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Date: August 31, 2021

To: Milwaukee County Board of Supervisors
Milwaukee County Executive, David Crowley

From: Corporation Counsel Margaret C. Daun
Assistant Corporation Counsel Judd H. Tabak
Outside Counsel, Reinhart Boerner Van Deuren, Jessica F. Culotti

Re: Pension Ordinance amendments to complete VCP compliance

BACKGROUND

- ERS is a tax-qualified retirement plan under the Internal Revenue Code ("Code"). To maintain its tax-qualified status, ERS must comply with Code requirements applicable to governmental plans, including administration in accordance with the Plan document, which consists of Milwaukee County Ordinance section 201.24 and the Pension Board Rules in Appendix B.

- As discussed with the County Board previously on various occasions [file 20-604, file 19-937], in 2014, Retirement Plan Services ("RPS") discovered that some provisions of ERS were not being administered in accordance with the Ordinances and Pension Board Rules, which resulted in operational errors.

  - These operational errors included both overpayments, where members and beneficiaries received more than they were entitled to receive, and underpayments, where members and beneficiaries received less than they were entitled to receive.

  - The Internal Revenue Service ("IRS") requires a tax-qualified plan to correct identified errors o maintain the plan's tax-qualified status.

- To correct the errors, ERS filed a Voluntary Correction Program ("VCP") submission with the IRS in 2014 and restated and added additional errors in 2017.[1] When a plan files a VCP

[1] ERS previously submitted a VCP to the IRS in 2007 to correct errors primarily related to the buy-ins and buy backs. The 2007 VCP was still pending with the IRS when the 2014 errors were identified. The IRS requested ERS file a separate VCP to correct the 2014 errors.

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submission, the plan discloses the identified errors to the IRS, and the IRS approves the plan's proposed correction methods.

- While corrections must be consistent with the IRS' correction program, under the Employee Plans Compliance Resolution System ("EPCRS")[2], employers have some discretion in determining how to correct plan errors. This is especially true for overpayment errors where the IRS requires that the plan be made whole for the overpayment (plus interest), but allows the employer discretion in determining how to make the plan whole through employer contributions, repayment of the overpayment from the recipient, or a combination.

- Given the options for correcting overpayments, in March 2019, while the VCP was pending with the IRS, the County Board adopted Ordinance amendments describing how ERS would correct overpayment and underpayment errors. Because the VCP was still pending with the IRS, the IRS had not yet approved ERS' proposed correction methods through the VCP process. This course of action was advised because the prior-submitted VCP was not approved by the IRS for nine years, and thus, to provide certainty for beneficiaries, employees, and taxpayers, the County moved forward with its planned corrections via the aforementioned Ordinance amendments.

    - The Ordinance amendments adopted by the County Board provide a framework to balance when the County would contribute a portion of the overpayment to ERS and when the recipient of the overpayment would repay the overpayment to ERS. The Ordinance includes two options for individuals who received overpayments:

        - Option 1 requires the recipient to repay the principal amount of the overpayment to ERS, while the County will pay the interest that has accrued on the overpayment. To avoid ongoing interest, the County will contribute in a lump sum to ERS in the amount of the overpayment plus interest, and the recipient will repay the principal to the County. If a recipient elects Option 1, the recipient waives his or her right to challenge the recalculated benefit and the overpayment.

        - Option 2 allows the recipient to challenge the recalculated benefit and the overpayment, but the County will not pay the interest on the overpayment to ERS. Accordingly, the recipient of the overpayment is responsible to repay the principal overpayment plus any interest to ERS once the challenge is finally adjudicated or a settlement is reached.

    - The adopted amendments also provide information related to interest rates for overpayment and underpayment corrections, claim periods and de minimis thresholds.

- In February 2020, the IRS issued a Compliance Statement to ERS resolving the errors reported on the VCP in 2014 and 2017. The Compliance Statement is based on EPCRS and

[2] *See* Revenue Procedure 2021-30 for the most recent version of EPCRS.

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the correction principles mandated by the IRS. Based on EPCRS, some of the IRS' approved correction methods were different than the correction methods included in the Ordinances adopted by the County Board in March 2019.

- In negotiating the VCP, the IRS reviewed the Ordinances and stated that the Ordinances should be carefully reviewed and updated to ensure compliance with EPCRS. Accordingly, these draft amendments reflect the changes required by the IRS to be in compliance with EPCRS.
    - In July 2021, the IRS issued a revised version of EPCRS. While most of the changes are not applicable to governmental plans such as ERS, there are a few changes that are helpful to the County and ERS members. Those changes are included in the draft amendments.
- The following provides an overview of the primary substantive changes included in the draft amendments.

ORDINANCE AMENDMENTS

- Amendments to Ordinance section 201.24(3.1)(1). Ordinance section 201.24(3.1)(1) describes how the County will make contributions to ERS for the portions of overpayments the County will contribute under Ordinance section 201.24(8.24).
    - *Subsection (b).* Subsection (b) provides that for overpayments, RPS will provide periodic reports to the Comptroller and Director of Administrative Services that detail the amounts the County will contribute to ERS for overpayments.
        - The draft amendments to subsection (b) include title changes and timing clarifications.
        - The draft amendments also clarify that the County will contribute any amounts owed under IRS requirements that cannot be recovered from the recipient of the overpayment. As noted above, the IRS requires a plan to be made whole for overpayments except in extraordinary circumstances not applicable here. Accordingly, if the plan cannot recover from the recipient of the overpayment, the plan sponsor must contribute the amounts.
    - *Subsection (c).* Subsection (c) of the Ordinance provides a procedure for the County to contribute the overpayment amounts to ERS, and for RPS to recover the principal amounts of the overpayments from recipients who elected Option 1.
        - As initially adopted, the Ordinance required RPS to collect the principal repayments from the individuals who elected Option 1 and use those amounts to reduce the County's ERS contributions on an annual basis.

