EMPLOYEES' RETIREMENT SYSTEM (ERS)

Milwaukee County

Pension Board

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June 14, 2018

Mr. Chris Abele
County Executive
Milwaukee County Courthouse
901 North 9th Street, Room 306
Milwaukee, WI 53233

Mr. Theodore Lipscomb, Sr.
Chairman, Milwaukee County Board of Supervisors
Milwaukee County Courthouse
901 North 9th Street, Room 201
Milwaukee, WI 53233

Dear County Executive Abele and Chairman Lipscomb:

Ordinance section 201.24(8.17)(b) of the Milwaukee County Code of General Ordinances provides the Pension Board at least 30 days to comment on the impact of any proposed benefit changes referred from the County Board. On May 15, 2018, the Pension Board received the referral of File 18-389 regarding Supervisor Weishan's draft Ordinance amendments which include amendments related to the forgiveness of overpayments and procedures to address future erroneous payments.

The Pension Board discussed the referral at its May 31, 2018 meeting, and as explained below, has a number of comments and questions related to the draft amendments. As noted throughout, Corporation Counsel's office advised me that it, with the assistance of the Pension Board's outside counsel, is preparing revisions to the amendments for your consideration based on these comments. The Pension Board understands that there is another version of the draft amendments that includes technical revisions, but that neither the sponsor of the amendments, nor any County Board Supervisor has put forth these technical amendments at this time. However, Corporation Counsel's office has advised me that it will be working from the version that includes the technical corrections to incorporate revisions based on the Pension Board's comments.

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As you know, without guidance from the County and a willingness to contribute unpaid overpayment amounts, the Pension Board is forced to attempt to recover overpayments from the members. Accordingly, the Pension Board is appreciative of the County's review of the difficult overpayment situation. However, there are issues that the Pension Board believes would warrant further examination and analysis by the Pension Study Commission, the Office of the Comptroller and the County Board of Supervisors. Those issues are explained in detail below. The Pension Board understands the process that such complex legislation takes, and would be willing to re-examine and comment further on later versions, if policymakers would find that helpful.

In addition, the Pension Board reviewed the fiscal analysis related to these amendments that was prepared by the Comptroller's Office. Understandably, the Comptroller's Office included a number of caveats in its fiscal analysis. Given the errors that were uncovered over the last few years that were previously unknown to the Pension Board and the County, the Pension Board urges the County to proceed slowly and carefully with these amendments and potentially consider alternatives to accomplish the same goals without a possible open-ended County commitment to pay for currently unforeseen errors.

The Pension Board would also encourage the County stakeholders to carefully consider the impact these amendments could have on the County and pension system with respect to collective bargaining agreements, administrative complexity, as well as tax compliance and litigation risks.

The Pension Board would further encourage the County to carefully review these amendments with the Director of RPS and RPS staff to obtain their thoughts and comments on the amendments, especially with regard to what effective dates are operationally feasible. RPS suggested to the Pension Board that ***at least*** a three-month delay would be required with regard to most of these amendments (and perhaps more time would be required with respect to certain amendments) because of a number of factors, most notably that many retirement applications have already been submitted for future retirements. RPS is most familiar with the day-to-day administration of ERS and can provide valuable insight on these operational considerations.

1. **Retirement Effective Date on the First of the Month**. The draft amendments to Ordinance section 201.24(2.19) appear to require all retirements to be effective on the first day of a month. The draft amendments also revise the Ordinance to pay a member through the last day of the month of death. Historically, a member's ERS benefit is paid from the member's retirement date through the date of death.

If the County amends the Ordinance to require that a member's retirement commence on the first of the month, it may result in challenges from current ERS members who will potentially be resistant to this restriction because a member could conceivably (i) need to use leave time if they want to "stop work" prior to a month's-end; (ii) lose out on a portion of a month's pension benefit payment; or (iii) if careful planning is not undertaken with an RPS counselor, possibly lose active member benefits by slipping into deferred vested status. Notably, the "first of the month" retirement date is widespread among other pension plans and after a certain transition period, would hopefully not be problematic for ERS. However, to attempt to reduce the litigation risk while members adjust to this new policy, policymakers may wish to consider revisions to this amendment such that (i) the effective date is pushed far enough out to permit a robust communications program; (ii) the policy only applies to new, but not pending retirement applications after the effective date; and (iii) language to clarify that this provision should not operate to force an otherwise "active status" member into "deferred vested status" if they retire in the middle of the month. Corporation Counsel's office has advised that it is incorporating these comments into a revised set of amendments with the assistance of the Pension Board's outside counsel.

