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TO: Milwaukee County Board of Supervisors  
Milwaukee County Pension Board  
Amy Pechaeck, Interim Director, RPS  
Chris Abele, Milwaukee County Executive

FROM: Margaret C. Daun, Corporation Counsel 

RE: Opinion of Duane Morris regarding temporary abatement of new collection proceedings and interest rate bifurcation until Agreed Upon Procedure review and fiscal analyses of policy options are completed

DATE: May 10, 2017

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The Office of Corporation Counsel, after reviewing the opinion of Duane Morris (attached hereto as Exhibit 1) at length, and given our understanding of:

- the progress of the Agreed Upon Procedures review to date;
- the numerosity and complexity of the various interest rate calculations that would be required by any abatement of new collection proceedings and the necessary bifurcation of interest payments and calculations as highlighted at pages 8-10 of the attached opinion; and
- the significant demands that are currently pushing RPS staff to their absolute maximum capacity at present (and noting that these demands may increase in the near term and would greatly increase should the abatement and interest bifurcation be implemented),

we strongly advise that recoupment abatement and interest bifurcation should not be adopted or recommended by either the County Board or the Pension Board, as such added complexity is nearly certain to lead to additional administration challenges and errors.

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May 10, 2017

Margaret C. Daun, Corporation Counsel  
Office of Corporation Counsel  
Milwaukee County  
901 N. 9th Street  
Milwaukee, WI 53233

**Re: Employees' Retirement System of the County of Milwaukee  
Treatment of Overpayments**

Dear Ms. Daun:

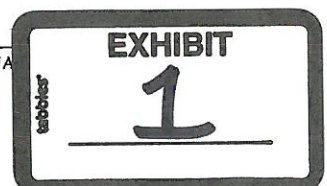
Pursuant to your request, this letter discusses various issues arising in connection with certain operational errors in the administration of the Employees' Retirement System of the County of Milwaukee ("ERS"). Specifically, ERS has overpaid a significant number of ERS retirees and you have asked for our analysis of the following issues arising from such overpayments:

1. The ERS Pension Board's ("Pension Board's") fiduciary duty during the pendency of an external review of payments from ERS.
2. The legal alternatives with respect to the correction of overpayments made to ERS retirees.
3. Comparative "best practices" of public funds with respect to the correction of overpayments including appropriate collection methods.
4. The Pension Board's ability to (i) suspend repayment and/or benefit offsets during the external review period; and (ii) suspend interest accruals during the review period.
5. Recommendations regarding the current ERS filings under the IRS Employee Plans Compliance Resolution System ("EPCRS").

DUANE MORRIS LLP

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**Background**

ERS is a tax-qualified, defined benefit plan established under the Internal Revenue Code of 1986 (the "IRC"). ERS further qualifies as a "governmental plan" under Section 414(d) of the IRC and Section 3(32) of the Employee Retirement Income Security Act ("ERISA"). ERS is established and maintained pursuant to Milwaukee County Code of General Ordinances Section 201.24 ("ERS Ordinance").

On June 29, 2007, ERS was submitted to the Internal Revenue Service under the EPCRS to disclose identified operational violations and propose voluntary corrections. This submission was supplemented on April 22, 2014 to address additional operational violations subsequently identified ("Supplemental VCP Submission").

The Pension Board has retained the accounting firm of Baker Tilley (in partnership with the County Audit Department) to perform an "Agreed Upon Procedures" ("AUP") review of ERS and verify the accuracy of items contained in the initial 2007 filing and the Supplemental VCP Submission.

**Discussion**

1. Fiduciary Duties of the Pension Board.

As noted, ERS is a governmental plan under Section 414(d) of the IRC and Section 3(32) of ERISA. Accordingly, ERS is exempt from the fiduciary provisions of ERISA. ERS is, however, subject to fiduciary standards as established under Wisconsin law which are significantly similar to the fiduciary obligations set forth in ERISA. Moreover, courts frequently rely upon ERISA and related DOL guidance when analyzing public plans.

ERISA Section 404 provides, in relevant part:

...fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and—

(A) for the exclusive purpose of:

(i) providing benefits to participants and their beneficiaries; and

(ii) defraying reasonable expenses of administering the plan;

•  
•  
•

(D) in accordance with the documents and instruments governing the plan.

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29 U.S.C. § 1104(a)(1). Similarly, Wisconsin's Uniform Prudent Investor Act provides:

A fiduciary shall invest and manage the assets solely in the interest of the beneficiaries.

