



Milwaukee County
Department of Human Resources
INTER-OFFICE COMMUNICATION

Date: May 13, 2014
To: Marina Dimitrijevic, Chairwoman, Board of Supervisors
From: Kerry J. Mitchell, Chief Human Resources Officer
Mark Grady, Deputy Corporation Counsel
Subject: **Overview and Chronology of Buy In and Buy Back Programs**

The so-called “buyback” and “buy-in” programs both involve the purchase of service credit by an employee. However, they apply to different situations and are based on different legal provisions. In fact, confusion between the two types of purchases caused some of the errors in past administration.

This memo is intended to outline the history of the Buy In and Buy Back programs of the Employee Retirement System, explain the recent discovery of operational issues related to Buy In and Buy Back transactions, and review the information discovered to date regarding past transactions that may have been in violation of our pension plan document.

DESCRIPTION OF BUY IN

The ability for an employee to complete a “buy in” arose out of the eligibility for optional membership in ERS for some employees, typically temporary, seasonal or short-term employees. Since its creation in 1937 by the state legislature, the pension plan has authorized the Pension Board to determine which classes of employees are mandatorily members of ERS and which classes of employees should have an option to become members of ERS. Since 1942, rules of the Pension Board have given seasonal and other temporary employees an option to join ERS. It was anticipated that the option would be exercised at the beginning of the optional employment.

The first buy in of optional service was apparently granted by the Pension Board in 1988 in response to an employee’s argument that the County had failed to notify him at the start of his earlier service that he had an option to enroll in ERS. Presumably to avoid litigation over the issue, the Pension Board granted the employee’s request that he be allowed to exercise the option retroactively. As set forth below, the approval was thereafter granted on a case-by-case basis to employees who made requests and was later granted to all applicable employees. In 1996, ERS Rule 207 was adopted by the Pension Board to codify the ability for an optional

employee to retroactively exercise that option. However, effective 1/1/2007, the Pension Board amended the rule to prohibit any further retroactive exercises of the option to purchase service credit through a buy-in.

The rule, and the Pension Board authorization and practice prior to adoption of the rule, permitted employees to purchase service credit in ERS for periods of employment during which the employee had an option to enroll in ERS, but had not done so at the time. For example, the employee worked in a seasonal position and therefore had an option to enroll in ERS, but did not do so when he started his seasonal employment. At some later date, the employee became employed in a position that was covered by ERS. The employee then was allowed to choose to retroactively purchase the optional service credit for the time when the employee could have done so as a seasonal employee, but had not.

DESCRIPTION OF BUY BACK

The “buy back” program became part of ERS in 1953 through action of the state legislature which at that time controlled the terms of the ERS pension plan (the County was granted authority over the terms of ERS in 1965). This provision authorizing a buyback was codified in section 201.24(11.1) of the Ordinances governing ERS. The “buy back” program addresses a situation different from a “buy in.” It applied where an employee was a County employee who was a member of ERS and made contributions (until recently, only employees who were members of ERS before 1971 made contributions). When the employee left employment, he could choose to request and receive a refund of his contributions and surrender all pension rights in ERS. If and when the employee returned at some later date to County employment in an ERS-covered position, the employee could choose to restore service credit for that prior period of employment by paying back (or “buying back”) the previously-refunded contributions, with interest.

Thus, both types of purchases of service in ERS were authorized by the pension plan and the Pension Board. The errors that have been reported do not relate to the authorization for these purchases, but relate to the manner in which the retirement staff administered these purchases of service.

CHRONOLOGY

The following summarizes pertinent history related to the development of the buy in and buy back programs. As noted above and set forth below, the programs became confused with each other, although they dealt with different situations.

1953-1971

- July 31, 1953 – The **buy back** program originated when Chapter 201 of the Laws of 1937 was amended by the legislature to create section 5(6)(a)5 to allow members who terminated

County employment and then later returned to County employment to repurchase prior service credit, provided the member repaid the amount he or she withdrew from his or her account with interest from the date of withdrawal until the date of redeposit.

- 1969 – The **buy back** program was amended in Ordinance section 201.24(11.1) to require two years of service and payment of the withdrawn amount, plus interest, by December 31, 1971, to purchase prior service credit that had been withdrawn.
- 1971 - The **buy back** program was amended to require that the rehired member pay his or her withdrawn benefit and interest within two years of reemployment.

