program that is funded through employee payroll deductions.¹⁹ The program covers the majority of California employees—approximately twelve million of California's workers.²⁰ Those not covered include railroad workers, non-profit agency employees, employees who claim religious exemptions, and most government employees.²¹

The California Legislature established the State's SDI program during its 56th session in 1946.²² The Legislature designed disability benefits to "compensate in part for the wage loss sustained by individuals unemployed because of sickness or injury and to reduce to a minimum the suffering caused by unemployment resulting therefrom."²³ The disability system picked up where unemployment benefits left off,

16. Although federal Social Security can be a source of disability benefits for injured workers in California, it will not be covered in this Comment as it does not cover the first five months of disability and requires that the individual be totally disabled. See Stacy L. Rollings, *Small and Mid-Sized Businesses Level the Playing Field with Voluntary Benefits*, BUSINESS-WOMAN MAG., Spring 2001, available at <http://www.bpwusa.org/i4a/pages/Index.cfm?pageid=3798> (last visited Oct. 10, 2005).

17. See Basics of Short Term Disability Insurance, *supra* note 11; see also Basics of Long Term Disability Insurance, *supra* note 11.

18. See About the DI Program, *supra* note 10 (indicating that only Hawaii, New Jersey, New York, Rhode Island, and Puerto Rico have state-funded employee disability programs).

19. See About the DI Program, *supra* note 10.

20. See *id.*

21. See *id.*

22. See Hans Adam Mattes, *Unemployment Compensation Disability Benefits in California*, 22 J. ST. B. CAL. 132, 132 (1947).

23. *Id.*

“provid[ing] partial indemnity for wage loss incurred by eligible individuals . . . because of disability.”²⁴

In addition to a desire to provide for the welfare of injured workers, California also found that establishing SDI was a practical answer to questions from the public surrounding an unemployment insurance surplus held by the State.²⁵ During World War II and the following postwar period, California accumulated a surplus from employee unemployment insurance contributions.²⁶ The public exerted considerable pressure on the State to stop employee payroll deductions, arguing that they were no longer needed.²⁷ Rather than stop the employee deduction system, the SDI program was established.²⁸

Today, the Disability Insurance Branch of the California Employment Development Department administers SDI.²⁹ The purpose of SDI has been expanded to

compensate in part for the wage loss sustained by any individual who is unable to work due to the employee’s own sickness or injury, the sickness or injury of a family member, or the birth, adoption, or foster care placement of a new child, and to reduce to a minimum the suffering caused by unemployment resulting therefrom.³⁰

The SDI program is funded completely by employees; employers take payroll deductions from the employees’ paychecks and send them to the State.³¹ Employees contribute 1.08%³² of their income up to \$857.71 per year for SDI.³³

An employee is eligible to collect SDI partial wage supplement if she is “disabled.”³⁴ Under California law, “An individual shall be deemed disabled on any day in which, because of his or her physical or mental condition, he or she is unable to perform his or her regular

24. Pat Merrick, *California’s Disability Insurance System*, 304 INS. L. J. 371, 372 (1948).

25. See Note, *Legislative Medicine for the Sick Worker*, 2 STAN. L. REV. 345, 346 (1949).

26. See *id.*

27. See *id.*

28. See *id.*

29. About the DI Program, *supra* note 10.

30. CAL. UNEMP. INS. CODE § 2601 (West 1986 & Supp. 2005).

31. See Cal. Employment Dev. Dep’t, Disability Insurance, <http://wwwedd.cahwnet.gov/direp/disdi.htm> (last visited Oct. 21, 2005) [hereinafter Disability Insurance]; CAL. UNEMP. INS. CODE § 2901 (West 1986); *Id.* § 2903.

32. Cal. Employment Dev. Dep’t, Tax Rates and Withholding Schedules, <http://wwwedd.cahwnet.gov/taxrep/taxrte9x.htm> (last visited Feb. 5, 2005) [hereinafter Tax Rates and Withholding Schedules]. The total SDI tax rate is 1.08%, but .08% of this goes towards a new benefit for paid family leave that is not covered in this Comment. *Id.*

33. *Id.*

34. CAL. UNEMP. INS. CODE § 2625 (West 1986 & Supp. 2005).

or customary work.”³⁵ “Disability” includes “[i]llness or injury, whether physical or mental, including any illness or injury resulting from pregnancy, childbirth, or related medical condition.”³⁶ It is important to note that qualifying disabilities are a result of off-the-job conduct; injuries arising on-the-job are covered by workers’ compensation.³⁷

In addition to being disabled, a qualified recipient must be employed or actively looking for work when he becomes disabled,³⁸ must have lost wages because of the disability if employed,³⁹ must have earned at least \$300 during a previous base period (usually the past four months),⁴⁰ must be under the care of a licensed physician who has certified the disability,⁴¹ and must have mailed in the proper forms within forty-one days of becoming disabled.⁴²

SDI recipients receive payment of a percentage of their lost wages for up to one year.⁴³ The benefit amount received is based on the employee’s income level.⁴⁴ Disabled employees receive a partial wage supplement ranging from \$50 per week to \$840 per week.⁴⁵ The payment maximum of \$840 per week applies to employees making \$19,830 or more per quarter⁴⁶ (or \$79,320 per year). This payment is reduced by any income in the form of sick leave pay, self-employment income, military pay, commission, wages, residuals, part-time work income, bonuses, workers’ compensation benefits, insurance settlements, or holiday pay.⁴⁷

Since SDI is state-mandated, it is often the first line of protection for employees and for some it may be the only protection. For those

35. *Id.* § 2626(a).

