LEOFF Plan 2 Retirement Board

December 13, 2023

Overpayment Responsibility

FINAL PROPOSAL

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ISSUE STATEMENT

When employers make an error that causes a retiree to receive an overpayment, the member is responsible for paying back the overpayment they incorrectly received.

OVERVIEW

In most cases members are responsible for paying back any overpayments they receive. However, there are situations where the employer is responsible for paying back overpayments, as well circumstances where portions of the overpayment, or other financial impacts caused by the employer misreporting information to DRS, is subsidized by the pension plan.

BACKGROUND AND POLICY

When DRS receives additional information about an employee's final average salary or service credit, they are required under RCW 41.50.130 to recalculate the retiree's retirement benefit. This is referred to as a "recalc". A recalc may result in either an increase or a decrease to a retiree's benefit. The recalc is both retrospective and prospective. As a result, two things occur: first, the retiree's monthly benefit changes moving forward. Second, DRS must either pay the retiree an additional payment of the difference in pension payments the retiree received and should have received; or collect from the retiree the difference in the pension payments they have received, and the recalculated benefit amount they should have received.

DRS prioritizes recalcs that are a result of an audit finding, as those are most likely to have the largest impacts on members. However, DRS does not audit employers on a regular basis. In fact, there are some employers who have never been audited by DRS. Instead, DRS relies on its Employer Support Division to answer employer questions and provide employer education and outreach to ensure that reporting is as accurate as possible.

When a recalc occurs and a retiree's benefit is lowered, the retiree may also owe DRS an overpayment for the pension benefits they were incorrectly paid. The determination of whether the member or employer must pay the overpayment is governed by RCW 41.50.130 – 139.

Typically, employers are only required to pay an overpayment in the following situations:

- Failure to properly report retiree return to work hours[1]; and,
- Erroneously reporting that an employee has separated from service.[2]

There is a statute of limitations of three years, under RCW 41.50.130. Under this statute of limitations, DRS can only bill the member for three years of overpayments from the discovery of the overpayment. For example, if on January 1, 2022, DRS discovered that a retiree received 10 years of overpayments. These overpayments total $10,000, $1,000 a year. DRS cannot collect the full $10,000. Instead, they may only collect $3,000, for the last three years of overpayments. The remaining portion of the overpayment, as well as any lost investment earnings, is subsidized by the plan.

Waiver of Overpayments

In most instances, the member is responsible for repaying the overpayment. This includes overpayments for an employer misreporting earnable compensation to DRS. The Director of DRS, in certain instances, may waive the collection of an overpayment under RCW 41.50.138. However, this is limited to instances of "manifest injustice".

DRS has not defined the term "manifest injustice" in WAC or in administrative policy. Generally, "manifest injustice" is used in criminal proceedings and "means something which is 'obviously unfair' or 'shocking to the conscience.' It refers to an unfairness that is direct, obvious, and observable."[3] DRS has only utilized their ability to waive collection in limited circumstances. Below is a chart of the number of times they have granted waiver of overpayment in recent years:

[1] RCW 41. 50.139

[2] RCW 41.50.139

[3] https://definitions.uslegal.com/m/manifest-injustice

Year	Approvals
1998	1
2006	2
2008	12
2010	1
2011	1
2012	4
2014	15
2015	2
2016	2
2017	11
2018	4
2021	2

