Office of Internal Audit

Required Minimum Distribution (RMD) Audit

August 14, 2023

Executive Summary

We have completed an audit of the Required Minimum Distribution (RMD) process managed by the Benefit Initiation Section (BIS) within the Benefit Services Bureau (BSB) of the Division of Retirement Services (DRS). This audit was completed in accordance with the fiscal year 2022-2023 Biennial Audit Plan to determine if the Department of Employee Trust Funds (ETF) has processes in place to ensure compliance with Internal Revenue Service (IRS) RMD requirements for retirement benefits.

For the audit period, which covered the RMD cycle for calendar year 2022, there were approximately 1300 members included in the process. Overall, we concluded that ETF has a formal process in place to monitor for and distribute RMDs. When the inactive members identified as requiring an RMD responded timely to ETF's mailed communications, benefits were distributed timely to meet the RMD requirements.

However, we found there were some process design issues that affected compliance with the RMD requirements in certain instances. These issues primarily related to active members at the required age who subsequently retire and those members who did not respond or respond timely to ETF's mailed communications. The current system configuration of the process, the division of the process among multiple areas of ETF, limited staffing resources within BIS having to be prioritized elsewhere, and some member non-responsiveness were all contributing factors to the issues identified. We provided management with recommendations in three areas to address these process design issues.

We also identified other process improvement recommendations for management's consideration. These focused on improving the customer experience by attempting to avoid mailing communications to those who have already taken the required benefit, clarifying communications, and avoiding sending communications to old addresses. We also provided considerations where additional data could be used in the process to assist in timely compliance with the requirements. Additionally, we provided suggestions for management to consider reducing the workload of the time intensive process.

Audit Objective and Scope

Our audit was conducted in conformance with International Standards for the Professional Practice of Internal Auditing.

The objective of our audit was to determine if ETF has processes in place to ensure compliance with IRS RMD requirements for retirement benefits. The scope included the RMD process in place for calendar year 2022. RMDs applicable to beneficiaries after a participant's death were not included in the scope of this audit. Additionally, we did not review the calculation of the benefits distributed.

Background

<u>RMD Requirements</u>
Wisconsin Statutes Chapter 40.015 and 40.23(4) require the Wisconsin Retirement System (WRS) to be administered following the IRS' RMD rules. Under section 401(a)(9) of IRS Code, for the WRS to be a qualified pension plan, the plan must "provide that the entire interest of each employee: (1) will be distributed to such employee not later than the required beginning date, or (2) will be distributed, beginning not later than the required beginning date, in accordance with regulations, over the life of such employee or over the lives of such employee and a designated beneficiary…". The Code in effect during 2022 resulted in the required beginning date for WRS members being April 1 of the calendar year following the later of – (1) the calendar year in which the employee attains age 72, or (2) the calendar year in which the employee retires. We note that the required age changed in 2023, going forward, which was outside the scope of our review.

Wisconsin Statutes Chapter 40.23(4) provides further guidance on when and how a benefit should be forced. However, the statutory language is more restrictive than the federal requirements on the timing of forcing a benefit. Wisconsin Administrative Code Chapter ETF 20.07 also includes information about the annuity options for RMD automatic distributions. However, the ages included within the Administrative Code language relating to RMDs are outdated and not aligned with federal requirements. BSB management indicated that ETF is actively attempting to change the State requirement language to align with the federal requirements. In the meantime, Wisconsin Statutes Chapter 40.015(2) states that, "No benefit plan authorized under this chapter may be administered in a manner which violates an Internal Revenue Code provision…", which allows ETF to ignore the more restrictive and outdated State requirement language and administer in accordance with federal requirements.

In 2022, failure to take a timely RMD, could result in a 50% tax on the amount required to be taken, but not withdrawn. ETF as the plan administrator is required to force the RMD if not taken proactively by a member. However, when that is not possible, the member (as the owner of the account) is considered ultimately responsible for the RMD, and any penalties associated with not taking it.