1988

- February 19, 1988 – Pension Board meeting minutes state that Thomas Smith requested to purchase service credit in ERS (through what is now called a "**buy in**") for time he worked as an optional employee on an emergency appointment. The Pension Board allowed Mr. Smith to join ERS for the period he was on emergency appointment if he paid 6% of his salary for that time period plus interest, at 5%. *This is the first documented authorization of a **buy in**.*
- February 19, 1988 – Pension Board meeting minutes indicate that the Pension Board denied the **buy back** of service credit where the member did not repay the owed amount within two years of reemployment. The member withdrew her funds in 1953. She subsequently became a member again in 1955. In 1971, the employee was advised to deposit the necessary funds, but she declined to do so. Sometime in 1987 or 1988, she requested to purchase her prior service. The Pension Board denied her request by a vote of four to three.

1989

- June 16, 1989 – According to meeting minutes, the Pension Board allowed a member to **buy back** prior service credit outside of the required two-year payment window. The member withdrew his contributions in 1962 and he became a member again in 1963. No individual notices were sent to notify rehired members of the opportunity to buy back service credit that they previously withdrew. The member appeared before the Pension Board and pled his case. The Pension Board allowed the member to redeposit the amounts withdrawn, or "buy back," his prior service credit with interest. The minutes note "[t]he Chairman indicated that this is not the first request before the Board and that it was within the Board's authority to grant his request." *This is the first documentation of the Pension Board allowing an employee to complete a buy back more than two years after reemployment. All of the buybacks that have been reported to the IRS with errors involve, among other things, employees being allowed to buy back their prior service more than two years after reemployment.*
- July 21, 1989 – The Pension Board again unanimously allowed a member to **buy back** service credit outside of the two-year window. At the meeting, the member asked if the Pension Board or ERS had any procedures to make sure rehired employees knew of the two year

requirement and the Secretary replied that a form letter was sent to rehired employees via certified mail.

1990

- April 19, 1990 – Pension Board meeting minutes indicate that the Pension Board reviewed the individualized request of a member who wanted to do a **buy in**. He said he was not aware that he could have joined ERS and he was not made an offer to join ERS when he was a seasonal laborer. The member requested that his membership date be retroactive to the date of his original employment. The Pension Board granted the member service credit and a retroactive ERS start date if he paid the contributions and accrued interest for the period of time during which he was unaware of his option to join ERS.
- September 21, 1990 – At this Pension Board meeting, the Chairman suggested that it was possible to develop a policy regarding the reinstatement of prior service, regarding general and similar cases that could be decided as a group. A special meeting was scheduled to discuss the issue.
- October 2, 1990 – Pension Board meeting minutes indicate that the Pension Board held a special meeting to discuss changing the interest rate it charged members who repurchase service credit through the **buy back** program.
- October 11, 1990 – Pension Board meeting minutes state that the Pension Board changed the interest rate for the **buy back** program, effective immediately, from 5% to the investment fund's actual rate of return.
- November 1, 1990 - Edward Marti and other rehired ERS members filed a lawsuit over ERS changing the **buy back** interest rate (the *Marti* lawsuit). The court held that the *Marti* plaintiffs were allowed to buy back their prior service credit at the 5% interest rate, due to insufficient notice to employees of the increased interest rate.

1991

- September 20, 1991 – The Pension Board discussed developing a notice to employees in order to implement the court decision and allow the changed interest rate to be applied to future **buy backs**.
- October 18, 1991 – Then-ERS Manager and Pension Board Secretary, Jac Amerell, reported on the status of the "buy back project." The Pension Board clarified the interest rate, waiting period and required payment dates for the specific group of employees entitled to participate in the buy back project.
- November 1, 1991 - The Retirement Office sent a memorandum to active employees discussing the time frame to purchase prior service credit at the 5% interest rate. However, rather than being limited to employees wishing to **buy back** previously forfeited service

credit, the memorandum contained the following language, which appeared to indicate that the memorandum was also addressed to employees who would desire to **buy in** time as an optional employee: "Current employees who...were never informed that they could pay their own annuity and become a member of the Retirement System." After December 31, 1991, the interest rate would be changed to the investment portfolio's actual rate of return. It is unknown whether, at the time the notice was sent, the Pension Board was aware of, knew of, or authorized this broader language applying the buy back case decision to employee buy ins.