With regard to the payment of benefits during the month of a member's death, the current draft amendments extend members' benefits for members who die on a date other than the first of the month until the end of the month of the member's or beneficiary's death, to avoid the administrative burdens of collecting small overpayments The Pension Board notes that this likely will require an actuarial adjustment to the benefit calculation tables, but that may be required anyway for a first of the month start date and urges consultation with ERS's actuary for implementation of this amendment.

2. **Disability Retirements**. It appears the draft amendments to Ordinance section 201.24(2.19) are intended to be applicable to disability retirements. It may be helpful for the amendments to clearly state that the Ordinance applies to disability retirements. Corporation Counsel's office has advised that these comments will be reflected in the revised set of amendments with the assistance of the Pension Board's outside counsel.

3. **Definition of RPS.** The draft amendments to Ordinance section 201.24(2.22) refer to RPS. A number of the current Ordinances and Rules refer to the "Retirement Office." To coordinate the draft amendments with the other Ordinances and Rules, it may be helpful for the term "Retirement Office" to be included in the definition of RPS. Corporation Counsel's office has advised that it is incorporating these comments into a revised set of amendments with the assistance of the Pension Board's outside counsel.

4. **Delegation of Authority to RPS**. While the Pension Board agrees with the codification of RPS's duties in Ordinance section 201.24(8.21), from a governance standpoint, the Pension Board is not delegating the duties. The County, as Plan Sponsor, is assigning them. Additionally, RPS's duties, regardless of the delegation, are limited to what is allowable under the Ordinances and Rules. The Pension Board would support a change to the draft Ordinance amendments that expressly limits RPS's authority to act to what is allowable under the Ordinances and Rules. Corporation Counsel's office has advised that these comments will be reflected in the revised set of amendments with the assistance of the Pension Board's outside counsel.

5. **County's Assumption of Overpayment Liability**. The amendments to Ordinance section 201.24(3.1)(c) appear to suggest that the County will be responsible for

contributing any overpayments that are not recovered from a member or beneficiary that would otherwise be legally required to be repaid to the trust. However, the Pension Board, in fulfilling its fiduciary duty to ensure that the trust is made whole for any overpayments, would request that the County consider including an affirmative statement that the County will make the trust whole for unrecoverable overpayments required under law, including recoveries that are limited by these Ordinance amendments. In order to comply with applicable law, the Pension Board cannot cease its efforts to recover overpayments from the recipients unless the County commits to make ERS whole for unrecoverable overpayments. Corporation Counsel's office has advised that these comments will be reflected in the revised set of amendments with the assistance of the Pension Board's outside counsel.

Additionally, the Pension Board is not clear how the estimate referenced in Ordinance section 201.24(3.1)(c) will be calculated and presented to the County. Is there a time frame within which the County will contribute these contributions? Will RPS provide the Pension Board with the amount of overpayments that it is unable to collect from the prior year and this will be the amount the Pension Board provides to the County? The Pension Board would appreciate clarification from the County stakeholders on these questions. Corporation Counsel's office has advised that it will review these questions and incorporate these comments into a revised set of amendments with the assistance of the Pension Board's outside counsel.

6. **Prospective Benefit Correction.** The creation of Ordinance section 201.24(8.24) aims to provide a structure under which overpayments and underpayments will be corrected by ERS. While the draft Ordinance provides information on how overpayments will be repaid to ERS and underpayments paid to members, the Ordinance does not include a definitive statement that erroneous benefit amounts, such as monthly benefit payments, will be prospectively corrected. The Pension Board would encourage the County to include a provision in the amendments that makes clear that ERS will adjust prospective benefits to the correct amounts regardless of the passage of time. This type of statement will lessen the likelihood that a member argues that the claims period in Ordinance section 201.24(8.24)(k) prohibits ERS from correcting prospective benefits. These prospective benefits must be adjusted to the correct amounts to maintain ERS's tax-qualification status. Corporation Counsel's office has advised that these comments will be reflected in the revised set of amendments with the assistance of the Pension Board's outside counsel.