ETF's RMD Process

ETF's BIS is responsible for calculations, eligibility determination, and processing related to various aspects of the WRS, including required distributions. Starting at one year prior to the RMD required age and continuing in subsequent years, BIS conducts an annual review to identify and communicate the RMD requirement with those WRS members who are no longer employed (inactive) and who have not taken a benefit. For 2022, this included identifying inactive members who were turning 71 or older that calendar year, which included approximately 1300 members[1]. BIS sends these members a *Forced Distribution Letter* (ET-4840) along with RMD requirement information to notify the member of the requirement to take a benefit. The ET-4840 mailing serves two functions. First, it notifies members that action will soon be required. Second, it asks members to confirm their address so that ETF can generate a retirement estimate, send a separation benefit application, or eventually force a distribution if the member does not apply. ETF does not send application materials or force a benefit without a confirmed address. The mailing is repeated a second time for those who don't respond. The mailings are completed in groups, based on age and whether it is going to the original participant or an alternate payee. This allows communications to be specific to each group. For the 2022 RMD cycle, the mailings were broken out as follows:

Mailing Age Groups	**Mail Date**	**Count**
Original Participant Turning 71 – First Mailing	2/9/2022	903
Original Participant Turning 71 – Second Mailing	5/17/2022	359
Alternate Payee (for which Original Participant Turning 71) – First Mailing	2/9/2022	10
Alternate Payee (for which Original Participant Turning 71) – Second Mailing	5/17/2022	4
Original Participant Turning 72 or older – First Mailing	3/14/2022	386
Original Participant Turning 72 or older – Second Mailing	8/24/2022	175
Alternate Payee (for which Original Participant Turning 72 or older) – First Mailing	3/14/2022	5
Alternate Payee (for which Original Participant Turning 72 or older) – Second Mailing	8/24/2022	2
Total Forms Mailed (includes First & Second mailings to same person)		1844
Total Individuals Included (Sum of First Mailing Counts above)		1304

When an individual returns an ET-4840, this triggers a case in ETF's imaging and workflow system, OnBase, for action to be taken by ETF staff. The case designates the

[1] For accounts that have an Alternate Payee (former spouse or domestic partner of a WRS member to whom the court has awarded a percentage of a member's WRS account or annuity through a Qualified Domestic Relation order), the RMD requirements are based on the original participant's age.

workflow as being part of the RMD process. BIS will review the returned form and then route the case to DRS' Member Services Bureau (MSB). MSB will then send a Retirement Benefit Estimates and Application or a Separation Benefit Application, depending on the member's vesting status. This is accompanied by RMD information explaining what will occur if their application is not received, customized for the age group they fall into. For members who return the designated application, the case will go back to BIS and a benefit will be paid as requested before the required date.

If a member returns the ET-4840, but fails to return the application materials sent, BIS will force the benefit (i.e., make an automatic distribution). A forced benefit will result in a lump sum payment of the account balance, or a life annuity with 180 payments guaranteed, depending on benefit value and vesting status of the account. Due to the configuration of the process and limitations in OnBase reporting, BIS manually tracks, using an Excel spreadsheet, who has returned an ET-4840 and whether they have applied for a benefit, or a benefit has been forced.

If a member does not respond to the ET-4840, BIS will add them to a spreadsheet, known as the 72 Abandoned List. This list is then provided to MSB for further contact attempts. However, this action creates a gap in the process. Based on the individuals included in our testing, when MSB was subsequently able to contact individuals prior to the RMD required beginning date, benefits were still not being forced as required.

Additionally, if a member does not return the ET-4840, but instead calls or submits an online request for an estimate and application, this individual can circumvent the workflow process that is triggered in OnBase by the return of the ET-4840. Depending on when this happens within the process and how quickly a member returns an application, if they do at all, a RMD may not be made timely.

Results and Recommendations

Positive Results

ETF has a formal process in place to monitor for and distribute RMDs. For the inactive members identified, who responded timely to ETF's mailed communications, benefits were distributed timely to meet the RMD requirements.

Findings, Recommendations and Management Responses

ETF is to distribute a lump sum payment or start a member's annuity by the IRS required beginning date. For participants in 2022, this meant the later of April 1 in the year they reached 73 or April 1 in the year after they retired. However, we found there were some process design issues that affected compliance with this requirement in certain instances. Due to the manual nature of ETF's RMD process, limitations of the workflow process as configured in OnBase and other ETF system limitations, and some non-responsiveness from ETF members, the process is very time intensive. BSB management has had to prioritize limited staff resources among competing priorities. Additionally, the process involves different bureaus of DRS, which leads to some siloed information and steps within the overall process. These factors all contributed to missed or untimely RMDs.

1. Late RMDs for Employees Terminating at or over RMD Age

Finding
ETF's monitoring for RMDs consists of an annual report, run in the first quarter of the calendar year, for inactive members who are over, at, or within one year of the required age. Members who work past the required age are not included in the RMD process until their employer sends the termination data to ETF, and ETF picks it up in the next annual RMD cycle. Depending on the timing of termination and data update in ETF's systems, members may only get an ET-4840 a month or two before the April 1 deadline to take an RMD in the year after they terminate employment. Others may not get an ET-4840 until after that deadline has passed (in a subsequent year). We identified five individuals in our sample of 60 who missed the RMD deadline as a result of this.

