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Memorandum

To: Phyllis Borzi, Assistant Secretary of Labor

From: Ellen A. Bruce, Director Pension Action Center

Date: November 19, 2013

Re: Pension Plan Overpayments

A gap in the law and regulatory scheme governing the recoupment of overpayments paid to plan participants has become apparent in a number of cases which we have seen lately at the Pension Action Center in the Gerontology Institute at UMass Boston. We feel it would be helpful to share with you the challenges participants face when a plan asks for a repayment of an overpayment and our recommendations for regulatory correction. As you may be aware, there has been a very large case of under and overpayment in the Sheet Metal Workers' Local No. 73 Pension Plan based in Hillside, Ill. These cases, and others we have, illustrate the injustice of unregulated recoupments.

Background

The Sheet Metal Workers' Union Local 73 received an audit of its plan in May of 2010 that found over and underpayments going back to 1974. It filed a Voluntary Correction Program (VCP) proposal with the Internal Revenue Service calling for the recoupment of overpayments from retirees with interest. A number of these recoupments go back 30 years and are in the tens of thousands of dollars; several are over \$100,000. The plan acknowledges that the overpayments were caused by the plan's incorrectly calculating benefits between 1974 and 2004 and that the participants neither knew of the overpayment nor contributed to it. Consequently, retirees are having their benefits reduced substantially and are being asked to pay back thousands of dollars in overpaid benefits although they were not at fault and it was entirely the plan's error. Monthly benefits are being lowered to the new amount calculated by the plan. Then the benefits are reduced again by 25% to recoup the overpayment. In addition, the plan has demanded immediate payments of large lump sums, telling the retirees that it does not expect the retiree to live long enough to pay back the plan. On top of these demands, the retirees are being required to pay back interest on overpayments at the rate of 7.25%! The plan stated in the VCP submission that 589 retirees were overpaid approximately \$5,214,772. The plan is offering a financial hardship waiver program that a retiree may apply for but does

not specify the criteria upon which the plan will grant the waivers. Many recipients are wary of filling the waivers as the information required is extensive and intrusive. Also, if the waiver is denied, the retiree has just given a road map to their assets for the plan to recoup.

Current regulatory environment

Since any recovery by a fiduciary under ERISA must be in equity (§502(a)(3)), the challenge in recoupment situations is to weigh the equities between the plan recovering the plan assets that it mistakenly dispersed and individual retirees' suffering a loss of income and/or assets.

Plans justify these recoupment actions by claiming that the plan has a fiduciary duty to collect overpayments on behalf of all other participants in the plan. Due to the lack of regulatory guidance regarding the process and the limitations on recoupments, plans create their own rules. Some plans just lower the benefit amounts with little or no warning to retirees and with no formal process for challenging the plan's actions. Although a Department of Labor Advisory Opinion specifically authorizes a plan administrator to consider the financial hardship to the retiree in these situations, this guidance does not seem to be widely known or followed. Also, the application of waivers is highly subjective. There is case law that supports our position that a plan must look at all of the equitable factors before undertaking any recoupment, but this is subject to interpretation.¹

In the lack of clearer and definite guidance in this area, plans take widely varying approaches. We have succeeded in getting some plans to waive some or all of the overpaid amounts, but we have also had plans fail to even acknowledge that these issues are subject to formal claims and appeals procedures. Plans and participants would all benefit from having more definitive guidance in this area.

We ask that the Department of Labor propose regulations that would address the process plans must undertake to reduce a retiree's benefit and recoup an overpayment, provide limitations on the overpayments that can be recouped, and provide guidance for the waiver of an overpayment.

Department of Labor

The Department of Labor does not have any regulations that specifically address the issue of recoupment of overpaid benefits. The Department of Labor has issued several opinion letters which touch on the issue of recoupment of benefits mistakenly paid but there are no clear regulations or guidelines on how and when recoupments of ERISA pension benefits may be

¹ In response to our contention that equitable principles should be applied to a client's situation, the Sheet Metal Workers plan stated that "there is no settled or definitive law (including case law) that relieves the Board of their duty to seek recoupment..." Letter dated October 16, 2013, from Sheet Metal Workers Local Union No. 73 Pension Fund to Jeanne Medeiros, Illinois Pension Assistance Project.

made. (See DOL PWBP Opinion 77-07, Opinion No. 77-08, Opinion No. 77-33, Opinion No. 77-34).²

Department of the Treasury

Plans qualified under IRS regulations prohibit the assignment or alienation of benefits but this prohibition does not apply to recovery of overpayments made to participants. (26 CFR §1.401(a)-13(c)(2)(iii)). Therefore, recoupment of overpayments is permitted but guidance as to under what circumstances and how the recoupment is carried out is not provided in regulation.³

Pension Benefit Guaranty Corporation (PBGC)

PBGC has provisions that regulate its collection of overpayments at Part 4022, Subpart E §4022.81 et seq. These regulations limit recoupments to 10% of the monthly benefit or the amount of the benefit in excess of the maximum guaranteeable benefit, whichever is greater. (§4022.82(2)) The regulations also provide that no interest will be included in the calculation of the overpayment. (§4022.82(5)). In the case of overpayments made to the participant by the plan prior to termination, the regulations limit recovery to looking back three years. (§ 4045 (b)(2)(a)).