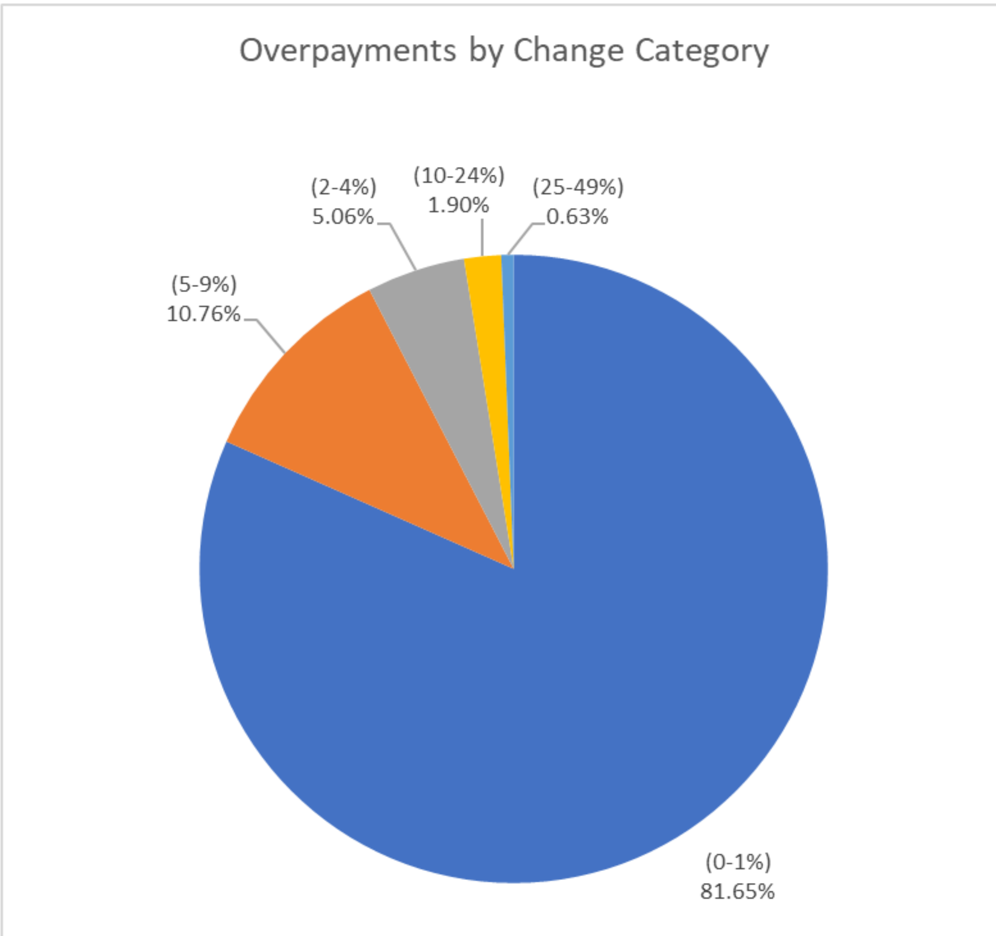
While the term is common in criminal law, it is also used in administrative law. For example, the Washington State Department of Social and Health Services (DSHS) uses the “manifest injustice” standard as an element of multi-factor test for waiving collection of certain client overpayments. DSHS has defined the term as:

> The overpayment is clearly unfair to the client based on the way that it occurred, and repayment would compromise the client's ability to meet basic needs.
>
> Factors which can be used as evidence […]:
>
> The client cannot repay the overpayment without drawing on funds needed for basic requirements. Document income and expenditures. Verify only questionable amounts.
>
> It is clear the client acted in good faith by following the rules required to maintain eligibility for public assistance.
>
>> a) The client reported income timely and accurately
>> b) The overpayment was solely due to department error; and
>> c) The client has "clean hands". That is, without fault. The client fulfilled all their responsibility to inform the department of changes in their circumstances.[4]

[4] https://www.dshs.wa.gov/book/export/html/21

Overpayment Data

DRS provided the Board with five years of LEOFF 2 Member overpayment data. The data showed that there were 3,485 recalcs that resulted in a benefit change. Of those, 150 resulted in overpayments. Twenty-Seven (27) of those recalcs had an impact to the members ongoing monthly benefit greater than 1%. Below is a chart of the 150 overpayments percentage impact on member's benefits:



Office of the State Actuary Analysis

During the November 2023 Board meeting, the Board motioned to receive a final briefing on the policy option to amend the law so that employers must pay back member overpayments when the overpayment is due to an employer error and for the statute of limitations for collecting overpayments to be shortened from three years to one year

OSA provided an analysis of the Board's proposal (see Appendix A). As part of that analysis OSA identified that shifting responsibility for paying the overpayments from the member to the employer has no expected impact on the LEOFF 2 trust fund, though it will impact employer budgets. OSA found that shortening the statute of limitation for collecting overpayments from three years to one year will result in a cost to the pension system if future overpayments continue beyond one year, because the trust fund will recover less overpaid benefits than under current law. Based on data supplied by DRS, OSA estimated that over the next 25 years, the trust fund will recover approximately $1 million less than under current law. OSA stated that this impact will not result in a supplemental contribution rate for this bill (see Appendix B).