Risk/Effect
Members who are at or over the RMD age, who don't proactively apply on their own by the end of the year that they terminate employment, will most likely not be included in ETF's RMD process in time to take a benefit by the required date.

Recommendation
BIS should consider and collaborate with other business areas to complete additional monitoring of and communication with active members nearing the required age. This could include:

- Incorporating a specific communication in the Annual Statement of Benefits mailing for those actives at or over the required age, reminding them that upon termination, they need to confirm their address and apply for their benefits by calendar year end.
- Sending the ET-4840 or an alternate letter to actives who are at the required age, instructing them to apply by year-end if they terminate employment.
- Adding a component in the recommended cycle-end review (see Finding 2 below) to identify any individuals terminating employment during the cycle year who are at or over the RMD age.

Significance: Medium – High

ETF Management Response
ETF Management agrees with this recommendation. We will implement these changes to the Annual Statements of Benefit during the next annual production cycle (ending in spring 2024) and examine solutions (including those suggested herein) for better communications with active members near RMD age.

Responsible Staff: Jim Guidry, Benefit Services Bureau Director and Gene Janke, Benefit Services Bureau Deputy Director.

Completion Date: 6/1/2024

2. RMD Cycle-End Review to Address Process Gaps

Finding

When members do not return the ET-4840 and are at the required age, they are added to the 72 Abandoned List by BIS and sent to MSB. However, there is not adequate tracking or follow-up done by BIS, in terms of the RMD process, to find out if these individuals were located and whether a benefit should be forced. Essentially, adding them to this list, stops the RMD process in the current cycle.

Additionally, a member can circumvent ETF's configured RMD workflow process when they don't return an ET-4840, but rather call or submit an online request for an estimate and application. In this instance, they would go through the typical benefit application process, but would not be in the workflow to force a benefit if they failed to return the application materials.

Due to staffing resource limitations, the manual tracking list used by BIS to monitor members through the RMD cycle is not being updated to the level it should be, to account for workflow issues caused by members not returning the ET-4840. Additionally, no final review is done by staff or management prior to the required date to ensure appropriate RMDs were taken for members who could be located.

For our random sample of 60 from the 72+ group, we found that 11 of 60 sampled (or approximately 18% of the random sample population) could have had forced distributions to meet RMD requirements but did not. Of these:

- Eight were due to members not returning the ET-4840, being put on the 72 Abandoned List, and not being tracked past this point. For these, contact was made late in the year by MSB. However, no benefit was forced since follow-up on these is not included in the design of the RMD monitoring process.
- One was due to the member calling in to request an estimate rather than sending in the ET-4840.
- One member submitted the ET-4840 just prior to the RMD required date. BIS indicated there was confusion relating to the Customer Experience initiative and providing a member the opportunity to apply, even with the deadline and possible IRS tax penalty.
- One seasonal employee who has typically worked spring through fall returned the ET-4840 in August and was sent a separation application, which was never returned. The employee was not working as of the RMD required date. Per ETF's internal policy, because seasonal employment is not guaranteed each year, seasonal employees are required to take RMDs, even if they plan to return to

work. However, the benefit wasn't forced due to lack of sufficient staff resources to process and monitor RMDs.

Risk/Effect

ETF did not force benefits for 11 members who they could and should have. Additionally, when members do not receive an RMD by their required date and have to be included in the next RMD cycle, member communications may become more complicated for ETF staff to manage if there is a change in IRS requirements, as occurred in 2023.

Recommendation

BIS should complete a RMD cycle-end analysis to determine if there are additional forced benefits to be distributed based on late information submitted by members and/or the ability of ETF to locate members that were previously not responding. This review should include adding members at or above the required age, whose employers reported a termination during the year after the running of the annual RMD report.

Significance: Medium – High

ETF Management Response

ETF Management agrees with this recommendation. We will revise the process to ensure that members who have a confirmed address and have not applied for the benefit are properly forced. After a preliminary meeting of DRS leadership, there is an agreement that the entire process should be analyzed in a comprehensive approach and may result in a redesign of the process. An emphasis will be placed on the type of situations referenced above and being in compliance by completing forced distributions if members do not respond timely. This process review will include examination of the "Process Improvement Considerations" listed at the end of this report (such as, timing and frequency of RMD report, edits to the ET-4840, and improved address information).