- November 22, 1991 – Mr. Amerell reported that 156 requests for the **buy back** had been received and an additional one to two per day were being received. The minutes did not distinguish between buy backs and buy ins and, although the numbers reported included both types, all of them were referred to as buy backs.
- December 19, 1991 – The County Board created the OBRA pension system to cover employees who are not mandatory members of ERS, such as seasonals and temporary employees. Federal law had been adopted that required the County to either begin covering these employees as part of the social security system, with taxes, or create a pension system for them. It was effective January 8, 1992.
- December 20, 1991 – Mr. Amerell reported that the Retirement Office had received 197 requests (characterized as buy backs) and an additional one to two per day continued to be received.

1992

- January 17, 1992 – Mr. Amerell reported that 278 buy back requests had been received and that no exceptions would be made to the December 31, 1991 cutoff date for the application of the lower 5% interest rate.
- March 20, 1992, June 11, 1992 – Mr. Amerell reported that the buy back project was over 50% complete and that \$471,054.85 had already been billed to employees.
- October 16, 1992 – Mr. Amerell reported that ERS had received some requests to delay payment of the buy back amount. The Pension Board reaffirmed the requirement that payment be made 90 days after notice to make payment is received.

1993

- May 21, 1993 – The Pension Board reiterated the 12/31/91 cutoff date for the lower interest rate and stated it would only review unique appeals to abandon this general rule.

1994

- March 29, 1994 – The Retirement Office received a letter from an attorney representing two Milwaukee County employees who claimed not to have received the November 1, 1991 memorandum or been aware of the change in interest rate and the applicable deadline.

The two employees also claimed that the memorandum did not apply to what is now known as the **buy in** program and that the memorandum only applied to the **buy back** program. On August 5, 1994, Mr. Amerell informed the employees' attorney that the Pension Board had denied this appeal.

1995

- November and December 1995 meetings – Pension Board meeting minutes indicate that the Pension Board and its subcommittees discussed codifying the Retirement Office's *ad hoc* **buy in** program in a rule.

1996

- January 10, 1996 - The Pension Board Administrative Committee recommended approval of Rule 207 to codify the past practices and Pension Board decisions related to **buy ins**.
- January 24, 1996 – Pension Board unanimously adopted Rule 207. *A later review of Retirement Office files indicated that 149 buy in applications had been processed by this date.* The January 24, 1996 version of Rule 207 stated that the buy in payment be made in one lump sum and that the buy in be for all periods of prior optional employment (no partial purchases).
- September 25, 1996 - The Pension Board indicated it would discuss a proposal to eliminate the **buy in** option at a future meeting.
- October 9, 1996 - The Administrative Committee of the Pension Board discussed the possible discontinuance of **buy ins**.
- October 23, 1996 - The Pension Board unanimously approved a recommendation to terminate **buy ins** in five years. The Pension Board directed Mr. Amerell to notify the general membership of the pending elimination annually.

1997

- January 22, 1997 – The Pension Board approved Rule 404 to codify the interest rate used in a **buy back** calculation as the fund's actual rate of return.
- July 31, 1997 – The Pension Board submitted the ERS plan document, including Rule 207 related to buy ins, to the Internal Revenue Service ("IRS") for a determination letter regarding the tax qualified status of ERS.
- September 30, 1997 – The IRS issued a favorable determination letter affirming ERS's tax qualified status, including Rule 207.

1998

- June 10, 1998 – Pension Board meeting minutes indicate that the Pension Board agreed to accept the recommendations of its "buy back subcommittee," which included certain

members of the Pension Board. The subcommittee had recommended changes to the **buy in** program, including accounting for changes in the law and eliminating the termination date for the buy in program.

- September 23, 1998 – Pension Board unanimously accepted a revised Rule 207, effective October 1, 1998. Among other things, the revised Rule 207 allowed employees to make up to four equal annual installment payments, in addition to the lump sum payment option. The revised Rule also codified that for those employees who completed a **buy in**, continuous membership would be deemed to begin as of the first date of optional employment for which an employee bought credit.
- November 30, 1998 – The Pension Board again submitted the ERS plan, including revised Rule 207, to the IRS for a determination letter regarding the tax qualified status of ERS.
- Two ERS members raised issues regarding the interest rate used under the **buy back** program and claimed that ERS was accepting buy back (rather than buy in) payments in four annual installments.