If an estate, trust, conservatorship, or guardianship has 2 or more beneficiaries, the fiduciary shall act impartially in investing and managing the assets, taking into account the differences between the interests of the beneficiaries.

Nothing contained in this chapter shall be construed as authorizing any departure from, or variation of, the express terms or limitations set forth in any will, agreement, court order, or other instrument creating or defining the fiduciary's duties and powers.

Wis. Stat. § 881.01(6), (7) and 881.02

In the context of overpayments, two specific fiduciary duties are of concern. First, the Pension Board has an obligation to “act solely in the best interests of all members and beneficiaries.” Consistent with this duty is the obligation to make every effort to assure that the plan is properly funded, including, seeking repayment of overpayment. This duty further implies that no individual member should be permitted to receive and retain a benefit in excess of that specifically accrued under the terms of the plan. Wisconsin fiduciary law expands this obligation in stating that the fiduciary has a duty to act “impartially” with respect to multiple beneficiaries thus creating an absolute duty to assure that no individual member benefits to the detriment of other members.

The second fiduciary principle is that the Pension Board, in administering ERS, has a duty to act is “in accordance with the documents and instruments governing the plan.” The significance of this obligation is twofold: First, it is a statutory fiduciary obligation under Wisconsin state law as noted above. Second, the failure to operate a plan consistent with the terms of the plan document could result in a loss of tax qualified status under the IRC. *See* 26 C.F.R. § 1.401-1(a)(2)-(3); Rev. Proc. 2016-51 § 5.01(3)(a).

The ERS Ordinance sets forth a benefit formula, and any erroneous payment (both overpayments and underpayments) constitute a failure to operate the ERS in accordance with its documents and instruments. The ERS plan document consists of the ERS Ordinance (Section 201.24) and the ERS Rules. Therefore, in order to maintain tax-qualified status under the IRC and comply with Wisconsin fiduciary law, the Pension Board must take affirmative steps to correct the overpayments and assure that members' benefit payments are consistent with the terms of ERS “documents and instruments.”

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2. Correction of Overpayments.

As a condition of maintaining tax-qualified status, full correction must be made in accordance with the EPCRS, Rev. Proc. 2016-51 § 6.02. The EPCRS sets forth specific guidance regarding the alternatives for correcting various operational defects including defects attributable to the overpayment of benefits. Approved methods of overpayment correction under EPCRS are as follows:

- Recovery of overpaid amounts from the retiree;
- Reduction in future benefits due to the retiree;
- Contribution to the fund of the overpaid amount by “the employer or another person”; and
- Retroactive amendment to conform the plan document to the plan’s operations.

The following section discusses each correction alternative, its authorization under the ERS Rules and suggestions for revisions to the ERS Rules.

*Recovery of Overpayment from the Member.*

Section 6.06(3) of EPCRS provides that a sponsor must take “reasonable steps” to have the overpayment (with appropriate interest) returned by the recipient to the plan. This method is also arguably authorized by ERS Rule 1050(1)(a) and (b):

(a) If a benefit should not have been paid, then the benefit shall cease, and a letter shall be sent to the member or beneficiary explaining the error and requesting repayment of the overpayment, plus interest from the date paid.

(b) If a benefit should have been paid but in a different amount, the member’s and/or beneficiary’s benefit shall be recalculated to reflect the accurate amount under the Ordinances and Rules. The corrected benefit amount shall be paid to the member and/or beneficiary going forward, and any necessary reduction to recover the overpayment shall be made in accordance with subsection (2) below.

We note, however, that Paragraphs (a) and (b) taken together suggests that repayment recovery method of (a) is only available in a case in which a benefit “should not have been paid.” In a case in which the payment was appropriate but the amount is incorrect, Paragraph (b) would apply. We do not think this was the intent, nor do we believe that a court would reach this interpretation. **Nonetheless, it is our strong recommendation that the language of**

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**Paragraphs (a) and (b) be revised to clearly allow for repayments in the event of both erroneous payment and payment of erroneous amounts.**

*Reduction of Future Benefits.*

Both the EPCRS and the ERS rules allow for the offset of future benefit payments. ERS Rule 1050(2) provides, in relevant part, as follows:

(2) Offset. If a member and/or beneficiary receives benefits exceeding those to which the individual(s) is or are entitled under the ordinance and rules, future benefit payments to a member and/or a beneficiary from ERS may be reduced until the amount of the overpayment, plus interest from the date paid, has been recovered by ERS.