36. *Id.* § 2626(b)(1).

37. *See* CAL. LAB. CODE § 3208 (West 2003).

38. *See* Cal. Employment Dev. Dep’t, State Disability Insurance (SDI) Claim Filing and Processing, <http://www.edd.cahwnet.gov/direp/dicfptx.htm> (last visited Feb. 5, 2005) [hereinafter SDI Claim Filing].

39. *See id.*

40. *See* CAL. UNEMP. INS. CODE § 2652 (West 1986). Interestingly, this wage requirement has not increased over time; this is the same amount that was required when SDI was originally enacted even though wages have significantly increased since 1946. *See* J. COMM. ON UNEMPLOYMENT COMPENSATION DISABILITY INSURANCE, FINAL REP., Assemb. Con. Res. No. 45, at 13 (Cal. 1965–1967).

41. *See* CAL. UNEMP. INS. CODE § 2708(c); SDI Claim Filing, *supra* note 38.

42. *See* CAL. UNEMP. INS. CODE § 2706.1.

43. *See id.* § 2653; About the DI Program, *supra* note 10.

44. *See* CAL. UNEMP. INS. CODE § 2655.

45. *See id.*; *see also* SDI WEEKLY BENEFIT AMOUNTS, *supra* note 8.

46. SDI WEEKLY BENEFIT AMOUNTS, *supra* note 8.

47. SDI Claim Filing, *supra* note 38.

who purchase private disability insurance, it also covers wage losses due to off-the-job injuries.

B. Private Disability Insurance

There are two categories of private disability insurance plans available to workers for individual purchase or purchase through their employers.⁴⁸ An employee may purchase a short term disability (“STD”) policy or a long term disability (“LTD”) policy, or both.⁴⁹

1. Private Short Term Disability Insurance

STD pays workers a percentage of their wages if they become temporarily disabled. That is, if they are unable to work for a short period of time due to non-work related sickness or injury.⁵⁰ Typically, a policy provides a worker with a weekly portion of his wages, ranging from 50% to 66 2/3% for a period of thirteen to twenty-six weeks.⁵¹ STD claims are most often filed due to pregnancy, pregnancy complications, non-back-related injuries, back injuries, and digestive or intestinal problems.⁵²

If an employer offers a disability insurance program to its employees, it is considered a “group plan.”⁵³ Often employers incur no additional costs when offering disability insurance options to their employees through a group plan,⁵⁴ because employees directly pay for group plans through payroll deductions. Therefore, employers need only offer the plan and then send the contribution to the carrier.⁵⁵ Educating employees about their options is a function the carrier willingly provides.⁵⁶ Supplementing premiums if the employer chooses to do so provides the only out-of-pocket cost to an employer.⁵⁷

48. See Insure.com, Many Americans Unsure About Disability, Survey Finds, <http://info.insure.com/disability/disability401.html> (last visited Feb. 4, 2005).

49. See *id.*

50. See Basics of Short Term Disability Insurance, *supra* note 11.

51. *Id.*

52. *Id.*

53. See *Employers Benefit in Productivity by Offering Disability Coverage*, BROWARD DAILY BUS. REV., Mar. 3, 1997, at A7.

54. See *id.*

55. See UnumProvident, Product Solutions for You and Your Employees, <http://www.unumprovident.com/products/small/productsolutions.aspx> (last visited Sept. 24, 2005).

56. See UnumProvident, Resources to Help Manage Your Program, http://unumprovident.com/products/mid/product_solutions/resroucestohelp.aspx (last visited Nov. 15, 2005).

57. See *id.*

The average premium for a group STD plan was \$144 per year in 1999.⁵⁸ Group policies are “guaranteed issue”—meaning a subscriber does not have to take a medical exam to prove insurability.⁵⁹ In 2001, 79% of employers nationwide reported offering STD benefits.⁶⁰ This number is likely much lower in California because the presence of SDI gives employers less incentive to offer additional disability benefits.⁶¹ A key reason given by those employers nationwide who do offer disability plans includes attracting and retaining employees.⁶²

Of those companies offering STD, 77% pay the entire premium.⁶³ Nevertheless, even if their company does not pay the premium, employees often participate in the program. Almost one-half of those companies offering STD benefits for employee purchase report that over 70% of the employees purchased coverage.⁶⁴

If a worker’s employer does not offer STD coverage, individual policies are only available on a limited basis.⁶⁵ These policies are hard to find and can be expensive.⁶⁶ Some providers sell “accident policies” that pay a person injured in an accident for each month of their injury.⁶⁷ Most people, however, do not opt for accident coverage.⁶⁸ Indeed, it is recommended that an individual avoid purchasing an individual STD plan if he has enough money saved to support himself for a short duration should he suffer a disabling injury.⁶⁹