POLICY OPTIONS

Option 1: Employer responsible and shorten statute of limitations

Employer must pay back overpayments when the overpayment is due to an employer error and the statute of limitations for collecting overpayments is shortened from 3 years to 1 year.

Option 2: Employer responsible, no change to statute of limitations

Option 3: Further study issue next interim

SUPPORTING INFORMATION

Appendix A: Bill Draft

Appendix B: OSA Email – Analysis of LEOFF 2 Overpayments Proposal, 12/1/23.

APPENDIX A

Bill Draft

AN ACT relating to pension overpayment responsibility; amending RCW 41.50.130 and adding a new section to chapter 41.50 RCW.

Sec. 1. RCW 41.50.130 is amended to read as follows:

(1) The director may at any time correct errors appearing in the records of the retirement systems listed in RCW 41.50.030. Should any error in such records result in any member, beneficiary, or other person or entity receiving more or less than he or she would have been entitled to had the records been correct, the director, subject to the conditions set forth in this section, shall adjust the payment in such a manner that the benefit to which such member, beneficiary, or other person or entity was correctly entitled shall be paid in accordance with the following:

(a) In the case of underpayments to a member or beneficiary, the retirement system shall correct all future payments from the point of error detection, and shall compute the additional payment due for the allowable prior period which shall be paid in a lump sum by the appropriate retirement system.

(b) In the case of overpayments to a retiree or other beneficiary, the retirement system shall adjust the payment so that the retiree or beneficiary receives the benefit to which he or she is correctly entitled. The retiree or beneficiary shall either repay the overpayment in a lump sum within ninety days of notification or, if he or she is entitled to a continuing benefit, elect to have that benefit actuarially reduced by an amount equal to the overpayment. The retiree or beneficiary is not responsible for repaying the overpayment if the employer is liable under RCW 41.50.139 **or New Section**.

(c) In the case of overpayments to a person or entity other than a member or beneficiary, the overpayment shall constitute a debt from the person or entity to the department, recovery of which shall not be barred by laches or statute of limitations.

(2) Except in the case of actual fraud **or overpayments under Sec 2**, in the case of overpayments to a member or beneficiary, the benefits shall be adjusted to reflect only the amount of overpayments made within three years of discovery of the error, notwithstanding any provision to the contrary in chapter 4.16 RCW.

(3) Except in the case of actual fraud, no monthly benefit shall be reduced by more than fifty percent of the member's or beneficiary's corrected benefit. Any overpayment not recovered due to the inability to actuarially reduce a member's benefit due to: (a) The provisions of this subsection; or (b) the fact that the retiree's monthly retirement allowance is less than the monthly payment required to effectuate an actuarial reduction, shall constitute a claim against the estate of a

member, beneficiary, or other person or entity in receipt of an overpayment.

(4) Except as provided in subsection (2) of this section, obligations of employers or members until paid to the department shall constitute a debt from the employer or member to the department, recovery of which shall not be barred by laches or statutes of limitation.

NEW SECTION. Sec. 2. (1) If an overpayment for a LEOFF 2 retiree was due to an employer erroneously reporting LEOFF 2 member information to the department, and the erroneous reporting was not the result of the member's nondisclosure, fraud, misrepresentation, or other fault, the employer is liable for the resulting overpayment.

(2) Upon receipt of a billing from the department, the employer shall pay into the LEOFF 2 retirement system trust fund the amount of the overpayment plus interest as determined by the director. The employer's liability under this section shall not exceed the amount of overpayments plus interest received by the retiree within one year of the date of discovery, except in the case of fraud committed by the employer. In the case of fraud committed by the employer, the employer is liable for the entire overpayment plus interest.

From:	Masselink, Luke
To:	White, Jacob (LEOFF)
Cc:	Nelsen, Steve (LEOFF); Won, Lisa; DeCamp, Mitch; Serra, Frank
Subject:	LEOFF 2 Overpayments Proposal
Date:	Friday, December 1, 2023 10:36:22 AM
Attachments:	Bill Draft.docx

External Email

Jacob,

As requested, we reviewed the impact on LEOFF 2 plan funding associated with the benefit overpayment change outlined in the attached bill draft. Below is a summary of our preliminary analysis.

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Summary of Proposed Change

This change is comprised of two components, both of which are applied in the event an overpayment is due to an employer's reporting error.