See also Section 1050(1)(b) above. EPCRS permits offset only in the case of periodic payments and does not allow offset to be applied to survivor's benefits. Appendix B § 2.04 (1)(a)(ii).

The ERS Rule goes on to provide that the offset may be assessed for up to one hundred percent (100%) of the ERS benefits until ERS has fully recovered the amount of the overpayment. Rule 1050(2)(a) allows certain factors to be taken into consideration when determining how the amount of the offset is determined with respect to the periodic payment. Factors include: (1) the reason for the overpayment; (2) the life expectancy of the individual; (3) the amount of the benefit versus the overpayment to be recovered; and (4) the financial resources of the individual.

While utilization of these factors is admirable, they suggest that the Retirement Office and the Pension Board have broad discretion in determining how the offset will be applied to different retirees. Such discretion has proven problematic in that ensuring consistent outcomes in substantially similar situations has been very difficult without clear, objective criteria. **Accordingly, it is our recommendation that the Pension Board adopts specific guidelines regarding the amount of offset that could be taken with respect to any given payment.**

One suggested method of applying offset limitations is set forth in guidance from the Pension Benefit Guaranty Corporation, the Federal agency that insures ERISA-covered defined benefit plans. The PBGC, in determining the amount of offset of benefits payable under PBGC-trustee plans, limits the amount of the offset to no more than ten percent (10%) of each periodic payment. 29 C.F.R. § 4022.82(a). We believe that a uniform limitation on periodic payment offsets (it need not be exactly ten percent (10%)), if established by rule, could limit legal risks. Alternatively, the Pension Board could consider adoption of a "sliding scale" of reduction limit based on the specifics of the enumerated factors (e.g., five percent reduction if monthly payments are less than \$3,000, ten percent reduction for monthly payments in excess of \$3,000, etc.).

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*Sponsor Contributions of the Overpayment.*

Under this alternative, if the overpayment is not remedied by repayment or member benefit reduction, the County could elect to make up the differential by a supplemental contribution.<sup>1</sup> While this alternative is not currently authorized under ERS, it can be argued that authorization is not necessary because the Pension Board has a fiduciary duty to seek payments from the County to insure that the ERS is “made whole” from the overpayment.

**Nonetheless, we believe that the Rules should be revised to expressly authorize County contributions following failed attempts of recoupment from the member and/or reduction in future benefits.** It may, however, represent the primary option in certain cases including, but not limited to, (i) if the member is deceased; (ii) the repayment amount is below a de minimis threshold; (iii) the payments are made to a minor; or (iv) other circumstances in which payment by the County is determined to be required in order to comply with legal requirements applicable to the ERS.

*Plan Document Amendment.*

The final authorized correction under EPCRS is a retroactive plan amendment which allows the plan document to conform with its operations. This type of correction is often used if a calculation is based on the application of an incorrect assumption. The advantage of this approach is that it is “zero cost” to the members and the County in that the members would be allowed to keep the overpayment and the County would not have to fund any deemed deficiency. Expressed authorization from the IRS is not needed to amend the Ordinance under such circumstances unless such amendment is part of a proposed correction plan under EPCRS. Nonetheless, we advise completion of the AUP review of the operational defects before determining whether this alternative is feasible.

3. Comparative Best Practices.

Corporation Counsel solicited the overpayment correction practices from numerous governmental retirement systems via the National Association of Public Pension Attorneys (“NAPPA”). We reviewed over twenty (20) responses from NAPPA member systems. Accordingly, we can make the following observations regarding the “best practices” utilized by governmental retirement systems.

- Without exception, every system allowed for the offset of future benefit payments. Certain systems impose limitations on the amount of reduction for future payments similar to the PBGC guidance.

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<sup>1</sup> The EPCRS suggests efforts must first be made for member corrections: “to the extent that the amounts returned by the recipient is less than the overpayment, adjusted for earnings at the plan’s earnings rate, then the Plan Sponsor or another person contributes the difference to the plan.” Rev. Proc. 2016-51 Appendix B, Section 2.04(1)(a).