1999

- March 18, 1999 - The IRS issued a favorable determination letter approving ERS's tax qualified status, including revised Rule 207.
- March 31, 1999 - The Pension Board approved an amended and restated Rule 207.

2000

- May 2, 2000 - Corporation Counsel provided a legal opinion that the applicable ERS membership date for employees who purchased prior service credit is the earlier, adjusted enrollment date, with the consequential side effects of the earlier enrollment date.
- November 2, 2000 – Pension benefit enhancements were adopted by County Board, effective 1/1/01.

2001

- January 1, 2001 – A review of Retirement Office files indicated that 209 **buy in** applications had been processed by the Retirement Office by this date.
- January 10, 2001 – The Pension Board submitted the ERS plan with the recent changes to the IRS for a determination letter regarding ERS's tax qualified status.
- July 23, 2001 – The IRS issued a favorable determination letter approving ERS's tax qualified status.

2002 - 2004

- December 11, 2002 - The Pension Board discussed suggested Ordinance amendments in closed session related to recently adopted federal tax law changes, known as “EGTRRA.”

2005

- July 20, 2005 - The Pension Board adopted an amendment to Rule 207 to provide that the buy in program would sunset, or terminate, on January 1, 2007, after which no buy in requests would be accepted. The Pension Board also approved a notice to be sent to employees.
- December 21, 2005 - Jack Hohrein, then ERS Manager and Pension Board Secretary, explained that the sunset notice had been sent out with the December 15 paychecks or deposit notices and that the notices had also been published in the Milwaukee Journal Sentinel and the Daily Reporter.

2006

- March 29, 2006 – County files lawsuit against Mercer for actuarial malpractice.
- July 19, 2006 – Mr. Hohrein reported that 150 **buy in** requests had been received since the notice was sent.

2007

- April 18, 2007 – The Pension Board submitted to the County Board proposed ordinance amendments reflecting changes required by the 2001 EGTRRA law. Item laid over.
- June 29, 2007 – ERS and the County filed a Voluntary Correction Plan (VCP) application with the IRS to self-report buy in and buy back operational violations.
- July 19, 2007 – The Pension Board submitted revised ordinance amendments to the County Board reflecting changes requested by the Personnel Committee of the County Board.
- July 20, 2007 – After receiving testimony, the Personnel Committee of the County Board amended the pending ordinance amendments and laid them over to the call of the committee chair and referred them to the Pension Study Commission.
- July 29, 2007 – Milwaukee Journal Sentinel article published regarding the buy in and buy back programs.
- August 9, 2007 – ERS and the County filed a supplemental VCP filing with the IRS regarding buy in and buy back operational violations.

- August 21, 2007 – ERS and the County filed supplemental VCP information with the IRS regarding buy in and buy back operational violations.
- September 18, 2007 – The Pension Board again submitted revised ordinance amendments to the County Board reflecting changes requested by the Personnel Committee of the County Board.
- September – November, 2007 – Pension Board explores use of outside investigators from Perkins Coie but plan is shelved pending resolution of the Mercer lawsuit negotiations or trial.
- September 27, 2007 – County Board takes no action on the proposed EGTRRA mandated ordinance amendments
- September 27, 2007 – County Board adopts a resolution (File 07-355) encouraging a review of past administrative practices, the termination of any prospective pension benefit that is determined to be in violation of Ordinances or federal laws and the recovery of any payments made in violation of law.
- September 2007 - ERS sent notice to members still in active County employment whose purchase of service credit included operational violations, advising them that their purchase included errors and may not be valid.
- December 6, 2007 – Jack Hohrein, ERS Manager, leaves employment.

2008

- February 20, 2008 to October 1, 2008 - ERS and the County filed supplemental VCP information with the IRS and respond to correspondence from the IRS regarding the filings.
- June 30, 2008 – New ERS Manager Gerald Schroeder is hired.
- December 12, 2008 – The Pension Board submitted the ERS plan document with the recent changes, and with the proposed EGTRRA amendments, to the IRS for a determination letter regarding ERS's tax qualified status.