2. Private Long Term Disability Insurance

LTD policies provide injured workers with income for a longer period of time, such as two years, five years, or until retirement.⁷⁰ Long term disability means that a worker is unable to earn more than

58. Basics of Short Term Disability Insurance, *supra* note 11.

59. *See id.*

60. EMPLOYEE BENEFIT NEWS & JHA, INC., THE EBN/JHA DISABILITY & ABSENCE MANAGEMENT SURVEY RESULTS 4 (2001), available at http://www.jhawebsite.com/central/datastore/studies/ebn_2001.pdf (last visited Feb. 5, 2005) [hereinafter EBN/JHA SURVEY RESULTS]. Smaller companies are not as willing to offer STD benefits; fifty-nine percent of companies with two to ninety-nine employees offered STD while eighty-eight percent of companies with greater than 5000 employees offered it. *Id.*

61. *See* Cook, *supra* note 7.

62. *See* EBN/JHA SURVEY RESULTS, *supra* note 60, at 4.

63. *Id.* at 3.

64. *Id.* at 5.

65. Basics of Short Term Disability Insurance, *supra* note 11.

66. *See id.*

67. *Id.*

68. *Id.*

69. *Id.*

70. Basics of Long Term Disability Insurance, *supra* note 11.

80% of his or her wages due to a sickness, pregnancy, or accidental injury.⁷¹ After a worker has been unable to work due to an injury for three to six months, an LTD policy will start replacing lost wages.⁷² LTD policies replace anywhere from 50% to 66 2/3% of the worker's lost wages.⁷³ Policyholders most often file LTD claims due to cancer, pregnancy complications, back injuries, cardiovascular conditions, and depression.⁷⁴ Often policyholders with an injury of long duration will use STD first and then move to LTD coverage once their STD coverage has expired.⁷⁵

The average group LTD premium in 1999 was \$180 per year.⁷⁶ If an employee leaves the company, the group LTD plan does not go with him.⁷⁷ Group insurers often provide an incentive to employers to have workers return to work even if on a part-time basis.⁷⁸ They will give a premium reduction for allowing partially disabled employees to return to work on a part-time basis.⁷⁹

Approximately 87% of companies nationwide offer LTD to their employees.⁸⁰ Again, these numbers are likely lower in California because of the SDI program, as the SDI program lulls people into a false sense of security.⁸¹ Of those companies offering LTD, 65% pay for the cost of the insurance.⁸² Larger companies are less likely to cover 100% of the cost of LTD.⁸³ Nevertheless, almost one-half of the organizations that offer LTD and pay all or part of the cost of the insurance report a participation rate of over 75% of employees purchasing the group coverage.⁸⁴

For workers who are unable to purchase LTD through their employers, individual LTD plans are available through financial planners or insurance and annuities agents.⁸⁵ Individual carriers look more

71. METLIFE SMALL BUS. CTR., METRO. LIFE INS. CO., BENEFITS DESCRIPTION; LONG TERM DISABILITY INS. 1 (2003) (from Jill Carlstrom, MetLife Sales Representative).

72. Basics of Long Term Disability Insurance, *supra* note 11.

73. *Id.*

74. *Id.*

75. *See* Cook, *supra* note 7.

76. Basics of Long Term Disability Insurance, *supra* note 11.

77. Mark Lang, *Disability Insurance Survival Key*, STAR (Ventura County), Aug. 8, 1999, at E02.

78. *Id.*

79. *Id.*

80. EBN/JHA SURVEY RESULTS, *supra* note 60, at 4.

81. *See* Cook, *supra* note 7.

82. EBN/JHA SURVEY RESULTS, *supra* note 60, at 3.

83. *Id.* at 5.

84. *Id.*

85. Basics of Long Term Disability Insurance, *supra* note 11.

closely at the policy applicant and consider a variety of factors to determine whether they will cover him and the premium amount.⁸⁶ These factors include age, benefit amount, benefit period, current health status, gender, tobacco use, and type of job.⁸⁷ In addition, the definition of disability will have an effect on the premium.⁸⁸ “A policy that pays benefits if [the worker is] unable to perform the duties of [his] *own* occupation is more expensive than a policy that pays benefits if [the worker is] unable to perform the duties of *any* job for which [he is] reasonably qualified.”⁸⁹

Most individual LTD policies are non-cancelable, which means that once the subscriber has taken the medical examination and been insured, the insurer cannot cancel the policy or raise the premiums.⁹⁰ In addition, most individual policies have features that allow benefits to keep pace with inflation or gradual salary increases by adding a percentage to the coverage each year.⁹¹ Individual LTD plans are expensive. In 2003, the average annual premium for a non-cancelable policy was \$1336.⁹²

II. Problems with California’s Current Partial-Wage Replacement System Include Administration, Policy Limits, Cost, and Availability

California’s current wage-replacement system is fraught with many problems including: (1) administrative problems and cost overruns, (2) insufficient benefit payment amounts, and (3) the requirement that many are forced to pay for a benefit they will never use. The current private insurance system forces those who must purchase individual disability insurance to pay high premiums and be subjected to greater scrutiny for coverage than those individuals who have plans through their employers.