Responsible Staff: Jim Guidry, Benefit Services Bureau Director and Gene Janke, Benefit Services Bureau Deputy Director

Completion Date: 1/1/2025

3. RMD Process Procedures and Published Information

Finding

BIS RMD process procedures had not been updated to reflect the move to OnBase and changes in law. This was a known issue and staff plan to update them as time permits. The procedures currently do not document the entire RMD process, including the part of the process covered by MSB, which is detailed in a separate MSB procedure document. An assessment and corrective action for when members may get excluded from the forced distribution workflow for not returning the ET-4840 is also not included. Some additional cross-bureau collaboration and training is needed to mitigate issues resulting from the current process design issues.

Additionally, we found a few ETF brochures and forms, not specific to the RMD process, but that reference RMD requirements, that are not being updated as RMD requirements change. The process being split, and the ownership of some ETF communications being split, between BIS and MSB has led to some siloed knowledge and responsibilities over ensuring updates are made for the RMD communications.

Risk/Effect
Not documenting the process from beginning to end, including the process gaps and mitigation strategies could cause knowledge to be lost internally and would make cross-training difficult. Due to the design of the process in ETF's systems, without identification of process gaps, consideration of mitigating action, and additional collaboration with other areas of DRS outside of BIS, members may drop out of the process if they don't respond to the ET-4840 and miss getting a timely distribution. Additionally, members may receive incorrect or conflicting information, leading to confusion, if not all RMD information is consistently updated.

Recommendation
When BIS updates their RMD procedures, collaboration with other areas of DRS, should result in RMD procedural documentation that includes the following items:

- Detail of the process from beginning to end including the BIS and MSB portions.
- Identification of any process gaps caused by current system configuration issues and mitigating action to be taken.
- Policy discussing the need for RMD compliance over allowing members time to apply.
- Listing of all ETF forms and communications that contain RMD requirement information.
- Methodology for planned annual training/guidance to be provided to DRS staff pertaining to RMD requirements, especially where process gaps have been identified.

DRS, comprehensively, also needs to ensure all ETF communications containing RMD requirements are appropriately updated when federal requirements change.

Significance: Medium – High

ETF Management Response
ETF Management agrees with this recommendation. DRS management will need to take a comprehensive approach to accomplish this recommendation by conducting a business process analysis. This will accomplish the identification of process gaps caused by current system configuration issues and clarify and codify policy. OIA’s findings show the need for an overhaul of the process that may require a redesign. In the short term, BIS and MSB will combine and store their procedures and RMD related

materials in a shared location so documentation on different administrative responsibilities is accessible by all responsible units. This can be done immediately. Annual training will be provided to DRS staff pertaining to RMD requirements, especially where process gaps have been identified. This requires a cross divisional effort of dedicated resources including trainers, a business analyst, and possibly a policy advisor. As part of the business process analysis, a priority will be placed on making sure that the issues in the findings are resolved. This multi-unit collaborative approach to process review and updating will also provide opportunities for incorporating the process improvement suggestions presented below that ensures that they are integrated in a way that minimizes the mailing inefficiencies identified and also allows for RMD processes to be performed at times during the year that minimizes the impact to other business needs for all DRS units involved.

Responsible Staff: Jim Guidry, Benefit Services Bureau Director and Gene Janke, Benefit Services Bureau Deputy Director

Completion Dates:
- Detail of the process from beginning to end including the BIS and MSB portions – October 1, 2023.
- Identification of any process gaps caused by current system configuration issues and mitigating action to be taken – July 1, 2024.
- Policy discussing the need for RMD compliance over allowing members time to apply – September 1, 2024.
- Listing of all ETF forms and communications that contain RMD requirement information – October 1, 2023.
- Methodology for planned annual training/guidance to be provided to DRS staff pertaining to RMD requirements, especially where process gaps have been identified – May 1, 2024.

Process Improvement Considerations and Other Items to Note

Other process improvement considerations to increase the efficiency and effectiveness of the RMD process were provided to management and are detailed below.

- <u>Reduce Lag Time Between List Generation and Mailing</u>
  For 2022, the report to identify individuals for the RMD mailing was run in January, but the mailing was not completed until March. Due to the lag time between the RMD report run and the mailing, some members received an ET-4840 despite having satisfied the RMD requirements. Additionally, other members were excluded from the mailing list who should have been on it, due to terminations reported during the lag time. From our sample of 60, there were six members who were sent an ET-4840 after a benefit was paid or set up. From our RMD report completeness testing, we also identified two members who were excluded from the mailing because their terminations were reported in February

after the report was run. This can lead to member confusion and missed notifications, reflecting poorly on ETF's customer service.

  - Recommendation: BIS should consider having the RMD report run closer to the time of mailing.

