Office of the Comptroller

Milwaukee County

Scott B. Manske • Comptroller

To: Theodore Lipscomb, Sr., Chairman, Milwaukee County Board of Supervisors

From: Scott B. Manske, Comptroller
Cynthia J. (CJ) Pahl, Financial Services Manager, Office of the Comptroller

Date: May 7, 2018

Re: Fiscal Analysis of Proposed Pension Ordinance Changes to M.C.G.O. 201.24 of the Employees' Retirement System

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SUMMARY

The Comptroller's Office reviewed the proposed ordinance changes to the Milwaukee County General Ordinances (MGO) as provided by Corporation Counsel at the request of the sponsoring Supervisor. The proposed ordinance changes modify the current pension ordinances to make various operational changes and to create a forgiveness policy.

There are certain provisions within the proposed ordinance changes that cause a direct fiscal impact to the County. These provisions are related to retirement commencement dates, applicable interest, statute of limitations and forgiving or waiving repayment obligations. **In summary, these changes result in a direct, calculable impact of $2.7 million as of September 30, 2018 based on information known at this time. This amount would increase each month thereafter if the liability is not paid in full at that time.** Furthermore, this amount could increase by approximately $1.0 million as of September 30, 2018 if the 2012 Voluntary Correction Program (VCP) submitted to the Internal Revenue Service (IRS) results in an interest rate other than the five percent simple established by the proposed ordinances.

Based on discussions with Corporation Counsel, if the County assumes the $2.7 million liability for the repayment obligation, that amount would become immediately payable to the Pension System by the County. The proposed resolution/ordinance authorizes the Department of Administrative Services, working in conjunction with the Offices of the Comptroller and Corporation Counsel, to allocate $2.7 million from Org. Unit 1945 – Appropriation for Contingencies to Org. Unit 1950 – Employee Fringe Benefits to increase the payment to the Pension System.

Due to the amount of the potential payment to the Pension System under the proposed policy, there will be an increase in the Pension System's assets which will have a positive impact on the County's annual required contribution (ARC) to the Pension System. However, absent this proposed policy, the Pension System would seek to collect these overpayments from affected pensioners and beneficiaries, resulting in a positive impact on the County's ARC also once collected. Therefore, there are no fiscal savings from a reduction in the ARC that is attributable to the proposed policy.

Historically, the Pension System corrected overpayments and underpayments as part of its responsibility to ensure the Pension System and pensioners and beneficiaries are "made whole." The proposed policy sets the guidelines for how the repayment obligation for overpayments and underpayments should occur going forward. Generally speaking, any single overpayment or underpayment is not going to have an actuarial impact on the Pension System, which results in no fiscal impact on the County. It is worth noting, however, that in any event in which a significant number of retirees or beneficiaries are affected there could be a resulting actuarial impact to the Pension System's assets or liabilities, which in turn could result in a fiscal impact on the County. Absent this proposed policy, these possibilities still exist, and therefore, there are no fiscal savings or costs attributable to the proposed policy.

DIRECT FINANCIAL IMPACT

Each of the provisions below has a direct fiscal impact on the County. Some of these financial impacts are calculable, and others are not. Based on the calculable data available, the total direct financial impact for 2018 would be $2.7 million. And although the proposed changes will result in future financial impacts, due to the character of the changes, it is not possible to calculate what the financial impact of these changes will be in future years. It is, however, likely to be less than the financial impact in 2018. Moreover, the proposed changes are likely to result in efficiencies in administering the Pension System, which should provide additional savings through streamlined processes and reduced errors.

- **Changing the date that a person can commence a retirement benefit from the date of retirement to the first day of the month immediately following a member's date of retirement.**

  - The direct financial impact on the County results from potential changes to employee behavior at retirement due to the proposed changes. Current eligible employees could choose to retire earlier in the month, later or around the same time. Retiring earlier or later would provide a salary savings or a salary cost, respectively. Those retiring around the same time would have no fiscal impact. The fiscal savings or cost of this provision is incalculable because it is not known how employees will react to this change.

- **Setting the applicable interest on overpayments and underpayments to five percent (5%) simple interest annually.**

  - If a forgiveness policy is enacted, setting a five percent (5%) annual simple interest will produce a lower overall liability for the County to assume. Based on 262 overpayment cases, a five percent (5%) annual simple interest results in an interest liability of $650,000. However, regardless of the interest rate set by this ordinance, the 2012 VCP could result in a different interest rate payable by the County (or pensioners/beneficiaries if the proposed changes are not enacted) on overpayments.

Interest Rate	Interest Owed as of 9/30/2018
5 % Simple	$650,000
5 % Compound	$828,000
8 % Simple	$1,042,000
8 % Compound	$1,583,000

  It is significant to note that the above amounts assume an interest calculation that pays all of the principle owed as of September 30, 2018. If the principal is not paid off as of September 30, 2018, additional interest will accrue under all scenarios and result in additional fiscal costs to the County (or pensioner/beneficiary). Furthermore, if the principal is paid off on September 30, 2018 (or some subsequent date) as five percent (5%) annual simple and the 2012 VCP results in a different interest rate owed, the County would incur additional fiscal costs to pay the difference.