86. See Am. Council of Life Insurers, Policy Cost, <http://www.acli.com/ACLI/Consumer/Disability+Income/NM12-02+Disabiliby+Income+Insurance%3a+Policy+Cost.htm> (last visited Feb. 5, 2005) [hereinafter Policy Cost].

87. *Id.*

88. See *id.*

89. *Id.*

90. Basics of Long Term Disability Insurance, *supra* note 11.

91. *Id.*

92. JHA, INC., 2003 U.S. INDIVIDUAL DISABILITY MARKET SURVEY 3 (2003), available at http://www.jhaweb.com/central/datastore/studies/id_mrk_survey_2003.pdf (last visited Feb. 5, 2005) [hereinafter 2003 MARKET SURVEY].

A. California State Disability Insurance

1. Costs and Administrative Problems Run Rampant

The SDI program has received more than its share of negative press.⁹³ In 1999, there was concern that the SDI fund would be \$279 million in debt by the end of that year and insolvent by August 2000.⁹⁴ Former Governor Gray Davis raised SDI rates by 80% from 2000 to ward off insolvency.⁹⁵ More recently, it was reported that in 1999 and 2000 SDI overpaid between \$124 million and \$200 million in benefits to workers who may not have been disabled.⁹⁶ In addition to the overpayment of undeserving claimants, \$191 million in claims were denied or delayed to truly disabled claimants because of paperwork errors.⁹⁷ This is not surprising considering that the percentage of paperwork mistakes made by SDI employees was 39% in 2001⁹⁸ and 27.5% in 2002.⁹⁹ In addition to mistakes made by SDI processors, SDI consistently quarrels with the Workers' Compensation program over erroneous payments.¹⁰⁰ California workers often try to manipulate the system by filing both SDI and workers' compensation claims for an injury suffered at work.¹⁰¹ This is because SDI pays more quickly than Workers' Compensation so the employee is not without income for as long.¹⁰² The Workers' Compensation program is required to reimburse SDI for these payments, but it can be a slow process.¹⁰³ The SDI program routinely wastes money because of these inefficiencies.¹⁰⁴

Even though the SDI program is theoretically self-supporting, the State instituted a hiring freeze in 2002 in anticipation of layoffs due to State budget cuts.¹⁰⁵ Because SDI is a self-supporting program, the freeze was instituted so that unfilled positions would be available to

93. See Robert Sallady, *Davis' Fix-It Man Is Back for More*, S.F. CHRON., Feb. 13, 2003, at A1; Robert Sallady, *Chief of State Disability Program Quits Under Fire, Takes New Post*, S.F. CHRON., Feb. 5, 2003, at A1; Dan Morian, *Tax Foe Davis Quietly Oks New Payroll Bite*, L.A. TIMES, Dec. 14, 1999, at A1.

94. Morian, *supra* note 93, at A1.

95. See *id.*; see also Jake Henshaw, *State Hikes Disability Rate*, DESERT SUN (Palm Springs), Apr. 1, 2000, at 1A.

96. See *Disability Plan Loses Millions*, *supra* note 5, at A1.

97. *Id.*

98. *Id.*

99. *SDI Program Seeks to Slow Torrent of Overpayments*, CAL. WORKER'S COMP. ADVISOR, Feb. 26, 2003.

100. *Disability Plan Loses Millions*, *supra* note 5, at A1.

101. See *id.*

102. *Id.*

103. *Id.*

104. *Id.*

105. *SDI Program Seeks to Slow Torrent of Overpayments*, *supra* note 99.

some of the workers affected by the layoffs.¹⁰⁶ The hiring freeze made it difficult for workers to properly check the validity of claims as the department had almost 15% fewer staff than normal.¹⁰⁷ During this time, over 17% of claims resulted in potential overpayments.¹⁰⁸

Moreover, administrative costs for the SDI program are high. For the 2004–2005 fiscal year, California allocated \$6.9 million of its budget for the operation costs of the SDI program.¹⁰⁹ Even though the program is self-supported, nearly \$7 million is still too much to pay for a program with such a high rate of administrative problems and overpayments. It is clear that the administration of this program is ineffective and costly to the taxpayers who are funding it. If an ordinary business had a 39% error rate, it is likely that it would soon be shutting its doors. That the SDI program has remained afloat is incredible. Nevertheless, simply not sinking due to administrative problems is not enough. California workers deserve to have their earnings go towards a program that is beneficial to them and in which they can have confidence that their contributions are not wasted by ineffective administration or payment to undeserving claimants.

2. The SDI Benefit Is Insufficient for Many California Workers

As previously mentioned, SDI payments are capped at certain levels. This means that workers above a certain income level will be inadequately compensated if they are injured on the job.

Consider Sam, the earlier example of an injured worker. Sam earns \$75,000 per year; his weekly income is \$1442. Based on his income level, if Sam is injured he will collect up to \$799 per week from SDI.¹¹⁰ This is \$643 less per week than he made while working. Although at first glance \$643 per week may seem insignificant, over the period of Sam's five-month injury, Sam will lose out on \$12,860 in earnings. This loss of earnings could significantly impact Sam's ability to pay his mortgage and other bills, and he could quickly sink into debt. If Sam's injury lasts more than twelve months, his situation worsens. He will not receive any payment after twelve months from SDI.

