



Milwaukee County
Department of Human Resources
INTER-OFFICE COMMUNICATION

Date: July 9, 2020

To: Marcelia Nicholson, Chairwoman, Milwaukee County Board of Supervisors

From: Erika Bronikowski, Director, Retirement Plan Services, Department of Human Resources.

Subject: Proposed Amendments to Correct Errors Reported on VCP

Background

On December 20, 2017 the Employees' Retirement System of Milwaukee County ("ERS") filed a Voluntary Correction Program ("VCP") with the IRS. VCPs are used to address pension calculation/administration inconsistencies and to correct language in pension Plan Documents with the authorization of the IRS. VCP submissions include a description of each type of error, the total affected population, and the proposed correction methodology. In December 2019, Retirement Plan Services ("RPS") brought forward to the Milwaukee County Board [File 19-937](#), that described, in detail, each of the error categories.

The current VCP was approved by the IRS on February 26, 2020 when a Compliance Statement was issued that provided authorization to proceed with the corrections. There are three types of corrections: Pension Board Rule revisions, Ordinance revisions, and benefit recalculations. All corrections are anticipated to be complete by December 31, 2020.

To date, the Pension Board has completed the necessary Rule changes and the Retirement Plan Services team ("RPS") is in the testing phase of developing an automated recalculation tool. As recalculations are completed, RPS will report status updates and anticipated costs to the County Board. Recalculations are anticipated to result primarily in underpayments owed to retirees.

Summary of Request

We are requesting that the County Board adopt the Ordinance changes necessary to correct five of the categories of errors on the VCP, as outlined below. Once the Ordinance changes listed below are made, the remaining errors will all be resolved through recalculations.

The enclosed Ordinance amendments have been reviewed by the IRS and approved through the VCP Compliance Statement for correction of these errors. The County Board must adopt these amendments to fully correct the errors reported on the VCP. A discussion of the consequences of not adopting IRS-approved Ordinance amendments is included at the end of this document as it relates to the tax-qualified status of the pension system.

RPS has worked with the Pension Board, Corporation Counsel, and external Counsel to the Pension Board and has consulted with the Comptroller's Office on these outlined pension changes to the Milwaukee County Code of General Ordinances.

Description of Proposed Ordinance Amendments

Section 1 of the Resolution – Ordinance sections 201.24(4.5) and (3.5) - Correction of Deferred Vested Benefit Errors. [ERROR L]

Background.

ERS members are eligible for monthly retirement benefits if they retire directly from County service (a “normal” retirement under Ordinance section 201.24 (4.1)) or, if vested, after termination of County employment (a “deferred vested” retirement under Ordinance section 201.24(4.5)).

- A member becomes a deferred vested member if they do not retire directly from County service and there is gap between termination of employment and retirement.

In order to be vested and eligible for a deferred vested benefit, Ordinance section 201.24(4.5) requires members to have earned sufficient service credit in ERS during their employment with the County. While some members may have to earn additional service credit, currently most ERS members have to earn 5 years of service to vest in their ERS pension benefit.

However, pursuant to Ordinance section 201.24(4.1), members who attain normal retirement age (usually age 60 or 64) while in active service are eligible for a normal pension benefit regardless of their years of service.

ERS has historically considered members who attain normal retirement age in active service to be eligible for benefits even if they have earned less than the required years of service. In other words, the members are automatically vested in their ERS benefits at the time they attain normal retirement age while in active service (“Autovested Members”).

- For example, if a member commences ERS employment at age 63 and terminates ERS employment at age 65. ERS would consider this member to be Autovested upon the attainment of age 64, which is the member’s normal retirement age.

Errors were created when RPS paid deferred vested benefits to these Autovested Members because Ordinance section 201.24(4.5) requires members to have attained a certain number of years of service credit to receive a deferred vested pension without an exception for the Autovested Members.

Additionally, if the Autovested Members are eligible for deferred vested benefits, then these members are eligible for the present receipt of a benefit. Under Ordinance section 201.24(3.5) if a member is eligible for the present receipt of a benefit, the member cannot receive a refund of contributions in the member’s Membership Account. However, some of these Autovested Members were allowed to receive refunds of contributions if their pension benefits were under \$100 per month.

Proposed Amendments.

Ordinance section 201.24(4.5). The proposed amendments to Ordinance section 201.24(4.5) add subsection (c) to allow members who “autovest” by attaining normal retirement age while in active service to be eligible for a deferred vested benefit.