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- Offsets were reduced to the extent that the overpayment results in the member having to (i) file an amended tax return; or (ii) pay any excise tax as a result of the overpayment. With respect to the cost of filing the amended return, the County could adopt a standard reduction or require proof by the member that the amended return had been filed and supporting documentation of the cost of such amendment. Similarly, the excise taxes due on the overpayment (for example as a result of an improper rollover) should be documented by the member before applied as a setoff against the overpayment amount.
- The member should be informed of the opportunity to avoid excise and income taxes on the overpayment. Relief for such excise and income taxes are available under IRC § 1341 (computation of tax where tax payer restores amounts paid in error) or relief under § 408(d)(5) of the IRC with respect to erroneous rollovers.
- Any reduction in the repayment or offset obligation of the member should be accompanied by a corresponding sponsor contribution to assure that the system is “made whole.”
- Requests for recoupment of an overpayment include an interest rate calculation that is either (1) stipulated under the terms of the plan (e.g., ERS Rule 1050(2)(b), Rule 403<sup>2</sup>); (2) reflective of the rate of return assumptions of the plan); or (3) an expressed rate as necessary to comply with the terms of a Compliance Statement under EPCRS.
- A request for repayment should not be accompanied by a threat of legal action. While certain systems do authorize the initiation of legal action to recover overpayments, this seems to be the exception rather than the rule. The Pension Board and the County should bear in mind that absent fraud, the overpayment is probably due to an error in administration. Therefore, the offset alternative discussed above is highly preferable to the initiation of litigation.
- Most systems prioritize the voluntary return of excess payments over the offset methodology. If the offset is unilateral most systems maintain an appellate process similar to that described in ERS Rule Section 1052(2)(d).
- Many systems allow for a waiver of action of “de minimis” amounts (typically less than \$100).

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<sup>2</sup> Even with expressed ERS rules, it is our understanding that there remains some dispute over the exact methodology of computing interest for purposes of the overpayment corrections.



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In sum, the ERS current overpayment corrective methodology is largely consistent with the various “best practices.” We believe, however, that it can be improved by the items noted above. A summary of the various overpayment correction practices is set forth at Exhibit 1.

**Actions Pending Completion of Agreed Upon Procedures Review.**

You have also asked whether the Pension Board may (1) suspend repayment or offsets; and (2) suspend the accrual of interest, during the AUP review.<sup>3</sup> As noted, the Pension Board has the obligation to assure that ERS is made whole for any excess payments to retain tax-qualified status, comply with Wisconsin fiduciary law and the ERS Ordinance. To that end, the current ERS rules suggest that a suspension of remedial actions and interest accruals during the AUP review would be consistent with EPCRS and the Pension Board’s fiduciary duties.

ERS Rule Section 1050(2)(c) provides, in relevant part:

Upon discovery of an overpayment, the retirement office shall notify the affected individual in writing and explain the nature and amount of the overpayment. The following information shall also be included in the notice:

(i) a request that the individual repay the overpayment in a lump sum payment;

(ii) a statement that if the member declines to repay the overpayment in a lump sum, ERS intends to reduce the amount of the individual’s future benefit payments until the overpayment amount, plus interest, has been recovered;

(iii) the effective date of the offset;

(iv) the amount that was overpaid;

(v) the total recovery amount (i.e. the overpayment plus interest from the date paid);

...

(viii) the reduced benefit amount that will be paid to the individual after the offset is applied.

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<sup>3</sup> Please note, this discussion does not relate to members who are currently subject to a repayment or offset process with ERS. These actions would only apply to overpayments for which collections have yet to begin.

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The Pension Board has the authority to review and interpret the terms of the ERS plan document as reflected in the Ordinance and the Rules. ERS Ordinance Section 201.24 (8.17). The prerequisite for correction is an exact, or near exact, determination of the erroneous payment and the net correction amount as required under items (iv); (v) and (viii) above. The Pension Board has authorized the AUP review for the specific purposes of verifying the accuracy of previously identified errors as well as the identification of new errors, if any. Therefore, it is legally permissible that neither repayment/offsets, nor interest calculations, be newly commenced until the AUP review can confirm the required corrections as well as the accuracy of those corrections.

The Pension Board has authorized Baker Tilly in cooperation with the County audit department to perform this review on its behalf. It would be consistent with the Pension Board's duties under ERS to forego the commencement of any new recoupment actions pending the conclusion of the AUP review and acceptance of its findings. Accordingly, the suspension of the repayments and offsets during the AUP review would be a permissible exercise of the Pension Board's fiduciary function.