106. *Id.*

107. *Id.*

108. *Id.*

109. STATE OF CAL., OFFICE OF THE GOVERNOR, GOVERNOR'S BUDGET 2004–2005 LWD 4 (2004), available at <http://www.documents.dgs.ca.gov/osp/GovernorsBudget05/pdf/lwd.pdf> (last visited Oct. 25, 2005).

110. SDI WEEKLY BENEFIT AMOUNTS, *supra* note 8, at 1.

The problem becomes even clearer as a worker's wages increase. Lucy, another hypothetical worker, earns \$100,000 per year or \$1923 per week. Based on her income, if Lucy is injured her SDI payments would be \$840 per week.¹¹¹ This amount will be \$1083 less per week than she normally earns. If injured for a period of five months, Lucy would suffer an earnings deficit of \$21,661.

The earning discrepancy does not only affect high-income workers. Low-income workers are also affected. For example, if Greg earns \$30,000 per year, then his weekly income is \$576. If Greg is injured, he can collect up to \$319 per week from SDI.¹¹² This results in a \$257 wage discrepancy per week; the discrepancy over a period of five months would be \$5158, a significant income loss for someone at Greg's earning level.

Clearly, SDI does not sufficiently compensate for the lost wages of those who are injured off-the-job. For the many workers who live paycheck to paycheck, reliance on SDI would cause serious financial hardship. In addition, the durational limit of SDI could have serious financial consequences for someone who is unable to work for more than one year.

3. SDI "Taxes" Workers for a Benefit Most Will Never Use

SDI is a mandatory program that is funded through employee payroll deductions or "taxes."¹¹³ Nevertheless, "[a]ccording to the U.S. Census Bureau, [an individual has] a one in five chance of becoming disabled."¹¹⁴ This means that approximately 80% of California workers will never be disabled and are forced to pay for a benefit they will never use.

In 2004, 744,542 SDI claims were filed¹¹⁵ compared to the 12 million employees who fund the program.¹¹⁶ That means that even if all of the SDI claims filed came from different workers, fewer than 7% of the individuals contributing to SDI actually received the benefit this year. Put another way, 93% of California workers were forced to pay for a benefit they did not use. Although the basic premise of private

111. *Id.*

112. *Id.*

113. Disability Insurance, *supra* note 31; *see also* Morian, *supra* note 93; Cal. Employment Dev. Dep't., Quick Statistics, *available at* <http://www.edd.ca.gov/eddquickstats.asp> (last visited Feb. 7, 2005) [hereinafter Quick Statistics] (referring to disability insurance as "Payroll Taxes Collected").

114. Basics of Long Term Disability Insurance, *supra* note 11.

115. Quick Statistics, *supra* note 113.

116. About the DI Program, *supra* note 10.

insurance is that many pay for a benefit they will never use, SDI is problematic because workers do not have a choice regarding payment for coverage or coverage level.

As previously mentioned, California employees contribute 1% of their income to SDI, up to \$857.71 per year.¹¹⁷ At this rate, if Sam works for thirty years, he will have contributed more than \$25,000 to SDI. If Sam is never disabled, he will have contributed a hefty sum to support others' lost wages without receiving any personal benefit. Sam has no choice as to whether he wants SDI protection, or at what level.

Because Sam has no choice as to whether he wants to contribute to SDI, California has levied a "tax" against him and other employees. It is unlikely, however, that many of those paying this tax will ever take advantage of it. The system forces the majority to pay for disabilities suffered by a minority of workers. In addition, it costs workers a large amount of income when looked at in terms of the span of one's career.

SDI has proven to be a program that is riddled with administrative problems, that does not provide sufficient benefits to workers who suffer off-the-job injuries, and that forces many to pay for a benefit they might not want or ever use.

B. Private Disability Insurance

Private insurance gives employees a choice as to whether or not they want to participate in a plan, but it is not without flaws. Individual plans are expensive and force subscribers to go through a myriad of steps in order to be insured. Individuals seeking STD have a difficult time even finding possibilities for coverage.¹¹⁸ While individual STD policies may be available, they offer limited coverage and are expensive.¹¹⁹

As previously mentioned, individual insurance can cost more than group plans offered by employers.¹²⁰ It is estimated that the average individual premium can cost five to ten times more than a group policy.¹²¹ For instance, the average group LTD costs \$180,¹²² while the average individual LTD plan costs \$1336.¹²³ Thus, it is much better for

117. Tax Rates and Withholding Schedules, *supra* note 32.

118. Basics of Short Term Disability Insurance, *supra* note 11.

119. *Id.*

120. See Lang, *supra* note 77, at E02.

121. Basics of Long Term Disability Insurance, *supra* note 11.

122. *Id.*

123. 2003 MARKET SURVEY, *supra* note 92, at 3.

employees to enroll in employer-offered group plans than to seek individual coverage.