- **Enacting a statute of limitations for correcting overpayments and underpayments.**

    - The time period for which a pensioner or beneficiary is responsible for the repayment of an overpayment is limited to those overpayments made within the past six years. The County would assume the liability for all overpayments older than six years. Conversely, the time period for which the Pension System is responsible for reimbursing pensioners or beneficiaries for underpayments is also limited to those made within the past six years. Any underpayments six years or older would not be due to the pensioner or beneficiary. This time period only applies to pensioners who retire on or after June 1, 2018. Therefore, this provision would not have any County financial impact until after June 1, 2024 at the earliest. (If the proposed changes are approved in their entirety, the "forgiveness rule" would apply and the County would be responsible for the entire repayment obligation for anyone retiring prior to June 1, 2018.) In cases where the County assumed the liability for an overpayment, it would result in a direct financial cost. In cases where an underpayment is not reimbursed, there would be no direct financial impact to the County.

- **Waiving or forgiving the repayment obligation of an overpayment amount.**

    - The pensioner retired prior to June 1, 2018 and is subject to the forgiveness policy set forth in the proposed ordinance.

        - This provision applies to 262 known cases in which there has been an overpayment in the past (the proposed statute of limitations does not apply to these cases). The total overpayment amount is estimated to be $1,840,000, with an additional $828,000 due for interest computed at five percent (5%) simple as of September 30, 2018. Per Corporation Counsel, the total amount of $2.7 million would be payable by the County immediately. If other cases are identified, this amount could increase for 2018, or could have a direct financial impact in future years. However, the fiscal cost for future years is incalculable. As stated earlier, it is likely to be less than $2.7 million if the Pension System is able to maintain the safeguards it is implementing to prevent future errors. There are important caveats to note:

            1. These costs are based on a five percent (5%) simple interest calculation. If the IRS requires a different interest rate to resolve the current 2012 VCP, the County would be required to pay additional interest costs as shown above. Interest on the unpaid interest portion would likely be due as well.

            2. This total amount of $2.7 million includes $140,000 in overpayments and $26,000 in five percent (5%) simple interest for "death overpays." This is a situation where a retiree's or beneficiary's last retirement payment was overpaid due to the retiree's or beneficiary's date of death during the month. The Pension System has requested that these 94 cases be

considered administrative in nature and not considered errors so that the County is not responsible for making the Pension System whole in these situations.

3. This total amount also includes 31 cases in which the total overpayment with five percent simple interest is less than $165, for a total liability of $2,245. The proposed changes include a $165 de minimus amount to which these cases would apply, assuming a five percent (5%) simple interest rate.

- For retirements granted after June 1, 2018, forgiveness of overpayments is possible under various proposed ordinance changes. While it is likely that there will be cases of overpayment forgiveness in the future, the financial cost of these cases is incalculable. As state earlier, it is likely to be less than $2.7 million if the Pension System is able to maintain the safeguards it is implementing to prevent future errors from occurring. However, any major error in the future could result in another substantial payment by the County.

BUDGETARY IMPACT

The total calculated cost for the proposed changes is estimated to be $2.7 million and would become immediately payable by the County. There is no current appropriation for this expense. The County would need to identify a source of funding from the 2018 Budget such as contingency funding to pay the Pension System. Because the future cost is incalculable, the impact on future budgets is unknown.

ASSUMPTIONS

- This fiscal note assumes that the proposed five percent (5%) simple interest on overpayments and underpayments applies to those liabilities that the County assumes. If the VCP requires a different interest rate, the amounts payable by the County provided herein will change.

- This fiscal note also assumes that the County will be required to pay all costs related to "death overpays" as discussed above. If the County is not required to pay this amount as requested in the 2012 VCP, the amounts payable by the County provided herein will be less. Should the proposed ordinance changes be approved, these types of overpayments would be nearly eliminated in the future, since a retiree or beneficiary would be entitled to the full month of payment in which he or she died.

- With respect to potential financial savings achievable from a reduction in the County's ARC, this fiscal note assumes none. In terms of overpayments and underpayments, a change to the ARC would be a result of a either an actuarial change in liabilities or an actuarial change in assets attributable specifically to this ordinance.

  Changes in Pension System liabilities occur when a retirement benefit is recalculated; however, this change offsets the change in liabilities that occurred when the retirement benefit was originally calculated. For example, prior to retirement, actuarial valuations project Employee X's liability at one amount, and allocate that charge to the County. If at retirement an erroneous retirement amount was granted to Employee X, the subsequent actuarial valuation would likely result in an adjustment to the total pension liability to account for the difference between the projected and actual liability for Employee X. This adjustment is then offset by another adjustment to the liability once the error is identified, and the actual retirement amount recalculated. The two adjustments offset each other. Furthermore, the correcting of retirement amounts is not a new, proposed practice, but one that has been exercised historically. Therefore, any change to the ARC due to liability modifications is not a direct result of these proposed ordinance changes, and would have occurred regardless.

Currently, the Pension System assets change as overpayments are recouped and underpayments are paid out. The proposed ordinance changes do not affect this; rather, the proposed ordinance change is directing who is responsible for fulfilling the repayment obligation for overpayments in certain situations. In other words, the Pension System under both current ordinances and proposed ordinances is required to be made whole and although a change to the assets may result, assets would have changed regardless of who made the payment. Therefore, any changes to the ARC due to asset modifications is not a direct result of these proposed ordinance changes, and would have occurred regardless.