

# Handling Withdrawals from Multi-Employer Public Pension Plans

June 24, 2015

Presented by

Adam Franklin  
Gina M. Ratto  
Eric Fisher



## Key Topics

- **This will be an issue of increasing importance as public employers deal with increased pension obligations**
- **Default situation is an employer cannot leave**
- **Some states have enacted statutory mechanisms to withdraw, with several common characteristics:**
  - Employers have to follow the statute to leave
  - Multi-step process
  - Employer's employees have a say
  - Withdrawing employer has to pay accrued vested benefits of its members
  - No withdrawals except for certain types of employers or certain time periods
  - Partial withdrawals

## Parameters

- Multi-employer public pension plans
- Not private plans governed by ERISA
- Not single-employer public plans
- Typically state-wide plans
  - Often for municipalities and other local governments

3

## Why Should I Care?

- Employers want to leave for several reasons:
  - Lower employer contributions as statewide plans become more expensive to cover shortfalls and changing demographics
  - Get a better return more cheaply
  - Portability for employees
  - Eliminate unfunded liabilities by leaving without paying
  - Recent GASB changes requiring recognition of unfunded liability

4



## Default – Cannot Leave

- Default is that election to join multi-employer public plan is irrevocable
- Written into statute in many states
- Okla. Stat. tit. 74 § 910(1) (“Such election shall be final and irrevocable and any employer now or hereafter participating in the System shall not be permitted to withdraw from the System under any circumstances, including a change in legal identity of such employer, where the purpose and functions of such employer remain essentially the same as at the time of filing of entry into the System.”).
- W. Va. Code § 8-22A-28 “Once a municipality or municipal subdivision elects to participate in the plan, the action is final and it may not, at a later date, elect to terminate its participation in the plan.”).
- Wash. Rev. Code. § 41.40.111(2) (“A unit of government which has become a retirement system employer may not withdraw from the retirement system.”).
- N.Y. Retire. & Soc. Sec. § 31(c) (“An agreement, made by such an employer pursuant to this section, to contribute on account of its officers and employees shall be irrevocable.”).

7

## Default – Cannot Leave

- Reasoning
  - “Clearly the Legislature intended this [public retirement] system to be permanent. It gave counties, cities, villages, and towns the right of election to come in. *It is significant that it gave them no power to withdraw.* The apparent purpose being to create a permanent Retirement System, the power to withdraw cannot be implied. If it is, a municipality may repeatedly elect to come in or withdraw.” *N.Y. State Emps.’ Ret. Sys. v. Bd. of Supervisors*, 283 N.Y.S. 405, 418 (N.Y. Sup. Ct. 1935) (emphasis added)
  - *People ex rel. Schuwerk v. Ill. Mun. Ret. Fund*, 128 N.E.2d 923, 925 (Ill. 1955) (holding there was no ability to withdraw because there was “no provision in the law for a participating municipality to withdraw from the Fund” and “no power of repeal exists as to an ordinance that constitutes the exercise of municipal power exhausted by its single exercise”).
  - *City of Tucson v. Walker*, 135 P.2d 223, 226 (Ariz. 1943) (“On July 21, 1941, the City of Tucson submitted itself to the jurisdiction of the State Police Pension Act of 1937, and we hold that it is bound by its choice. Because of such wording, may a city again and again go back and forth in the matter of selecting a suitable system for pensioning its policeman?”).
  - Colo. AG 1949 Op. No. 1469-49 (Apr. 11, 1949) (stating that a school district could not withdraw from Colorado PERA because the PERA statutes “*contain no provision whatsoever for withdrawal*”; “Since there is no provision for withdrawal in our statute, a school district that affiliates with the retirement system continues in the system regardless of the acts or omissions it performs under the acts.”) (emphasis added).

