



State of New Jersey

PHILIP D. MURPHY
Governor

SHEILA Y. OLIVER
Lt. Governor

DEPARTMENT OF THE TREASURY
DIVISION OF PENSIONS AND BENEFITS

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ELIZABETH MAHER MUOIO
State Treasurer

JOHN D. MEGARIOTIS
Acting Director

April 18, 2019

Bernard Mihalko

[REDACTED]

RE: [REDACTED]

FINAL ADMINISTRATIVE DETERMINATION

Dear Mr. Mihalko:

I am writing in reference to the decision of the Board of Trustees (Board) of the Public Employees' Retirement System (PERS) to deny your request to cancel your outstanding loan balance and waive the accrued interest owed as determined by the Division of Pensions and Benefits (Division). The Board initially reviewed and denied your request at its meeting of January 16, 2019. You appealed the Board's decision via letter dated February 12, 2019. In your appeal, you argue that the mistake was made by the Division as it violated its own policy and procedures and did not notify you of the remaining balance owed on your loan until several years later. At its meeting of March 20, 2019, the Board considered your appeal of that decision and determined that there are no material facts in dispute and directed the Board Secretary in conjunction with the Attorney General's Office to prepare Findings of Fact and Conclusions of Law, which were presented and approved by the PERS Board at its April 17, 2019 meeting.

The Board has reviewed your written submissions and the relevant documentation, and finds that the statutes, regulations and relevant case law governing the PERS do not permit the Board to waive the accrued interest on the outstanding loan balance.

FINDINGS OF FACT

The record establishes that you were enrolled in the PERS in December 1971 as a result of your employment with Middlesex County. Prior to your retirement, you took a pension loan from your PERS account and were issued a check number 162056, dated February 6, 2002, in the amount of \$10,000.00. Interest was calculated at 4.00% per year.¹ A Certification of Payroll Deductions (certification) was issued to your employer noting that your loan deductions would begin on March 1, 2002, for a total of 24 monthly payments in the amount of \$435.33. At that time, Middlesex County should have provided you with a copy of the Certification.

On November 14, 2002, the Division of Pensions and Benefits (Division) received your retirement application requesting an Early Retirement effective January 1, 2003. On December 4, 2002, Middlesex County submitted a Certification of Service and Final Salary-Retirement form, certifying your last date of service would be on December 31, 2002. The record indicates that loan deductions were remitted on your behalf for the period from March 1, 2002 through December 31, 2002, therefore, 10 monthly payments for a total of \$4,353.30 was remitted to the Division. Thus, a remaining loan obligation existed prior to your retirement.

There is no record that the Division provided you with a payoff amount which you would be required to submit in order to satisfy the remaining loan obligation. However, you have represented you were informed through a telephone conversation with Division staff that you needed to submit a lump sum payment in the amount of \$5,112.28 in order to satisfy your loan obligation. The Division did receive your check dated January 2, 2003 in the amount of \$5,112.28, which was deducted from your loan balance at retirement, leaving an outstanding loan balance in the amount of \$834.05. At its meeting on January 15, 2003, the Board approved your Early retirement effective January 1, 2003.

¹ The interest rate of 4.00% was set by the State Treasurer pursuant to N.J.S.A. 43:15A-34.

On November 15, 2017, the Division notified you that a review of your PERS membership account revealed that you had an outstanding loan balance in the amount of \$834.05 as of January 1, 2003. The letter further indicated that prior to your retirement you had a loan balance due of \$5,946.33 and that even though you remitted a payment of \$5,112.28, a balance existed in the amount of \$834.05 which was never paid nor was it collected through your retirement checks. In order to satisfy the principal balance and accumulated interest, you were informed that the principal balance would be withheld from your December 1, 2017 retirement check and that the accumulated interest would be calculated and deducted from your January 1, 2018 check.