2009

- May 19, 2009 – ERS and the County settle lawsuit against Mercer.
- September 10, 2009 – IRS sends correspondence request containing questions and issues with the June 29, 2007 VCP filing.
- October 28, 2009 – ERS and the County respond to the IRS's questions and issues contained in the letter dated August 14, 2008, and await a response/direction. *Until 2014, this is the last correspondence ERS had to or from the IRS regarding the VCP filing.*

2011

- January 13, 2011 – Employee Benefits Director Dave Arena leaves employment.

July 29, 2011 – ERS Manager Gerald Schroeder leaves employment.

2013

- February 20, 2013 – Pension Board amends Rule 202 to terminate the ability for seasonal employees to opt into ERS membership.

2014

- March 14, 2014 – Corporation Counsel submits to the County Board, at request of the Pension Board, proposed ordinance amendments reflecting changes required by the 2001 EGTRRA law and other recent federal law changes, including the PPA and the HEART Acts.
- Late March, an upcoming employee pension was being calculated, per our normal process. ERS Director discovers that the employee utilized some pre-tax dollars to purchase service credit, which is inconsistent with plan design. Alerts Corporation Counsel for additional review.
- April 2, 2014 – Notify the Pension Audit Committee of the Pension Board and discuss.
- April 3-8, 2014: ERS Director and team perform additional review and uncover several past Buy In and Buy Back scenarios that were not processed in compliance with plan provisions.
- April 9, 2014: ERS Director alerts Kerry Mitchell, Chief Human Resources Officer.
- April 10, 2014: Meeting with the County Executive to advise him of the situation.
- April 11, 2014: Meeting with external counsel to examine the issue further. Also, employee whose pension estimate triggered this review was notified his retirement eligibility was in question.
- April 11 – 22, 2014: Investigated the issue and examined historic records to determine who this may affect. Meet with counsel about options. Prepared letters to send to retirees and employees to make them aware of the situation.
- April 22, 2014 - Active members whose purchases of service credit include errors are advised that they should not make retirement determinations that are based on inclusion of their purchased service credit. Retired members are advised that their benefits are being reviewed and that they will be advised on pension benefit changes in September.
- May 1, 2014 – Notice of Claim filed on behalf of all affected retirees and employees.
- Current: Ongoing analysis to determine a firm estimate of financial impacts.

SUMMARY OF BUY IN AND BUY BACK ANALYSIS TO DATE

There are four types of errors that occurred over time:

- 1) Employees who were not eligible to participate in either the Buy In or Buy Back programs did indeed purchase service credits through these programs.
- 2) Some employees who participated in either the Buy In or Buy Back programs utilized pre-tax dollars to make their purchases of service credits, which was not permitted in the ordinances, and was inconsistent with plan design.
- 3) Some employees bought back more than 25% of their annual salary, which was not permitted in the ordinances, and was not consistent with plan design.
- 4) Some buybacks were allowed to be completed more than two years after the employee's return to county employment, contrary to existing ordinances and plan design.

| | Not eligible | Total Affected | > 25% of comp | > 2 yrs to purchase | 457 Money | Total SC purchased | Total Money Paid |
|--------------|-----------------|-------------------|---------------------|------------------------|--------------|-----------------------|---------------------|
| Ineligibles | 13 | 13 | | | | 23.1465 | \$69,959 |
| Buy In | | 122 | 73 | NA | 81 | 320.91687 | \$1,295,370 |
| Buy Back | | 105 | 40 | 94 | 9 | 469.80597 | \$1,076,556 |
| TOTAL | 13 | 240 | 113 | 94 | 90 | 813.86934 | \$2,441,885 |

| | |
|----------------------------------|--------------|
| Approximate overpayments | \$14,000,000 |
| Possible approximate recoupment* | \$11,500,000 |

**Calculation based on averages, it is based solely on the value of the service purchased, and does not account for other resulting increases in benefits, etc.*

NEXT STEPS

- 1) Hire a third party retirement specialist to assist in discovering all errors that must be corrected, and to perform calculations to provide an unbiased determination.
- 2) Once we have analyzed all of the data and re-calculated monthly pension benefits and active member service credits to determine the overall impact, we will report the information.
- 3) Employees and retirees will receive formal communication about the status of purchased service credits.

Cc: Chris Abele, County Executive
Raisa Koltun, Interim Chief of Staff, County Executive's Office
Kelly Bablitch, Chief of Staff, County Board
Marian Ninneman, Employee Retirement System Director
Scott Manske, Comptroller
Paul Bargren, Corporation Counsel