1. The employer would now be responsible for the reimbursement of the overpayments, rather than the annuitant.
2. Current law requires reimbursement of overpayments received by the annuitant, plus applicable interest, within three years of the date of discovery. This proposed change will reduce the reimbursement requirement from three years to one year from the date of discovery.

Summary of Cost Impacts

- Component 1 has no expected impact on the LEOFF 2 trust fund, though it will impact employer budgets.
- Component 2 will result in a cost to the pension system if future overpayments continue beyond 1 year, because the trust fund will recover less overpaid benefits than under current law. **Based on data supplied by DRS, we estimate that over the next 25 years, the trust fund will recover approximately $1 million less than under current law. This impact will not result in a supplemental contribution rate for this bill.**

Special Data

- DRS provided data containing all corrected LEOFF 2 overpayments that occurred over the past five years. Most of these overpayments were the result of an employer initially misreporting a retiree's salary or service. For example, an employer may have mistakenly reported a portion of a member's salary as pensionable, when in fact it was not.
- The data showed that approximately 30 overpayments were corrected each year, or 158 over the entire timeframe listed above. On average, overpayments were corrected within 20 months of the original benefit calculation date. Once the benefit was recalculated with the correct data, the average monthly benefit reduction was $62 per month.

Assumptions and Methods

- We relied on the DRS-provided data to estimate the frequency and severity of historical overpayments. We assume this experience will continue to occur in the same manner in the future. Actual overpayments could be more or less than assumed.
- To estimate the cost of this proposal, we calculated the annual expected difference between the overpayment reimbursements that the LEOFF 2 trust fund would have received under a one-year cap versus a three-year cap, based on the data provided by DRS. This annual amount was roughly $16,000. We then assumed this same loss over each of the next 25 years, grown annually with assumed salary and membership growth. This resulted in a 25-year future value cost of approximately $1 million.
- This calculation assumes salary growth of 3.25%, consistent with our 2023 Economic Experience Study. It also assumes annual membership growth of 0.80%, consistent with the Projection and Risk Assumptions Study System Growth assumption.
- Unless otherwise noted in this email, we relied on the same assumptions, methods, and data as the 2022 Actuarial Valuation Report.

Disclosures

We prepared this analysis to support LEOFF 2 deliberations during the 2023 Interim. This analysis may not be appropriate for other purposes. In my opinion, the actuarial assumptions, methods, and data used are reasonable for the purposes of this pricing exercise. However, the use of another set of assumptions, methods, and data may also be reasonable and might produce different results.

This analysis does not assume any other proposed changes to the retirement plan. The combined effect of several changes could exceed the sum of the individual components.

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If this bill were to advance during session, we would create an Actuarial Fiscal Note (AFN). The results of that AFN may change from what we have shown above, but we do not expect any changes to be significant. We may also prepare sensitivity analysis as part of that AFN, illustrating how the costs of this proposal could look different than our preliminary best estimate.

We are available to answer any questions,
Luke

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OSA website
"Supporting financial security for generations."
Pronouns (He/Him)

LEOFF Plan 2 Retirement Board

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Issue

- When employers make an error that causes a retiree to receive an overpayment the member is responsible for paying back the overpayment they incorrectly received

Issue History

- Initial Briefing in July
- Comprehensive Briefing in September
- Board requested a Final briefing on policy option to have:
  - Employer pay the overpayment when the overpayment is due to an employer error
  - Shorten the Statute of Limitations (SOL) from three (3) years to one (1) year when collecting overpayments

DRS Data

- Approximately 30 overpayments corrected each year
- Overpayments corrected within 20 months (average) of original benefit calculation date
- Average monthly benefit reduction was $62 per month after recalculation

OSA Analysis

- Shifting overpayment responsibility to the employer has no expected impact to LEOFF 2 Trust Fund
- Changing SOL from 3 years to 1-year:
  - Over 25 years, LEOFF 2 Trust Fund will recover approximately $1 million (estimated) less than under current law
  - This impact will not result in a supplemental contribution rate for this bill
- OSA Assumptions and Methods are included in the Board Materials (Appendix B)

Next Steps

1. Motion to endorse legislation making employer responsible and shortening statute of limitations from 3 years to 1 year
2. Motion to endorse legislation to have employer responsible for overpayment, but no changes to statute of limitations
3. No action

Thank You

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