Although group plans can be less flexible in terms of tailoring to the individual's needs,¹²⁴ they do not usually require medical examinations for subscribers and are guaranteed-issue, meaning an insurer will often provide coverage for an employee, regardless of the employee's health.¹²⁵ Individual plans pay close attention to age, current health status, gender, and other traits that may make it more difficult for a subscriber to receive coverage.¹²⁶

III. Eliminating SDI and Mandating that Employers Offer Private Insurance Is the Solution

To provide sufficient benefits to California workers who suffer from off-the-job injuries, California must make major changes to its system. Eliminating SDI and mandating that employers offer private insurance will help to ensure that workers have sufficient wage replacement benefits and that they are not paying for a benefit they do not want or will never use. In addition, it will save the State money without imposing extra costs on employers.

Every worker needs wage replacement in case she suffers an off-the-job injury and is unable to work because a person's ability to earn a living is her most important asset.¹²⁷ However, individuals will find that purchasing disability insurance on their own is incredibly expensive. In addition, requirements, such as medical exams, may make it difficult for some to qualify for disability insurance.

California must pass a law mandating that employers who currently qualify under SDI offer private group disability insurance. This does not mean that they must pay for any part of the insurance premium, just that they make private insurance available to their employees. This program will benefit the State, employees, and employers.

A. Benefit to California

Mandating private insurance eliminates an inefficient bureaucracy from the State's budget. Unlike the problem-riddled SDI program, monitoring and enforcement costs for a private disability mandate will be minimal as employees have an incentive to monitor

124. See Lang, *supra* note 77, at E02.

125. See Basics of Long Term Disability Insurance, *supra* note 11.

126. Policy Cost, *supra* note 86.

127. Silverman, *supra* note 3, at F-4.

their employers and report to the State if they are not in compliance with the law. The California Department of Insurance (“CDI”) can easily fold monitoring and enforcement into their current program. Currently, the CDI “licenses and regulates the rates and practices of insurance companies, agents, and brokers in California.”¹²⁸ The CDI is already regulating and overseeing those companies who would offer private insurance in areas such as medical and life insurance. The CDI Commissioner is responsible for regulatory enforcement, consumer protection, and licensing.¹²⁹ In addition, the Commissioner also responds to consumer complaints by investigating and prosecuting companies accused of Insurance Code violations.¹³⁰ Monitoring the private disability program would be an easy and cost-effective task for the CDI, particularly since employees have an incentive to self-monitor, leaving only enforcement as a real task under this mandate.

Mandating that employers offer private insurance will put California ahead of other states that do not offer supplemental disability programs. Those states typically do not offer any type of benefit to employees who become injured off-the-job. Instead, these states simply inform workers how to get private disability insurance or how to file a claim under the federal Social Security Disability program.¹³¹ States that only inform employees of how to purchase individual private insurance or file a federal claim are doing employees a disservice for two reasons. First, as previously mentioned, individual disability plan rates are expensive. Second, an employee must be completely disabled for at least five months to qualify for federal benefits.¹³² By mandating that employers offer private group insurance, California will be ensuring that all employees have an opportunity to take advantage of group rates and have access to coverage as soon as they are disabled. Thus, Californians will be ahead of citizens in other states

128. Cal. Dep’t of Ins., About Us, <http://www.insurance.ca.gov/0500-about-us/0100-cdi-introduction/> (last visited Jan. 17, 2006).

129. *Id.*

130. *Id.*

131. See N.C. DEP’T OF INS., A CONSUMER GUIDE TO DISABILITY INSURANCE 3–5 (2002), available at <http://www.ncdoi.com/consumer/publications/health%20insurance%20and%20managed%20care/a%20consumer%20guide%20to%20disability%20insurance.pdf> (last visited Oct. 20, 2005) (explaining private disability insurance to consumers); Mont. Dep’t of Pub. Health & Human Servs., Disability Serv. Div., Disability Determination Services, available at <http://www.dphhs.mt.gov/dsd/dds/index.shtml> (last visited Jan. 22, 2006) (explaining that the department works with the social security administration to file claims); Ill. Dep’t of Employment Sec., Employment Services, <http://www.ides.state.il.us/program/employer.asp> (last visited Oct. 20, 2005) (referring employees to the Social Security Administration for disability benefit information).

132. See Rollings, *supra* note 16.

who are merely provided information without any state support behind the information.

Mandating that employers offer private insurance will also benefit the State. Because this program does not require employers to incur costs, there is no incentive for non-compliance. Employers only have to offer private insurance—they do not have to supplement the costs. Because employers already have benefit programs in place, they can roll private disability insurance into their existing health and welfare offerings. Administration costs will be practically non-existent. Mandating private insurance allows California to eliminate the costly, problematic SDI program that has been an administrative embarrassment.

B. Benefit to Employees

Employer-sponsored group plans are much less costly to employees than individual plans and do not require subscribers to go through the lengthier process required of individual subscribers.¹³³

Requiring employers to offer private insurance will benefit employees economically. In 2005, the mean wage in California was \$42,940,¹³⁴ which means the average California employee pays \$429.40 per year for SDI.¹³⁵ As previously mentioned, group rates are substantially lower than individual rates for private insurance.¹³⁶ The average annual premium for a group LTD policy is \$180,¹³⁷ which is \$211 less per year than SDI. Employers can provide employees with large savings on private plan premiums simply by offering them.