- The proposed amendments allow members who previously commenced deferred vested benefits to retain those benefits.
- The proposed amendments also allow RPS to commence deferred vested benefits for the Autovested Members who, but for the vesting requirements in this section, would have been eligible for a benefit. However, this benefit will be prospective only to avoid creating errors under the Code's required start date rules (i.e., benefits must commence by the April 1 after a member attains age 70-1/2).

Ordinance section 201.24(3.5). The proposed amendments to the second sentence of the first paragraph of Ordinance section 201.24(3.5) clarify the prior treatment of Autovested Members by allowing a member whose pension benefit amount is below \$100 per month to elect to receive a refund of his or her contributions instead of receiving a monthly pension benefit. Autovested members who retire after June 1, 2020 may also make this election if the election is made in accordance with Ordinance section 201.24(3.11).

Effective Date. January 1, 2011, which is the beginning of the Plan Year in which the errors first occurred.

Section 1 of the Resolution - Ordinance section 201.24(3.5) – Refunds of Membership Accounts Upon Death. [ERROR Q]

Background.

Beginning in 2011, ERS members started making employee contributions to ERS. These contributions are held in a member's Membership Account. Ordinance section 201.24(3.5) currently provides that upon the death of an active member or a deferred vested member who is not receiving a benefit, the member's beneficiary will be paid, in a lump sum, the balance of the member's Membership Account upon the date of death.

Additionally, under Ordinance section 201.24(3.5), if the beneficiary is eligible for an annuity benefit due to the member's death, the beneficiary will receive that benefit. The Ordinance further provides that if the amount of the Membership Account at the date of a member's death exceeds the total of the amount of the annuity payments made to the beneficiary after all payments have been made, such excess shall be paid in a lump sum to the member's beneficiaries.

RPS has made payments to beneficiaries using interest payable through the date of distribution instead of the date of death, which resulted in overpayments.

Amendment.

The proposed amendments revise the first paragraph and the second paragraph of Ordinance section 201.24(3.5):

First, the proposed amendments revise the first and second paragraphs of the Ordinance to provide for interest to be paid on contributions in a member's Membership Account through the date of disbursement, not the date of the member's death or termination.

Second, the proposed amendments delete the last sentence of the second paragraph of the Ordinance to eliminate the requirement that RPS track annuity payments paid to beneficiaries in order to pay any excess of the Membership Account after the annuity payments are completed.

- It would be an administrative burden for RPS to track not only interest that would accrue on the Membership Account, but the amounts that are being paid to the beneficiary. This treatment is consistent with what is paid to members (i.e., members either receive a refund of contributions or an annuity benefit, not both).

Effective Date. January 1, 2011, which is the beginning of the Plan Year in which the errors first occurred.

Section 2 of the Resolution - Ordinance section 201.24(5.16) – Election of Back drop by Beneficiaries. [ERROR B]

Background.

A member who remains in County employment past his or her retirement date may elect to receive a back drop form of benefit when the member actually retires from County employment. Pursuant to Rule 711, only active members may elect to receive a back drop.

Additionally, members who remain in County employment past their retirement dates may elect a Protective Survivorship Option (“PSO”) under Ordinance section 201.24(7.1). In this election, the member may designate a single beneficiary to receive a survivor benefit if the member dies while in active service and before the member retires. This PSO is automatically paid to a married member’s spouse who dies in active service after the member’s retirement date even if no PSO election is made.

Errors occurred when some members’ spouses who were entitled to PSOs were allowed to elect back drops after the members’ deaths.

Proposed Amendments.

The proposed amendments to Ordinance section 201.24(5.16) correct the errors described above by retroactively allowing a surviving spouse who was eligible for and receiving a PSO to elect a back drop if the back drop was elected by the surviving spouse between January 1, 2002 and December 31, 2004.

The proposed amendments will only correct errors for surviving spouses that were eligible for and receiving the PSO benefit. If an individual received a PSO benefit in error, this amendment will not correct that election of a back drop. Further, this amendment only corrects past errors, it does not allow future surviving spouses to elect a back drop at the time they receive a PSO.

Effective Date. January 1, 2002, which is the beginning of the Plan Year in which the errors first occurred.

Section 3 of the Resolution - Ordinance section 201.24(7.1) – Minimum Distribution Incidental Benefit. [ERROR U]

Background.

Under the Code and corresponding Regulations, distribution options that are in the form of a joint and survivor annuity for the joint lives of a member and a non-spouse beneficiary must meet the minimum distribution incidental benefit (“MDIB”) requirement.

For ERS purposes, this requirement is applicable to retirements with optional forms of benefit under Ordinance section 201.24(7.1)(1) and the PSO under Ordinance section 201.24(7.1)(3).