By letter dated November 21, 2017, you requested documentation supporting the Division's findings that you had a loan balance prior to your retirement. Further, you did not recall submitting a personal check for \$5,112.28. Subsequently, you were provided with a notice that interest is owed in the amount of \$676.22. The interest period is from January 1, 2003 through December 31, 2017 and an interest rate of 4.00% was used to determine the amount of interest. The interest rate for loans requested prior to June 8, 2007 is set at 4.00%. N.J.S.A. 43:15A-34. Loans requested after June 8, 2007 have an interest rate set annually by the State Treasurer. Ibid. The interest rate remains constant through the life of the loan.

On December 13, 2017, the Division provided you with account screen prints and documents related to your loan. You were advised that the Division was unable to verify how the payoff amount was communicated to you since there was no record of a payoff letter with the figure of \$5,112.28. Further, you were informed that all pension loans must be repaid to the retirement system in accordance with the PERS enabling statutes, including the Correction of Errors N.J.S.A. 43:15A-54. Additionally, the Division was unable to waive any interest for the outstanding loan balance as N.J.S.A. 43:15A-34 and 34.1, the Internal Revenue Code (IRC) and applicable regulations require that interest be paid on the loan balance until the loan is fully paid. You were provided with appeal rights to the PERS Board.

On January 31, 2018, you informed the Division that prior to your retirement you contacted the Division and were informed that the balance owed was \$5,112.28, which you paid. You requested the Division cancel the outstanding loan obligation as well as waive the accrued interest in the amount of \$676.22. By way of letter, dated February 14, 2018, the Division reiterated that it was unable to waive any interest on the outstanding loan balance. By copy of said letter, the Board office was notified of your appeal of the Division's decision. On February 28, 2018, you were advised that your appeal was pending and that you would be notified when the matter was scheduled for consideration.

On December 11, 2018, you were notified that the PERS Board would consider your appeal at its meeting on January 16, 2019. The Board considered your submission as well as all relevant documentation and denied your request to refund the accrued interest in the amount of \$676.22². The basis for the Board's decision was set forth in its letter dated January 22, 2019.

Thereafter, you appealed the Board's determination. In the appeal, you noted your prior arguments and requested the Board return the \$676.22 to you due to the extenuating circumstances of the matter, including your position that the Division quoted you the payoff figure of \$5,112.28, the Division's failure to collect the outstanding loan balance when you first retired, and the length of time it took for the Division to notify you of the outstanding loan balance. The Board considered your appeal at its meeting of March 20, 2019. The Board determined that there were no material facts in dispute and directed the Board Secretary in conjunction with the Attorney General's Office to prepare Findings of Fact and Conclusions of Law which constitutes the Board's Final Administrative Determination.

CONCLUSIONS OF LAW

N.J.S.A. 43:15A-34 governs the repayment of a PERS member's pension loan and states in part that "[t]he rate of interest for a loan requested by a member prior to the effective date of

² This amount was deducted from your January 1, 2018 retirement check.

P.L.2007, c.92 (C.43:15C-1 et al.) shall be 4% per annum on any unpaid balance thereof." After the enactment of Chapter 92, the State Treasurer sets "a commercially reasonable rate" on January 1 of each calendar year. Ibid. Further:

Loans shall be made to a member from the member's aggregate contributions. The interest earned on such loans shall be treated in the same manner as interest earned from investments of the retirement system.

[N.J.S.A. 43:15A-34.]

N.J.S.A. 43:15A-34.1 governs the payment of loans carried into the member's retirement:

In the case of any member who retires without repaying the full amount so borrowed, the Division of Pensions and Benefits shall deduct from the retirement benefit payments the same monthly amount which was deducted from the compensation of the member immediately preceding retirement until the balance of the amount borrowed together with the interest is repaid. In the case of a pensioner who dies before the outstanding balance of the loan and interest thereon has been recovered, the remaining balance shall be repaid from the proceeds of any other benefits payable on the account of the pensioner either in the form of monthly payments due to his beneficiaries or in the form of lump sum payments payable for pension or group life insurance.