If repayments/offsets are suspended, the Pension Board must also make a determination regarding the treatment of interest accrued during the period of the AUP review. Specifically, neither EPCRS nor the ERS correction rules offer any "holiday" or suspension on interest accruals pending an external examination. Accordingly, interest accrued during the AUP review must be added to the correction amount. The County could legally consider suspending the assessment of interest against the **member's obligation** during the period of the AUP review, but in that case, the **County** must assume the obligation to pay interest accrued during that period. Interest assessment against the member would resume once the member is notified of the final overpayment calculation and would continue until the full overpayment obligation is satisfied. **However, as illustrated below, bifurcation of the interest payment obligations will be an administrative challenge, adding to the significant administrative burden of the correction.**

Consider the following simple example. Assume that a member commenced monthly annuity payments on February 1, 2015 and the payments are evaluated as part of the AUP review beginning on June 1, 2017. Upon completion of the review on November 1, 2017, it was determined that the aggregate overpayments to the member was \$2750. It was further determined that the accrued aggregate interest attributable to the payments was approximately \$450 of which \$62 represented interest accrued during the AUP review period of June 1<sup>st</sup> through November 1<sup>st</sup>. In this case, the total amount required to satisfy the "make whole" obligation is \$3200 (\$2750 plus \$450). Given, however, that the determination of the required correction was delayed due to the AUP review, the County could legally agree to pay the \$62 interest accrued during such period so as minimize the adverse impact of the AUP review on the member. Once, however, the correction amount is affirmatively determined and communicated to the member's interest obligation would resume and be added to the member's correction obligation of \$3138 (\$3200 minus \$62). Interest would continue as part of the member's correction obligation until the full overpayment obligation is satisfied.

Duane Morris

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Again, it should be noted that this is a simple illustration. In fact, the interest calculations would be much more complex given that interest accrues from each periodic overpayment. **It is probable that this calculation would compound the complexity of the correction, add to the time necessary to complete the correction and could lead to additional errors. While the interest allocation is legally permissible, given these administrative complexities, such allocation may not be advisable.**

**Impact on Current EPCRS Filing.**

As a final issue, you have asked for our views on the impact of the AUP review on the Supplemental VCP Submission. It has been my experience that IRS agents are favorably inclined to filings if kept abreast of all new developments as soon as possible. Therefore, given that the AUP review may produce additional changes to the Supplemental VCP Submission, I understand that the Pension Board's outside counsel notified the agent of this possibility. Accordingly, counsel also requested a reporting extension until the AUP review is complete, as the review may uncover additional errors which must be reported to the IRS. It is our understanding that the IRS agent has agreed to the postponement of updates to the 2014 VCP submission until December, 2017.

\* \* \*

I hope this letter has been responsive to your concerns. If you have any additional questions regarding this analysis, please do not hesitate to contact me.

Sincerely,



John A. Nixon  
Partner

JAN/fs

cc: Amy Pechacek, Interim Director, ERS  
ERS Pension Board  
County of Milwaukee Board  
Jerry Heer, Director of Audits

Exhibit 1

System	Member Repayment	Offset of Future Benefits	Employer/Administrator Contribution	Plan Amendment	Collection Methods	De Minimis/Hardship Forgiveness	Statute of Limitations
CalPERS		Yes					3 years, 10 years in event of fraud
CalSTRS		Limited to 5% of payment if due to system error; 25% if due to member error			Suit for restitution		
Contra Costa County ERM	Yes	Yes				Less than \$50, discretionary if less than \$5,000	
Georgia Municipal Retirement System	Yes		Yes	Yes		Hardship	
Illinois Municipal Retirement Fund		Yes	Yes, if due to Employer Error				
Indiana Public Retirement System	Yes	Yes			Outside contractor State AG in event of fraud	Less than \$100	
Maine PRS	Yes, in lump sum or payment plan	Yes; First priority, up to 100% of benefit			Allows recovery from state tax refunds	Less than \$500 automatic b/t \$500 and \$2000 subject to discretion	

System	Member Repayment	Offset of Future Benefits	Employer/Administrator Contribution	Plan Amendment	Collection Methods	De Minimis/Hardship Forgiveness	Statute of Limitations
Montana Teachers Retirement Fund	X	Yes, withhold up to 50% of monthly benefit	Yes, if due to employer error	Discretion to pursue collection by other means			
Municipal Employees Benefit Fund of Chicago	Repayment in two years or one year if due to member/beneficiary misrepresentation				Fund will file suit to enforce repayment		
Ohio PERS	Yes	Yes			Any manner provided by law		
Pennsylvania Public Schools ERS	Yes	Yes					
San Jose Police	Yes, only three years if due to system error				All legal remedies including claim on estate	Less than \$50; discretionary if less than \$5,000	
Wisc. Dept. of Employer Trust Funds	Yes	Yes			Referred to DOR, deducted from life ins. proceeds, fraud and large amount referred to DOR	Less than \$100	5 years