Errors occurred where a non-spouse beneficiary received an unreduced 100% joint and survivor benefit, which does not satisfy the MDIB requirements. Additional errors occurred when RPS only reduced two survivor annuities to the minimum amounts necessary to satisfy the MDIB requirements (e.g., 73%), but these annuities are not provided for under the Plan.

Proposed Amendments.

The proposed amendments to Ordinance section 201.24(7.1) add to subsection (3) that an eligible member may elect a PSO in the form of a 50% joint and survivor annuity, which may be required if a member elects a non-spouse PSO beneficiary that would violate the MDIB rules if the benefit was paid in a 100% joint and survivor annuity.

The proposed amendments also add a new subsection (5) that expressly prohibits a member from electing a joint and survivor annuity that will exceed the Code's minimum distribution incidental benefit. The proposed amendments further provide that if a member elects a form that does not comply with the Code's requirements, RPS will reduce the elected benefit to the next survivor benefit option the member was eligible to elect.

- As an example, the Ordinance allows a member at retirement to elect a joint and survivor annuity in the amounts of 100%, 75%, 50% and 25%. If a member elects a 75% joint and survivor annuity with a non-spouse beneficiary and this form of benefit would violate the Code's requirements, RPS may reject the member's election and only allow that member to elect a 50% or 25% survivor annuity, which does not violate the Code.

Effective Date. January 1, 2007, which is the beginning of the Plan Year in which the errors first occurred

Section 4 of the resolution, Ordinance section 201.24(11.11) – Correction to 2007 VCP. [ERROR T]

Background.

In 2007, ERS filed a VCP with the IRS. The primary errors reported on this VCP were with regard to the administration of the buy-ins and buy-backs. ERS no longer allows buy-ins or buy-backs.

Through a buy-back, a member who previously terminated County employment and took a distribution of his or her Membership Account was allowed to repurchase past service credit in ERS upon reemployment with the County. However, the Ordinances and Rules did not allow a member to purchase past service credit using a rollover from a member's prior employer's retirement plan. Despite this, in 1994, RPS allowed a member to repurchase past service credit using a rollover from the member's prior employer's 401(k) plan.

This error was reported as part of the 2007 VCP. Other errors on that VCP included the use of Milwaukee County 457 Plan funds to purchase or repurchase service credit. The 457 Plan errors were corrected by the County Board through Ordinance amendment in 2015.

The Compliance Statement for that VCP reported the correction method for the error caused by the 401(k) rollover was to rescind the member's repurchase of service credit and refund the money to the member. The member's benefit would then be calculated without regard to the repurchase of service credit.

This member has since asked the Pension Board and ERS to allow his repurchase of service credit because it is similar to the members who used 457 Plan funds to purchase or repurchase service credit. Because Ordinance section 201.24(11.11) provides for the sources from which a member could have purchased or re-purchased service credit, the Ordinances need to be amended to allow ERS to recognize this member's purchase of service credit.

Proposed Amendments.

The proposed amendments amend Ordinance section 201.24(11.11) retroactively to August 1, 1994 and allow a member to complete a buy-back using amounts rolled over from a 401(k) plan if the buy-back was completed between August 1, 1994 and November 1, 1994. This will correct the error that occurred when RPS allowed a member to use his former employer's 401(k) plan assets to repurchase service credit.

Effective Date. August 1, 1994, which is the month during which the error occurred.


Tax Qualified Status and Pension Systems

The Employees' Retirement System of the County of Milwaukee ("ERS") is a tax-qualified retirement plan under the Internal Revenue Code ("Code"). In order to maintain its tax-qualified status, ERS must comply with Code requirements applicable to government plans, including being administered in accordance with the plan document. For ERS, the Plan document consists of the Ordinances passed by the County Board (Ordinance section 201.24) and Rules enacted by the Pension Board (Appendix B of Ordinance section 201.24).

It is critically important for a plan like ERS to maintain its tax-qualified status, which entitles ERS and its members to favorable tax treatment. If the Internal Revenue Service ("IRS") "disqualifies" a plan for failing to comply with the Code, the plan loses this favorable tax treatment. Among other consequences of disqualification, employees realize taxable income and trust earnings are taxed. Additionally, Milwaukee County as Plan Sponsor may bear further administrative costs and face potential penalties and sanctions from the IRS.

The IRS requires tax-qualified plans to correct errors in order to maintain tax-qualified status.

As discussed above, ERS filed a Voluntary Correction Program ("VCP") submission with the IRS to correct the identified errors. Through the VCP process, a retirement plan discloses its errors to the IRS and proposes correction methods for the IRS's review. The IRS then approves of the corrections and issues a Compliance Statement that sets forth the corrections that a plan must make in order to close the VCP and maintain its tax-qualified status.



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