7. **Use of Ordinances and Rules.** The amendments creating Ordinance sections 201.24(8.24)(b) and (c) use the term "Ordinances" to determine erroneous overpayments and underpayments. Because the Plan document consists of the Ordinances and Rules, it may be clearer and reduce claims to use "Ordinances and Rules." Corporation Counsel's office has advised that it is incorporating these comments into a revised set of amendments with the assistance of the Pension Board's outside counsel.

8. **Interest on Underpayments**. The draft amendments to Ordinance section 201.24(8.24)(b) provide that RPS will pay the underpayment plus applicable interest calculated as of the date of each underpayment. The IRS's error correction program requires interest to be

calculated through the date of correction. Corporation Counsel's office has advised that these comments will be reflected in the revised set of amendments with the assistance of the Pension Board's outside counsel.

9. **Overpayments and Underpayments.** Sometimes members will have both an overpayment and an underpayment. It may be helpful for the Ordinances to include direction to RPS on how to address that situation. Corporation Counsel's office has advised that it is incorporating these comments into a revised set of amendments with the assistance of the Pension Board's outside counsel.

10. **Interest Rate.** The draft amendments to Ordinance section 201.24(8.24)(d) provide for a 5% simple interest rate with an exception for a different rate if that rate is mandated by the IRS as part of the VCP. In resolving the VCP filed by the Pension Board and the County in 2007, the IRS mandated 5% interest for overpayments and 8% interest for underpayments. The IRS required compound interest for all calculations. In 2014, another VCP was filed, which was restated and updated in 2017, to include additional errors. The IRS agent who handled the 2007 VCP agreed to retain the 2014 VCP and noted that he may require one interest rate at 8% compound interest for all errors because the IRS generally requires one interest rate for all corrections.[1]

The Pension Board is concerned about utilizing an interest rate for future errors that may likely differ from the interest rate that will be established and approved by the IRS through this most recent VCP or generally through the IRS's error correction program. If the IRS ultimately requires a different rate than the 5% simple rate established in the draft amendments, the Pension Board is concerned that the corrections will need to be revised. Corporation Counsel's office advised that it will be working with the Pension Board's outside counsel to create a hybrid solution to the Pension Board's concerns and to delay the implementation date of this interest rate until the IRS has issued a Compliance Statement in connection with ERS's open VCP.

11. **Overpayment Recovery Method with No Future Benefits Payable**. The draft amendments that create Ordinance section 201.24(8.24)(e) provide for different overpayment recovery methods. However, the default recovery method appears to require RPS to recover the overpayments through offsetting future benefits. Can the Ordinances specify how RPS should recover the overpayments if, pursuant to the corrected benefit calculation, no prospective benefits are payable? RPS has stated that there are members in this situation. Corporation Counsel's office has advised that it is incorporating these comments into a revised set of amendments with the assistance of the Pension Board's outside counsel.

12. **Reduction or Waiver of Repayment Under VCP**. The draft amendments creating Ordinance section 201.24(8.24)(g) provide for a reduction or a waiver of a member's

[1] The Pension Board recently changed ERS's actuarial equivalence rate to 7.75%. It is possible the IRS would agree to 7.75% but if the rate was 8% when the error occurred, the IRS could still require 8%.

overpayment under certain circumstances. One of these circumstances is "an agreement between the county and the Internal Revenue Service" pursuant to a VCP. The Pension Board is unclear how a VCP compliance statement will act as a reduction or waiver of a member's overpayment. Compliance statements explain how the plan will correct the reported errors. As you know, plans must be made whole for overpayments. A compliance statement will not reduce or waive an overpayment from a member *unless the plan sponsor has committed to contributing those amounts*. Related, compliance statements typically state that the member will repay the overpayment through offset of future benefits, but if the member is unable to repay the full amount (plus interest), the plan sponsor (the County) will contribute the remainder. The County's VCP filings include this language throughout with respect to particular errors. The Pension Board is concerned that the draft amendment as currently written could be used by members to argue that their overpayments should be entirely "waived," and that they should be alleviated of any obligation to repay the trust, even without the "settlement" that is set forth in subsection (j), because the compliance statement provides that the County will contribute the overpayment amounts. The Pension Board understands from Corporation Counsel's office that this is not the intent of the amendments. Corporation Counsel's office has advised that these comments will be reflected in the revised set of amendments with the assistance of the Pension Board's outside counsel to eliminate this potential spurious argument from members.

13. **Reduction of Overpayments Due to Equitable Factors.** The draft amendments creating Ordinance section 201.24(8.24)(h) allow RPS to reduce a member's monthly repayment amount based on certain equitable factors. RPS appears to make the determination of when a member's benefit should be reduced based on these factors.

