To: Theodore Lipscomb, Chairman, Milwaukee County Board of Supervisors
James Schmitt, Chairman, Finance & Audit Committee
Members, Milwaukee County Finance & Audit Committee

From: Timothy Coyne, Director, Retirement Plan Services

Date: August 30, 2018

Re: File 18-###: Summary of Cooperative Potential Pension Ordinance Amendment Package

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I. Background

a. VCP in 2014
b. New errors discovered in early 2017
c. Interim Director, focused on developing processes and procedures for routine tasks, including robust peer-checking of benefit calculations
d. Pension Board engages Baker Tilly for a 3-phased Agreed Upon Procedures Review (phase three completed in October 2017)
e. Plan Sponsor engages Funston Advisory Services to undertake governance audit and make governance recommendations
f. VCP filed December 2017 and is pending
g. Ongoing related, complicating litigation

II. Current State Challenges

a. Uncertainty dominates
    i. How will retirees be treated?
    ii. How will the trust be made whole?
    iii. What will the IRS do in response to the VCP?
    iv. How will taxpayers be treated?
    v. What will the courts require?
b. How does the County take responsibility for its administrative errors in a manner that is fair to ERS members and taxpayers?
c. Outcomes in hands of entities other than the County as plan sponsor/settlor – the IRS (first VCP took 7 years), the courts, and the Pension Board (and PB members must only look to fulfill their fiduciary duties in the interest of pension members and beneficiaries)
d. Outcomes and solutions may be many years away if left to outside entities.
e. Potential downside risks to the County and taxpayers increase markedly over time.
f. None of the entities that currently can fashion a solution are ideally positioned to represent the interests of taxpayers.

III. <u>Guiding Principles in Creating a Cooperative Solution</u>

a. Need common sense solutions to reduce uncertainty for all stakeholders – current retirees, current employees/future retirees, and taxpayers
b. Need fairness for current retirees, current employees/future retirees, and taxpayers
    i. Current Retirees – County needs to be accountable for its responsibility related to errors
    ii. Current Employees/Future Retirees – County must ensure that the trust is made whole
    iii. Taxpayers – Cannot be left with unlimited and unknown liability related to errors
c. Time is of the essence because costs to County and taxpayers are going up because of interest, and costs to retirees with overpayments also increase over time
d. RPS needs operational certainty

IV. <u>Concepts in Proposed Cooperative Solution</u>

a. Adopts best practices
    i. Cleans up definitions and allocation of responsibilities
    ii. Mandates start date of pensions (as well as benefit enhancements) as first of the month
    iii. Statute of limitations is now 6 years
    iv. Explicitly states interest rate as 5% simple for overpayments and underpayments
    v. Explicitly establishes a system for correction of overpayments and underpayments
b. New overpayment process:
    i. Mandates that County immediately make trust whole, so that the member/beneficiary no longer pays back the trust, but rather pays the County back.
    ii. Will use the pension stabilization fund as source for County's payments to trust related to overpayments.
    iii. Creates a mechanism where the County takes responsibility for the interest on an overpayment in exchange for the member accepting the corrected benefit amount. Under the agreement, while the County pays the interest amount, the member remains responsible for the repayment of the principle amount of the overpayment.
    iv. If the member does not want to enter into the agreement, they are responsible to repay the overpayment and interest, and may challenge the correction before the Pension Board and/or a court, as is the case now.
    v. RPS administers this new overpayment process and collects repayments on behalf of the County.

vi. Repayments to the County, collected and totaled by RPS, will then reduce the County's required funding contributions each year dollar for dollar. If the County's required funding contribution eventually becomes zero for any particular year, the repayments will go into the pension stabilization fund.
vii. Establishes objective factors to downwardly adjust repayment plans based on financial hardship.
viii. Permits members currently in repayment to take advantage of this new process for whatever overpayment balance remains (if this plan is adopted).
ix. Explicitly permits County to seek to recover funds if member dies in repayment, but does not mandate that action.

V. <u>How does Proposed Solution Fulfill Principles?</u>

a. Makes trust whole immediately
b. Reduces and may eliminate any threat to qualified status / risk of audit related to benefit calculation errors
c. May bring the VCP to a close more Enequickly
d. Provides an additional argument for the County to push for the IRS to accept 5% simple interest in the VCP
e. Corrections to known benefit calculation errors do not have to be delayed awaiting an interest rate decision by the IRS
f. Limits potential County/taxpayer exposures
g. Significant cost savings for retirees in repayment plans because those liabilities, under the new plan, will stop increasing further (due to interest rate uncertainty)
h. Additional significant cost savings for retirees in repayment plans because a lower interest rate will apply regardless of the interest rate ultimately approved by the IRS (County can dictate the rate, instead of the IRS, and so the rate will be lower, like 1%, instead of 5% simple or 8% compounding)
i. Will likely reduce the amount of litigation
j. Appeals by retirees related to repayment plans will be handled by the courts, which will ensure fairness and consistency in outcomes over time. Appeals by retirees related to benefit calculations will still be heard first by the Pension Board.
k. Adoption of best practices will significantly reduce benefit calculation errors in the future
l. Repayment determinations will consider financial hardships in a fair and consistent manner

Bottom line: If the County takes no action now, and leaves its fate to the IRS and the courts, the costs to the County and taxpayers – as well as the costs to current retirees with overpayments – could be significant. Moreover, the solutions fashioned by the courts or the IRS may be inequitable and/or unfair in balancing the interests of taxpayers, current retirees, and future retires. So, by acting now, as outlined in this plan, the County ensures a solution that fairly balances the interest of all stakeholders and creates certainty ***today***. The alternative is to wait for an unknown period of time, for an unknown solution from an outside entity, with unknown costs to all stakeholders.