One might be concerned that a sudden influx of companies seeking group insurance would cause rates to increase dramatically. However, the private disability market is already a well-established nationwide market. As such, the insurance market is a competitive one, and providers will be competing for the business opportunities that will result from this state action. This competition will benefit private consumers, who can take advantage of lower prices as a result of price wars aimed at outbidding the competition.

133. Basics of Long Term Disability Insurance, *supra* note 11.

134. Cal. Employment Dev. Dep't, Occupational Employment Survey Results, *available at* [http://www.calmis.ca.gov/file/occup\\$/oeswages/Cal\\$oes.xls](http://www.calmis.ca.gov/file/occup$/oeswages/Cal$oes.xls) (last visited Feb. 8, 2005).

135. This figure is based on the required 1.08% payroll deduction minus the .08% that funds Paid Family Leave. *See* Tax Rates and Withholding Schedules, *supra* note 32.

136. *See* Basics of Long Term Disability Insurance, *supra* note 11; *see also* 2003 MARKET SURVEY, *supra* note 92, at 3.

137. Basics of Long Term Disability Insurance, *supra* note 11.

Currently, the voluntary disability market is experiencing a boom and showing major growth in the employee benefit market.¹³⁸ Because benefit costs for employer-sponsored programs are increasing due in part to an aging workforce of baby boomers, many employers are offering voluntary plans, including LTD and STD.¹³⁹ This push into the market means that plans are now available to workers at all levels of the income spectrum.¹⁴⁰ One insurance industry commentator stated, "Benefit-wise it is a good deal for the typical low or mid-level employee who could never afford coverage as an individual."¹⁴¹

Besides cost savings, an additional economic benefit of mandating that employers offer private disability insurance is the absence of payment and duration caps.¹⁴² Policy subscribers can elect to receive 50% to 66 2/3% of their salary until age 65,¹⁴³ while SDI payments cap at a certain income level and only pay for one year.¹⁴⁴ Returning to the hypothetical example of Sam who makes \$75,000 per year, if he is injured for five months and purchased private insurance at the 66 2/3% payment level, he will receive \$961 per week. This is \$162 more per week than he would have received from SDI (\$3240 more over the course of his injury). In addition, if Sam's injury lasts seventeen months, he will still have wage replacement for the final five months of his injury. His SDI coverage would have ended after twelve months.

With regard to our other hypothetical worker Lucy, who makes \$100,000 per year, if she is injured but bought private insurance at the 66 2/3% payout rate, she will receive \$1282 per week in benefits. This is \$440 more per week than she would have received from SDI; her payment from private insurance over five months of injury would be \$8840 more than she would have received under the current State plan.

138. Neal Lucchi, *Boom Time for Voluntary Benefits: For Employees, Voluntary Benefits Are a Matter of Economics. For Employees, It's a Matter of Priorities*, RISK & INS., Apr. 1, 2004, available at http://www.findarticles.com/p/articles/mi_m0BJK/is_4_15/ai_115345937 (last visited Oct. 10, 2005).

139. *See id.*

140. *See* Molly Butler Hart, *Aging of Aquarius: Death-Defying Boomers Expand the Market for Group Disability Benefits*, LEADER'S EDGE, July/Aug. 2004, available at http://www.ciab.com/TemplateMagazine.cfm?Section=Editorial&MagazineTimeFrame_ICID=113&MagazineYear_ICID=108 (last visited Oct. 20, 2005).

141. *Id.*

142. Basics of Long Term Disability Insurance, *supra* note 11.

143. *See id.*

144. SDI WEEKLY BENEFIT AMOUNTS, *supra* note 8, at 1; About the DI Program, *supra* note 10.

Greg, who makes \$35,000 per year, also benefits from private insurance even as a lower-wage earner. If he purchased insurance at the 66 2/3% payout rate, he will receive \$384 per week. This is \$65 more per week than the SDI payout, or \$1300 over five months. Again, if either Greg or Lucy suffers an injury lasting more than twelve months, they also benefit because coverage does not end after twelve months.

In addition to economic benefits, group plans provide more flexibility to employees than SDI. Employees can decide whether to pay for coverage and if so, at what level.¹⁴⁵ Under SDI, employees are taxed and have no choice with regards to participation by contribution, while under the private insurance model employees may decide for themselves whether this is a benefit worth purchasing. Some may choose to purchase it while others may choose to rely on other sources of income, such as savings or stock ownership. Employees can also tailor their plans in terms of the amount of coverage they would like or what premium they want to pay. More coverage means higher premiums.¹⁴⁶ Plan selection also offers employees more options under private insurance. For example, if Sam's company has a comprehensive sick-leave program that allows him to accrue up to six weeks of sick-leave, he may decide he does not need STD and may elect to purchase only LTD.

The flexibility that mandated private insurance gives to employees in terms of choice of coverage level, premium, length of coverage, and whether to purchase coverage at all are benefits that SDI does not offer. Employees should be able to choose what type of insurance, if any, their wages can pay for based on their financial needs. In addition, a private disability insurance system is economically efficient.¹⁴⁷ For those who do purchase it, the wealth is distributed from healthy policyholders to disabled ones.¹⁴⁸ Private insurance accommodates individual workers in a way that SDI cannot.