IRS guidance requires benefits to be "definitely determinable" to avoid plan sponsors from having significant discretion over pension benefits. The Pension Board is concerned that since RPS is part of the Plan Sponsor, the discretion that it appears to exercise under this amendment could be seen by the IRS as too much discretion for benefits to be considered "definitely determinable," if the Pension Board's appeal authority is limited. Rule 1050 provides a similar procedure, but the Pension Board (which is not part of the Plan Sponsor) has discretion to change the offset amount upon appeal. The IRS provided ERS with a determination letter on the plan document that included Rule 1050. Corporation Counsel's office has advised that it is incorporating these comments into a revised set of amendments with the assistance of the Pension Board's outside counsel.

14. **Settlement of Prior Overpayments**. The draft amendments creating Ordinance section 201.24(8.24)(j) provide that, subject to certain conditions, RPS may settle any dispute with respect to overpayments made to members prior to June 1, 2018. This settlement option is based on a fixed set of terms as specified in subsection (j) – i.e., a "take it or leave it" offer, wherein members agree to the corrected monthly benefit amounts in exchange for the County repaying the trust with interest for their past overpayments. The Pension Board is concerned about the effect of this provision on current open litigation cases, and given the current status of some litigation matters, the Pension Board urges the County to carefully consider the effective

date of this particular amendment. Corporation Counsel's office advised that it will discuss these concerns in closed session with the County stakeholders.

15. **De Minimis Threshold for Underpayments.** Similar to overpayments, the IRS's error correction program also provides a de minimis threshold for underpayments ($75). If the underpayment meets the standard in the correction program, a plan does not need to pay the underpayment to the member. Should the draft amendments to Ordinance section 201.24(8.24) also include a de minimis exception for underpayments? Such an exception would relieve RPS from the administrative burden of processing small underpayments. The Pension Board has previously suggested adding this type of provision to the Plan. Corporation Counsel's office has advised that these comments will be reflected in the revised set of amendments with the assistance of the Pension Board's outside counsel.

16. **Claim Period for Underpayments.** The draft amendments creating Ordinance section 201.24(8.24)(b) limit the underpayments to be paid to members to a specific claim period (i.e., 6 years). While the Pension Board understands that some plans do use a claim period for underpayments, the IRS's error correction program requires full correction of underpayments, which requires members to receive all of the missed benefits, subject to the above-noted de minimis threshold. Accordingly, the Pension Board has some concerns about proceeding with a claim period for underpayments. Unfortunately, the IRS is no longer offering its prior determination letter program that provided individually-designed plans like ERS with comfort that the plan document and any subsequent amendments are compliant with the tax-qualification requirements under the Internal Revenue Code. The IRS's other determination programs (such as the issuance of Private Letter Rulings) are not often available for these types of questions for tax-qualified retirement plans. Therefore, the County will likely be unable to obtain IRS approval on such an amendment. The Pension Board would, therefore, request that the County consider eliminating the claim period for underpayments.

17. **Approval for ERS to Comply with Tax Liens and Levies**. One of the errors reported to the IRS as part of the 2014 VCP was ERS's compliance with notices from the IRS and the Wisconsin Department of Revenue requesting that ERS send all or a portion of a member's benefit to the IRS or Department of Revenue for payment of unpaid taxes. Compliance with these notices is not currently allowed under the Ordinances and Rules. The correction proposed to the IRS in the current VCP by the Pension Board and the County is a retroactive Ordinance amendment that would allow ERS to comply with these notices. However, the amendment as drafted may not correct all of the errors, so the Pension Board requests that it be broadened to achieve compliance. Corporation Counsel's office has advised that it will work with outside counsel to broaden the revised set of amendments to correct the errors reported on the VCP.

18. **Effective Date.** Unless otherwise expressly stated, the draft amendments provide an effective date of December 24, 1967 (see Section 9 of the draft amendments). The Pension Board has concerns about the use of a retroactive effective date outside of a VCP. Corporation

Counsel's office advised that it would revise the amendments to change the effective dates for these affected sections.

If you would like to discuss anything further, the Pension Board would welcome an open dialogue with the County Executive and the County Board to determine how best to proceed with amendments that protect ERS and the members.

Sincerely,

/s/

Michael Harper, Chairperson

Pension Board of the Employees'
Retirement System of the County
of Milwaukee