The PERS is a "qualified governmental defined benefit plan pursuant to sections 401(a) and 414(d) of the federal Internal Revenue Code of 1986, as amended, or such other provision of the federal Internal Revenue Code, as applicable, regulations of the U.S. Treasury Department, and other guidance of the federal Internal Revenue Service." N.J.S.A. 43:3C-18(a). The Director of the Division is "authorized to modify the provisions of the [PERS], when a modification is required to maintain the qualified status of the [PERS] under the Internal Revenue Code of 1986, applicable regulations of the U.S. Treasury Department, and other guidance of the federal Internal Revenue Service (IRS)." N.J.S.A. 43:3C-18(c).

IRC Section 401(a) and federal tax law require that pension loans comply with IRC Section 72(p). Specifically, IRC Section 72(p)(2)(B) requires pension loans to be repaid within 5 years of issuance and IRC Section 72(p)(2)(A) prohibits total outstanding loan amounts from exceeding

\$50,000. Ibid. If a member fails to repay the pension loan within the 5-year period or the amount exceeds the IRS limit, then the loan becomes a “deemed distribution” taxable as income to the member and subject to additional penalties. IRC Section 72(p)(1). The deemed distribution does not cancel the loan obligation, which still must be repaid to the Plan, with applicable interest. See Rev. Proc. 2016-51, Section 6.02(1).

The PERS Board is also aware that the issue of the repayment of loans in retirement implicates more than just your loan. Because the PERS is a federally tax-qualified plan, as required by N.J.S.A. 43:3C-18(a), the PERS’s failure to comply with all the requirements of the IRC could result in the IRS determining that the PERS is no longer a tax-qualified plan under IRC Sections 401(a) and 414(d). To that end, the Board is aware that the State Treasurer and Director of the Division, in accordance with his authority and responsibility under N.J.S.A. 43:3C-18(c) to keep the PERS tax-qualified, signed a Closing Agreement with the IRS. In addition to setting forth methods to repay certain loans, the Closing Agreement reiterates that the plan is subject to IRC Section 72(p). Even when a loan is not properly repaid under the provisions of IRC Section 72(p), and there is a reported deemed distribution, the deemed distribution would not relieve a member of the obligation to repay the loan, with interest.

While the Board noted that the remaining balance on your loan was not carried into retirement and that this last payment was not deducted from your monthly retirement benefit, N.J.S.A. 43:15A-54, provides for the correction of errors, stating, in pertinent part:

If any change or error results in an employee or beneficiary receiving from the retirement system more or less than he would have been entitled to receive, then on discovery of the error, the retirement system shall correct it and, so far as practicable, adjust the payments in such a manner that the actuarial equivalent of the benefit to which he was correctly entitled shall be paid.

While the Board noted your arguments, it has no authority to grant your request to waive and refund the amount of accrued interest charged on your loan as doing so could harm the overall pension scheme. See Sellers v. Bd. of Trs., Police & Firemen's Ret. Sys., 399 N.J. Super.

51, 62 (App. Div. 2008). Reducing interest on the outstanding loan balance would violate N.J.S.A. 43:15A-34 and N.J.S.A. 43:15A-34.1, IRC Section 72(p), and the State's Closing Agreement with the IRS, which could result in the PERS no longer being considered a tax-qualified plan, which would affect the entire State, all employers in the PERS, and every member and retiree.

As noted above, the PERS Board has considered your written submissions and because this matter does not entail any disputed questions of fact, the PERS Board was able to reach its findings of fact and conclusions of law in this matter on the basis of the retirement system's enabling statutes and without the need for an administrative hearing. Accordingly, this correspondence shall constitute the Final Administrative Determination of the Board of Trustees of the Public Employees' Retirement System.

You have the right, if you wish to appeal this final administrative action to the Superior Court of New Jersey, Appellate Division, within 45 days of the date of this letter in accordance with the Rules Governing the Courts of the State of New Jersey. All appeals should be directed to:

Superior Court of New Jersey
Appellate Division
Attn: Court Clerk
PO Box 006
Trenton, NJ 08625

Sincerely,



Jeff Ignatowitz, Secretary
Board of Trustees
Public Employees' Retirement System

G-10/JSI

C: C. Chianese (ET); D. Dinkler (ET); M. Kusmierczyk (ET)
DAG Amy Chung (ET); DAG Robert Kelly (ET)