8



## Statutory Change to Allow Withdrawal

- Certain states enacted legislation allowing employers to withdraw
- Several defining characteristics

11

## Employers Have to Follow the Statute to Leave

- Read with default rule that decision to join is irrevocable
- As a result, the employer must comply with all requirements

12

## Employer Has to Follow the Statute to Leave

### Generally several steps

- Decision by employer to withdraw
- Employee vote
- Application/notification to system
- Accounting of liabilities
- Payment of liabilities
- Handling of vested and non-vested member accounts

13

## Multi-Step Process to Withdraw

### Step 1: Decision by employer to withdraw

Employer's governing body passes a resolution by majority vote (AL, AK, AR, CO, FL, ME, NH, OK\*, RI, TN, TX, UT\*)

Public hearing required (FL)

Employer resolution must pass with 2/3 vote (ID, MT)

14

## Multi-Step Process to Withdraw

### Step 2: Employee vote

- Key that employees often have a say in this decision
- Unanimous consent of employees to withdraw (AL)
- 3/4 approval of employees (NH)
- 2/3 approval of employees (AK, CO, ID, TN)
- Simple majority approval of employees (MT, RI)
- Employee “consent” required (MD)

15

## Multi-Step Process to Withdraw

### Step 3: Application/notification to system

- Explicit or implicit, must inform system that have withdrawn
- Part of requirement that must follow statute and its conditions to withdraw
- Opportunity for system to ensure have followed conditions like employee approval and later requirements like payment of liability and disposition of accounts

16

## Multi-Step Process to Withdraw

### Step 4: Accounting of liabilities

- With limited exceptions, must determine if there is unfunded actuarial liability
- Pension system actuary conducts this calculation
- Need to determine which benefits are included and the actuarial assumptions used in the calculation
- If challenged, what is the review process?

17

## Multi-Step Process to Withdraw

### Step 5: Payment of liabilities

- Cannot leave without paying
- Two general methods
- Calculation as of date of withdrawal for unfunded accrued liabilities
  - Most common
  - Payment often a lump sum but some states allow for a multi-year payment plan
- Or, workers stay in the system and there is perennial (or multi-decade) obligation on withdrawn employer to continue to make payments for unfunded liability
  - AL (perennial obligation), TN (30 year window)

18

## Multi-Step Process to Withdraw

### Step 6: Handling of vested and non-vested member accounts

- Common result—vested have option to stay in system (but not accrue further service credit) but non-vested members are forced to withdraw
- Statutes likely address how inactive members of the employer are treated
- Transfer would be to employer's new retirement plan

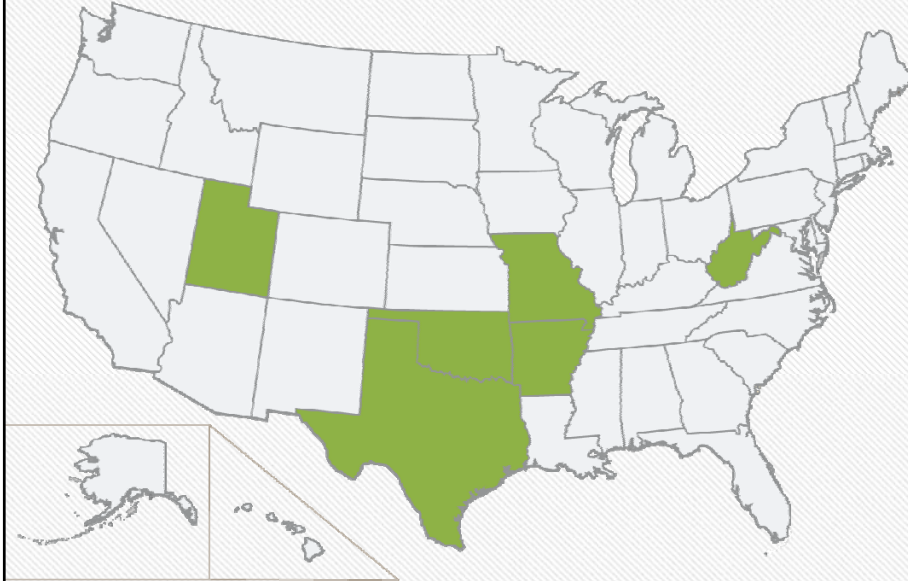
19

## Some Limitations on Withdrawals

- Only certain employers
- Colorado—only local government employers (over 150 employers out of 400 in system)—but none from four other divisions, including state agencies, schools, and judges
- Virginia—only can withdraw if employer privatizes