Case law

The case law relating to the collection of overpayments by the plan does not provide a clear approach to when or how a plan will be allowed to recoup an overpayment. Some cases have denied recoupment on the basis that because ERISA only allows equitable remedies, the money paid must be clearly identifiable (*Kroop v. Rivlin*, No.-CV-1401 (S.D.N.Y. Sept. 27, 2004) or because the plan did not have a clear provision to recover overpayments, (*Phillips v. Brinks Co.*, 632 F. Supp. 2d 563 (W.D. Va. 2009). In *Kapp v. Sedgwick CMS, AT&T Benefit Umbrella Plan I*, 2013 WL 26051, 3 (S.D. Ohio, Jan. 2, 2013) the court provided a six-part analysis of items to be considered in weighing the equities of recouping an overpayment for which the participant was not at fault. The six factors are:

1. The amount of time which has passed since the overpayment was made.
2. The effect that the recoupment would have on that income,

² The regulations do limit to 25% the amount a benefit may be reduced in overpayment cases where there was a suspension of pension benefits upon reemployment but guidance in other circumstances is not provided. (see 29 CFR § 2530.203-3.)

³ The IRS does provide some recoupment guidance to plans seeking to go through its Voluntary Compliance Procedures to avoid plan disqualification. Revenue Procedure 2013-12, provides that correction of an overpayment in defined benefit plans are corrected in accordance with rules “similar” to §415 failures (§6.06(3)). It does not provide more specific guidance than that and the §415 guidance is clearly meant for highly paid employees. Additionally, Revenue Procedure 2013-12 has never been subject to public comment or a hearing.

3. The nature of the mistake by the administrator,
4. The amount of the overpayment,
5. The beneficiary's total income, and
6. The beneficiary's use of the money. (Citing *Wells v. U.S. Steel & Carnegie Pension Fund, Inc.*, 950 F.2d 1244, 1251 (6th Cir. 1991).

Although these factors are useful equitable concerns for courts, they do not provide the specific guidance that would standardize the procedures and criteria for plans and participants.

Regulatory Solutions

Clarify that the administrative claims and appeals process applies to overpayments

The regulations should make clear that plans must follow the plan appeal process before it can recoup an overpayment. Some of our clients have first found out about an overpayment when they received a reduced check.

Limit the years the plan can go back

There should be some time limit to how long a plan can look back for recoupment. The three year limitation used by the PBGC seems a reasonable time for recouping overpayments that retirees did not cause. The Sheet Metal Workers' Local No. 73 Pension Plan went back 34 years which is clearly unfair to the participants.

Make clear fiduciary insurance should cover the losses for longer periods of time.

If a plan's overpayments go back farther than three years, the plan's fiduciary insurance should cover those losses. In the cases where the overpayment happened through no fault of the retiree, it likely was caused by a fiduciary breach within the plan. The risk of overpayments or underpayments caused by the fiduciary is one that the fiduciary should insure against, not the participant.

Limit the percentage of the benefit that can be recouped

Having a retiree's benefit reduced is a hardship to begin with even if the retiree is not poor or low income. It forces a retiree to readjust her spending and expectations. It can be particularly upsetting to older retirees. Reductions in the benefit even further to recoup the overpayment should be limited to soften the impact on the retiree since it was not the retiree's fault. The PBGC limits recoupment of overpayments to 10%. (29 CFR §4022.82) A reduction in benefits beyond 10% to recoup an overpayment would be unfair to the participant, especially considering that she has already had her benefit reduced due to the recalculation of the benefit.

Prohibit collection of interest on the overpayment

The collection of interest on the overpayment caused by the plan is punitive.⁴ First, the participant would never have earned any interest on the money if she spent it as she received it. Second, the interest to be paid would be difficult to determine fairly. Using the interest rate that the plan would have earned is unfair as it is highly unlikely that the participant, investing far less money, could have earned the same amount.

Set up guidelines for waivers of overpayments

In addition to regulations limiting when and how plans can recoup overpayments generally, DOL should provide guidance for when overpayments should be waived for hardship. Currently it is up to each plan to determine the criteria it will use to waive overpayments. The determination should consider not only whether the individual has assets sufficient to repay the overpayment but the loss of security which would be caused by repaying the overpayment. We would recommend that a baseline amount of liquid assets should be considered off limit. In support of this approach, Medicaid allows the spouse of an institutional Medicaid recipient to retain \$109,560, an amount which is increased by a COLA every year. Also, factors other than income and assets should be considered in determining hardship such as age and disability. It is our opinion that in cases where the overpayment was caused by the plan, recoupment should be sought only in cases where the individual has substantial assets, e.g. over \$1 million.

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⁴ In the Sheet Metals situation, interest appears to have been assessed for as many as 20 to 30 years solely because the plan did not discover the mistake and then act to correct it in a timely manner.