Forty-five states do not offer state-sponsored disability insurance, leaving employees to rely on private disability insurance.¹⁴⁹ The workers in these states have not suffered because of a lack of disability insurance. Economies have not collapsed because employees must rely on private insurance. The same will be true in California—workers

145. See Basics of Long Term Disability Insurance, *supra* note 11.

146. See *Employers Benefit in Productivity by Offering Disability Coverage*, *supra* note 53, at A7.

147. Robert E. Wright, *How Government Disables Private Disability Insurance*, FREEMAN: IDEAS ON LIBERTY, Feb. 2003, at 25.

148. *Id.*

149. See About the DI Program, *supra* note 10.

will still have protection if they suffer an off-the-job injury that affects their ability to work, however, that protection will now be more comprehensive and flexible than the protection provided by SDI.

C. Benefit to Employers

Employers can offer private disability plans without incurring any cost.¹⁵⁰ As previously mentioned, 87% of employers nationwide offer group long term disability benefits and 79% offer short term benefits.¹⁵¹ While the average number of employers offering group coverage is likely less in California, there are still employers who are currently offering these programs.¹⁵² A mandate eliminating SDI and requiring employers to offer private group insurance does not affect those employers already offering plans to their employees, rather it mirrors their approach. In fact, their payroll administration costs may decrease because SDI deductions are no longer required. Requiring this program will not force California businesses currently not offering disability insurance to incur great cost as they can roll it into their existing benefits administration. Voluntary programs are easy for employers to administer.¹⁵³ Most companies surveyed described the ongoing administration of voluntary plans as “minor” or “a wash” compared with the value of the programs.¹⁵⁴

Although supplementing the premium cost would not be required, it is likely that many businesses would choose to do so as a recruiting and retention tool. If all companies are required to offer such programs, some might choose to gain a competitive edge in terms of attracting candidates and retaining employees by supplementing some of the employee costs of those programs. Indeed, 56% of employers who currently supplement premium costs acknowledge doing so to attract and retain employees.¹⁵⁵

Both employers and employees also benefit from incentives to return workers to their jobs, even if on a part-time basis. If a disabled employee returns to work in some capacity, employers commonly re-

150. *Employers Benefit in Productivity by Offering Disability Coverage*, *supra* note 53.

151. EBN/JHA SURVEY RESULTS, *supra* note 60, at 4.

152. See generally Pac. Gas & Elec., Pay, Benefits and More, http://www.pge.com/careers/pay_benefits_more/index.html (last visited Apr. 10, 2005); McKesson Corp., Benefits, <http://www.mckesson.com/benefits.html> (last visited Apr. 10, 2005); The Clorox Co. Benefits Summary, http://www.thecloroxcompany.com/careers/pdf/empl_benefit_111904final.pdf (last visited Apr. 10, 2005).

153. See Rollings, *supra* note 16.

154. *Id.*

155. EBN/JHA SURVEY RESULTS, *supra* note 60, at 4.

ceive group premium reductions from carriers.¹⁵⁶ These reductions are then passed on to employees. The worker has an incentive to return to work in the form of a premium reduction. The employer benefits because it does not have to replace injured workers for as long with replacement workers who might be less skilled or less efficient at the job.

One may be concerned that small and mid-sized employers would not be in a position to offer private benefits, but these concerns are unfounded. The voluntary market allows these companies to provide benefit programs that are more attractive to employees, helping them compete with larger companies in terms of recruiting.¹⁵⁷ Small employers who do not currently offer voluntary plans cite cost and low risk of disability to their workforce as reasons for not doing so.¹⁵⁸ As previously mentioned, however, these plans do not need to cost employers anything out of pocket so the cost concern is easily addressed. In addition, education will show employers that the risk of disability to their workers is high. Mandating private insurance will require employers to become educated about the risk their employees have of an injury as well as the fact that these programs need not be costly at all.

When employers offer private disability insurance employees win in terms of cost savings, flexibility, and ease of receiving coverage. In addition, the program saves California money and gives employers additional recruitment and retention mechanisms as well as incentive for employees to return to their jobs.

Conclusion

California's current partial-wage replacement system is insufficient, administratively challenged, and imposes a tax on many who will never reap the benefits of their contribution. Eliminating SDI and mandating that employers offer private insurance will benefit California employees and the State in general. This is a step that the State must take in order to provide its valuable work force with the benefits necessary to survive an off-the-job injury.

With one of the world's largest economies, California is incredibly dependent on its workers. The State needs to take action to pro-

156. Basics of Long Term Disability Insurance, *supra* note 11.

157. See Rollings, *supra* note 16.

158. AM. COUNCIL OF LIFE INSURERS, DISABILITY INCOME INSURANCE: PENETRATING THE SMALL-EMPLOYER MARKET 13 (2002), available at <http://www.acli.com/NR/rdonlyres/eb6r5gritaexavzsv6s46svzafokltsg45yxvqyapnug65jvq6mke3jkasq2xt5cbuz3lyoqwqshp/DI+Research.pdf> (last visited Oct. 20, 2005).

tect these workers in a manner that is cost-effective and that provides sufficient benefits if they suffer an off-the-job injury. Mandating that the SDI program is eliminated and that employees offer private insurance is a cost-effective, comprehensive solution.