20

## Very Limited Withdrawal



21

## Severe Limitations on Withdrawals

- Strict conditions or narrow time periods
- Arkansas: since 1981, only water or sewer departments of municipal employer that are privatized
- Missouri: since 1968, all local governments have to be in plan except that local health agencies can withdraw
- Oklahoma: no withdrawal besides public hospitals who joined during four month period in 1971-72 and 1989-90
- Texas: can only withdraw if no active employees in system
- Utah: public hospitals only could withdraw, and they had to withdraw by June 2009
- West Virginia: four mental health services centers had option to withdraw before May 1997

22

## Partial Withdrawals

- Idaho: When membership declines by 25% for each of two consecutive years. Result is employer is treated as requesting complete withdrawal and must pay withdrawal liability.
- Montana: "Substantial number of employees"
- ERISA – 70% contribution decline in a year or partial cessation of employer's contribution obligation

23

## Other Statutory Considerations

- Requirements to set up new plan?
- Ability to re-affiliate?
- What choices do vested employees have?
- What choices do non-vested employees have?

24

## Calculating the Liability

- **Know the venue for review:** administrative or in court?
- **Plan actuary**
  - If court, is the actuary an expert under Rule 26?
  - If so, what type of expert?
  - Privilege issues may arise
- **What will be the interaction between the plan actuary and the actuary retained by the withdrawing employer?**
  - Is this an audit?
- **Presumptions accorded to plan actuary**
  - ERISA standard: “[A]ny determination made by a plan sponsor under [statute] *is presumed correct unless the party contesting the determination shows by a preponderance of the evidence that the determination was unreasonable or clearly erroneous.*” 29 U.S.C. § 1401(a)(3)

25

## California – Withdrawal Permitted

- CalPERS administers retirement benefits on behalf of the State of California and more than 3,000 public school and local agency employers, with more than 1.6 million members (employees and retirees).
- The State is “mandated” into CalPERS; “public agencies” may participate in the system, subject to an eligibility determination.
- “Public agencies” are cities, counties, districts or other local authorities or public bodies of or within the State.

26

## Withdrawal From CalPERS

- Voluntary Termination (by the Public Agency)
- Involuntary Termination (by CalPERS)
- System-to-System Transfers
  - Total or Partial
- Succeeding Agency/Mergers

27

## Requirements for Voluntary Termination

- Participation in CalPERS for at least 5 years
- Resolution of intent to terminate adopted by public agency governing body
- At least one year later, governing body must pass, by 2/3 vote, an ordinance or resolution terminating participation in CalPERS
- If participation in CalPERS was originally approved by an ordinance adopted by majority vote of the electorate, ordinance adopted by majority vote of electorate required for termination
- CalPERS Board approval of ordinance or resolution

28

## Involuntary Termination by CalPERS

- CalPERS' Board resolution adopted by majority vote
- Effective 60 days after notice of adoption of resolution mailed to the public agency
- Board may terminate if:
  - Public agency fails for 30 days after demand to pay any contributions owed to the system
  - Public agency fails for three months after demand to file any information required in administration of the system
  - Board determines public agency has ceased to exist
  - Other

29

## Liability Upon Termination

- CalPERS' actuaries perform actuarial valuation of the terminating agency's plan assets and liabilities (i.e., all existing obligations to employees and former employees)
- Excess assets returned to the public agency
- If assets insufficient, public agency must pay shortfall

30

## Terminated Agency Pool

- Upon termination, assets and liabilities of the terminating plan are merged into the Terminated Agency Pool (TAP)
- Actuarial risk to pay benefits to retirees/ employees of terminating agency shifts to CalPERS
- Assets of the TAP held for exclusive purpose of paying benefits of terminated agency employees
- As of June 30, 2013, funded status of TAP was ~249%; TAP assets conservatively invested (low discount rate)

31

## Potential Reduction in Benefits

- If the terminating agency fails to pay full amount of termination liability, “all benefits... shall be reduced by the percentage [of the shortfall]”
- CalPERS Board has some discretion to not reduce benefits in certain cases, but cannot negatively affect the actuarial soundness of the TAP

32

## System-to-System Transfers

- Several ways CalPERS service (liabilities) and associated member and employer contributions (assets) can be moved from CalPERS to another system
- CalPERS Board may, but is not required to, agree to transfer
- Few details outlined in statute; fiduciary duty to protect interests of system and members
- Very rare/infrequent