- ET-4840 Language Modifications
  If a member who is sent an ET-4840 does not return it, they will be put on the 72 Abandoned List which halts the RMD process and directs MSB to make further location attempts. This can result in an untimely or missed RMD. While some members may not receive the ET-4840 due to ETF having an incorrect address, it appears that others are simply ignoring it, potentially thinking that the benefit will just be forced.
  - Recommendation: ETF could consider adding specific language to the ET-4840 that if a member doesn't return the form, confirming their address, ETF is not able to send application materials or force a required distribution.

  As previously noted, the report to identify individuals for the RMD mailing was run in January, but the mailing was not completed until March. During the time between the report run and mailing, some members had benefits set up or paid. From our sample of 60, four members were sent an ET-4840 after a benefit had been paid and two members were sent an ET-4840 in March 2022 despite having an annuity scheduled to begin in April 2022. As noted previously, reducing the lag time between creating the RMD report and the mailing could reduce the risk of a member receiving an ET-4840, after satisfying the RMD requirement. However, it is likely that instances could still occur, due to timing differences with when a benefit is processed versus when the mailing goes out.
  - Recommendation: ETF could consider updating the ET-4840 to include disclaimer language that address information should be submitted unless a benefit has been received or a signed application is on file with ETF.

- Use Most Recent Address Information
  We found one member who reported an address change after the first ET-4840 mailing by other means than returning the ET-4840. A second ET-4840 was then sent to the former address. While this notification from the member could serve as address confirmation for the RMD process, BIS staff would not necessarily know that this change was submitted. The report used for the ET-4840 mailings is not rerun for the second mailing to incorporate the most recent address information. Therefore, a member may not receive mail communications or if they receive forwarded mail, may be confused as to why ETF is not using the most recently provided address.
  - Recommendation: If BIS continues to do a second mailing, consider rerunning the RMD report to identify any address changes between mailings.

- Using Annuity Deposit Data from Other Benefits Paid to the Member to Force RMDs for Members Not Responding to ET-4840s
  Two of the eight members identified in Finding 2 as not having a forced distribution after being put on the BIS 72 Abandoned List and being subsequently contacted by MSB, were actually receiving annuities from ETF as beneficiaries for other accounts. Thus, ETF had confirmed direct deposit information already for these members. This type of cross-reference is not being done currently.
  - Recommendation: To improve customer experience, BIS could discuss with the business analyst running the RMD report, whether the report can be modified to assist in identifying these instances. Otherwise, if staff resources would allow, this type of cross-reference could be included in the recommended cycle-end review included in Finding 2.

- Reduction and Prioritization of Work Effort
  There is one individual assigned in BIS to oversee the RMD process, which includes the eight separate mailings, tracking of approximately 1300 individuals (for 2022), and forcing of benefits. Staff and management indicated that there are limited resources to dedicate to the time intensive RMD process. The need to prioritize other things may delay the process or not allow for it to be completed in its entirety.
  - Recommendation: BSB management could assess the effectiveness of doing two mailings versus one and determine if one mailing, mid-year to those who are a year younger than the required age (71 mailing for our review) is sufficient.
  - Recommendation: ETF could prioritize sending out the mailing to those at the required age (72+ for our review) before the younger age mailing.

Member Account Data Inaccuracies – We recognize data cleansing and data management has been a focus of ETF for several years. During our review, we noted a few instances where incorrect data impacted the RMD process. There was one member in our sample of 60 who received an ET-4840, despite having been on a retirement annuity for several years, due to incorrect processing of their account in ETF's systems. An additional three members were incorrectly sent an ET-4840 because their employers had provided the wrong date of birth for them. While not significant in terms of compliance with RMD requirements, sending non-applicable notifications to members can reflect poorly on ETF's customer service. We are reporting these examples to demonstrate the specific effects of continued risk of incorrect data due to human error and/or incorrect employer reporting. Member online access to accounts, as planned in ETF's pension administration modernization efforts, would allow members to see their data and help to mitigate this risk. We note that for the instances identified here, it appears incorrect data has now been updated, and we did not identify any action items for ETF to take.

Audit Methodology

The OIA conducted this audit by performing the following testing procedures:

- Reviewing ETF information communicated to members for accuracy as compared to IRS RMD requirements.
- Reviewing the report of members identified for inclusion in the RMD process for accuracy and completeness.
- Reviewing a sample of members included in the RMD process for appropriate RMD communications, timely benefit distribution, and the forcing of a benefit when necessary. The sample tested included 25 of the 913 members in the 71 RMD population and 60 of the 391 members in the 72+ RMD population.