    - The IRS did not agree to this procedure. When a recipient elects Option 1, the County contributes the full overpayment to ERS, including interest. Therefore, from the IRS' perspective, ERS has already been made whole for the overpayment.

    - As part of the VCP, the IRS determined that while RPS may, on behalf of the County, collect the principal overpayment amounts, RPS cannot use those amounts to reduce future contributions from the County. Instead, the IRS agreed that RPS could collect and hold the principal repayments in an account separate from other ERS accounts and periodically pay these amounts to the County. RPS stated that it would be administratively preferable to pay these collected amounts to the County on a monthly basis. The draft amendments reflect this procedure.

  - *Subsection (d).* The draft amendments to subsection (d) clarify that the amounts paid to ERS by individuals who elect or are placed into Option 2 are ERS Plan assets and will be paid to the ERS trust. The County does not contribute any portion of an overpayment for individuals who elect or are placed into Option 2. Instead, these individuals are required to pay the full overpayment, plus interest, to ERS.

- <u>Amendments to Ordinance section 201.24(8.24).</u>

  - *Subsection (2).* This subsection describes how ERS will correct underpayments. The IRS refused to allow a retirement plan to establish a claims limitations period for underpayments. Instead, the IRS requires full correction of any underpayment, subject to a de minimis exception equal to $75. Accordingly, the draft amendments to this subsection remove the claims period for underpayments.

  - *Subsection (3)(c).* This subsection describes the overpayment repayment options.

    - The draft amendments to subsection (3)(c)(i) clarify that if a member is repaying the principal amount of the overpayment under Option 1, the repayment must be paid post-tax. As explained above, because the County is making ERS whole under Option 1, the individual is simply repaying the County the principal amount of the overpayment, which the IRS determined cannot be taken pre-tax.

    - The draft amendments to subsection (3)(c)(ii) clarify that under Option 2, the member will be repaying the full amount of the overpayment, plus interest, and that interest will continue to accrue on the overpayment until it is paid in full.

  - *Subsection (3)(f).* For individuals who have received overpayments and are receiving future benefits from ERS, RPS may offset their future benefits to recover the overpayments under either Option 1 or Option 2. This subsection provides that the minimum offset amount will be the amount necessary for the individual to repay the overpayment plus applicable interest under Option 2 over 60 months..

  - The Ordinances adopted by the County Board in 2019 provided for an offset calculation based on the State of Wisconsin's overpayment repayment structure. In practice, it is an administrative burden for RPS to review the State's collection procedures each year and change RPS' collection procedures when the State's procedures change. Accordingly, the draft amendments reflect a consistent offset method to ensure administrative efficiency and accuracy.

- *Subsection (3)(h).* This subsection describes the monthly repayment options, including lump sum repayment and monthly repayments.

  - The draft amendments clarify the deadline for repayment of an overpayment in a lump sum.

  - The draft amendments also allow the Director of RPS to agree to voluntary repayment plans for individuals who are not receiving future benefits from ERS that can be offset to recover the overpayments.

- *Subsection (4).* For full correction of overpayments and underpayments, the IRS requires interest to be paid. This subsection of the Ordinance provides the interest rates to be charged for overpayments and underpayments.

  - EPCRS requires that underpayment amounts be increased to reflect interest at a rate equal to the plan's actuarial equivalence rate (currently 7.5% for ERS). The IRS required this rate for purposes of the VCP as well.

  - For overpayments, EPCRS provides plan sponsors some discretion in determining the interest rate to be charged as long as it is reasonable. ERS proposed an interest rate of 5% compounded annually for overpayments in the VCP. This was approved by the IRS.

  - The draft amendments reflect these interest rates.

- *Subsection (5).* The draft amendments to subsection 5 clarify the de minimis exceptions to full correction of overpayments and underpayments.

  - For overpayments, the County previously determined that it would not pursue overpayments that are less than $165. However, the IRS' newest version of EPCRS increased the de minimis amount for overpayments to $250. Accordingly, ERS is not required to correct any overpayments under $250. The draft amendments adjust this de minimis exception to match current EPCRS guidance.

  - For underpayments, the IRS will allow a retirement plan to forgo payment of a underpayment that is less than $75 if the plan determines that the costs of processing and delivering the distribution is less than amount of the distribution. The draft amendments reflect this IRS requirement.

- *Subsection (6).* This subsection includes a 6-year claim period within which any overpayment must be identified, and repayment initiated. Any overpayments that fall outside of this 6-year period cannot be recovered from the member and the County must contribute the amounts to ERS.
    - The draft amendments clarify that this claim period only applies to overpayments because as noted above, the IRS requires full payment of underpayments.
    - The draft amendments further clarify that the County will contribute any overpayments that are outside of the 6-year period.

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