33

## Permitted System-to-System Transfers

- Transfer of entire plan of public agency to a county retirement system
- Partial transfer of local firefighters' plan due to transfer of local firefighting function
- Partial transfer of local members' plan due to transfer of particular functions of the local members

34

## Permitted System-to-System Transfers

- Partial transfer of safety members' plan due to transfer of firefighting or law enforcement functions
- Transfer of entire plan to a city retirement system
- Total or partial transfer to plan of succeeding entity

35

## Succeeding Agency/Mergers

- Merger of contracts when succeeding agency participates in CalPERS

36

## System-to-System Transfers: Examples

- Los Angeles County Employees' Retirement Association
- San Francisco Employees' Retirement System
- California municipal bankruptcy cases (considered, but so far, not pursued)

37

## Case Study: *Colorado PERA v. Memorial Health System and City of Colorado Springs*

- **Colorado PERA**
  - More than 400 employers across state
  - Withdrawal allowed since 1988
  - Ten employers had followed the provisions to withdraw, including two in 2011-2012 when Memorial dispute occurred
- **Memorial Health System**
  - system of 3 public hospitals owned by City of Colorado Springs
  - members of PERA since 1952
- **Memorial comprised 25% of PERA's local government division when withdrew**
- **Memorial first came to PERA Board in 2010**
- **Withdrawal figure of \$245M when division was \$1B underfunded**

38

### **Case Study: *Colorado PERA v. Memorial Health System and City of Colorado Springs***

- Nationwide bid for hospital system
- City to receive \$1.9B to lease Memorial for no less than 40 years
- \$259M initial payment of which \$185M was for withdrawal liability

39

### **Case Study: *Colorado PERA v. Memorial Health System and City of Colorado Springs***

- **City, instead of paying PERA, filed suit**
  - Argued withdrawal provisions did not apply to privatization or a lease
  - Argued withdrawal provisions did not apply because Memorial did not apply to PERA to leave and could not meet all requirements
  - Argued that withdrawal provisions did not apply to a partial withdrawal where Memorial was part of the City that remained a member

40

## Case Study: *Colorado PERA v. Memorial Health System and City of Colorado Springs*

- **Key Legal Issues**

- Interpretation and application of withdrawal statute
- Exhaustion of administrative remedies
- Common law claims beyond statutory provisions
- Determination and review of withdrawal liability
- Privilege issues related to PERA actuary

41

## Case Study: *Colorado PERA v. Memorial Health System and City of Colorado Springs*

- **Feb. 2014: District Court finds for PERA on summary judgment on liability**

- “The Court finds that the City and MHS violated the statutory termination provisions by failing to apply to the PERA Board to withdraw and by failing to comply with all of the statutory termination provisions prior to withdrawing its status as a PERA employer.”

- **Order left amount of withdrawal liability for trial**

- City claimed \$100M for withdrawal liability
- PERA’s actuary calculated at \$190M for liability, plus interest

- **Sept. 2014: Parties settled and Memorial paid \$190M**

42

## Resolving a Withdrawal

- Determine venue: administrative review or in the courts?
- Considerations if in court
  - Preliminary injunction
  - Equitable claims
  - Common-law claims
  - Employees/other employers
- Plan's fiduciary duties are to its members, not to the withdrawing employer

43

## Legislative and Administrative Considerations

- No ability to withdraw or terminate contribution obligations absent full compliance with all statutory provisions
- Trigger of withdrawal provisions by objective and subjective criteria giving deference to pension system to determine
- Address remedy for pension system and employees for an employer's failure to comply
- Define partial withdrawal and address privatization of portions of a workforce
- Include all plan obligations within withdrawal liability such as health plans and other benefits
- Require administrative review procedure with discretion of plan actuary
- Set forth actuarial assumptions to be applied to calculate withdrawal liability

44

## Concluding Thoughts

- Evolving area of the law
- More employers likely to consider withdrawal
- Retirement systems should be prepared for the contingency by considering what statutory and administrative provisions are needed to handle all attempted withdrawals

45

## Closing

### Our contact information

Adam Franklin  
(303) 863-3738  
afranklin@copera.org

Gina Ratto  
(916) 795-2594  
Gina\_Ratto@CalPERS.ca.gov

Eric Fisher  
(303) 223-2069  
efisher@rplaw.com

46