



H.F. 3938
(Murphy, M., by request)

S.F. XXXX
(_____)

Executive Summary of Commission Staff Materials

Affected Pension Plan(s): Volunteer Firefighter Relief Associations
Relevant Provisions of Law: Portions of Minnesota Statutes, Chapters 6, 69, 356, and 424A
General Nature of Proposal: Recommendations of the Volunteer Fire Working Group sponsored by the State Auditor
Date of Summary: March 27, 2008

Specific Proposed Changes

The bill:

- (a) requires public accountants to report volunteer firefighter relief association misconduct;
- (b) authorizes security brokers to hold pension plan assets directly;
- (c) allows subgrouping of mutual fund investments for applying statutory limits on "other" investments;
- (d) requires security brokers to provide written acknowledgment of security insurance coverage;
- (e) adds a specific statutory definition of "ancillary benefits";
- (f) allows volunteer firefighter relief associations and their municipalities a local option in defining "surviving spouse";
- (g) eliminates an obsolete deferred service pension interest provision;
- (h) eliminates a mandated method for deferred service pension interest calculations;
- (i) clarifies the current ancillary benefit limitations; and
- (j) eliminates the authorization for the payment of funeral benefits from volunteer firefighter relief association special funds.

Policy Issues Raised by the Proposed Legislation

1. Appropriateness of adding pension plan activities to the public accountant misconduct reporting requirement.
2. Appropriateness of permitting investment broker-dealers to directly hold public pension plan assets.
3. Accuracy and appropriateness of the proposed refining of the "other investment" limitation determination process.
4. Appropriateness of redefining "surviving spouse" for volunteer fire benefit coverage purposes and the appropriateness of local options in the definition.
5. Appropriateness of allowing diverse methods for calculating deferred service pension interest.
6. Appropriateness of the proposed clarification of the ancillary benefit limitation.
7. Appropriateness of retaining the current short service enhanced death benefit provision.
8. Appropriateness of repealing current local volunteer firefighter relief association laws not conforming with ancillary benefit limitations.
9. Appropriateness of removing funeral benefits as an authorized volunteer firefighter relief association special fund disbursement.

Potential Amendments

- H3938-1A (technical amendment) renumbers various clauses within a paragraph in Section 3 of the bill to make the provision read more clearly.
- H3938-2A (technical amendment) corrects a grammatical error in Section 3 of the bill.
- H3938-3A eliminates the change allowing broker-dealers to hold pension plan assets directly.
- H3938-4A enhances the requirement for "excess SIPC insurance" if the broker-dealer holding of assets is to be retained.
- H3938-5A requires additional disclosures about the limitations in any "excess SIPC insurance."
- H3938-6A eliminates local option in surviving spouse definition, with status set at active service termination.
- H3938-7A eliminates local option in surviving spouse definition, with status set at date of death.
- H3938-8A retains single deferred service pension interest calculation method.
- H3938-9A adds liability calculation procedure to account for short service enhanced survivor benefit coverage.
- H3938-10A repeals nonconforming local ancillary benefit laws, with local approval.



TO: Members of the Legislative Commission on Pensions and Retirement
FROM: Lawrence A. Martin, Executive Director *JAM*
RE: H.F. 3938 (Murphy, M., by request); S.F. xxxx: State Auditor's Volunteer Fire Working Group Recommendations
DATE: March 12, 2008

Summary of H.F. 3938 (Murphy, M., by request); S.F. xxxx

H.F. 3938 (Murphy, M., by request); S.F. xxxx amends Minnesota Statutes, Sections 6.67, 69.011, Subdivision 1, 356A.06, 424A.001, 424A.02, and 424A.05, relating to the Office of the State Auditor, the public pension plan fiduciary responsibility law, and the volunteer firefighter relief association substantive law, by making the following changes:

1. Public Accountant Misconduct Reporting Requirement. The requirement that public accountants report local government misconduct to the State Auditor is expanded to the various local Minnesota public pension plans, including volunteer firefighter relief associations (Section 1);
2. Security Brokers Authorized to Hold Pension Plan Assets. Insured security brokers and their agents are included as authorized holders of statewide or local Minnesota public pension plan assets (Section 3);
3. Allows Mutual Fund Investments to be Allocated into Portions for Applying Statutory Limits on "Other Investments". The "other investments" portion of the authorized investment list for all but the smallest Minnesota public pension plans is modified to allow mutual fund investments that include portions of "other investments" to be allowed into respective portions to apply the 20 percent statutory limit (Section 4);
4. Security Broker Written Acknowledgment of Security Insurance Coverage. As part of the current broker investment authority acknowledgment, security brokers and their agents are required to acknowledge that sufficient insurance has been obtained to cover the amount of Minnesota public pension plan assets held (Section 5);
5. Addition of a Specific Definition of Ancillary Benefits. A definition of "ancillary benefits" as any benefit other than a service pension is added to the substantive volunteer firefighter relief association benefit law (Section 6);
6. Local Option Redefinition of Surviving Spouse. Volunteer firefighter relief associations are provided an option to define "surviving spouse" as the legally married spouse either at the time of active service termination or at the date of death (Section 7);
7. Removal of Obsolete Deferred Service Pension Interest Provision. A State Auditor's Office calculated actual total rate of return deferred service pension interest method demonstration project, scheduled to expire on December 31, 2008, is eliminated (Section 8, Paragraph (c));
8. Elimination of Single Mandatory Deferred Service Pension Interest Calculation Method. The single method for calculating interest for deferred service pensions is eliminated in favor of the calculation method specified by the relief association and approved by the municipality (Section 8, Paragraph (d));
9. Clarification of Ancillary Benefit Limitation. For ancillary benefits paid to or on behalf of active members, the ancillary benefit is the earned service pension amount at the time of the qualifying event, calculated without any partial vesting reduction. For ancillary benefits related to deferred members, the relief association has flexibility with respect to the benefit amount payable (Section 9); and
10. Special Fund Funeral Benefit Authorization Eliminated. The authority for the payment of funeral benefits from a volunteer firefighter relief association special fund is eliminated, with a cross-reference in Minnesota Statutes, Section 69.011, Subdivision 1, is corrected (Sections 2 and 10).

Relevant Background Information

Background information on relevant topics is attached, as follows:

- Attachment A: Public Pension Plan Fiduciary Responsibility Law. Background information is presented on the 1989 codification of public employee fiduciary responsibility provisions and subsequent amendments.
- Attachment B: Securities Investor Protection Corporation (SIPC) Brokerage Default/Fraud Insurance. Background information is presented on the Securities Investor Protection Corporation (SIPC) and insurance against broker-dealer financial default or fraud.
- Attachment C: Deferred Volunteer Firefighter Relief Association Service Pensions. Background information is presented on the statutory provisions governing the payment of deferred volunteer firefighter service pensions and the interest payable on those deferred service pensions.
- Attachment D: Regulation of Volunteer Firefighter Relief Association Ancillary Benefits. Background information is presented on the statutory limitations on the payment by volunteer firefighter relief associations of benefits other than service pensions.
- Attachment E: Volunteer Firefighter Relief Association Special Fund Disbursements. Background information is presented on authorized disbursements from the special fund of a volunteer firefighter relief association.

Technical Amendments

Amendment H3938-1A numbers the clauses into which the last portion of paragraph (a) has been divided. The numbering of the five clauses will make the sentence easier to read.

Amendment H3938-2A corrects a grammatical error in the bill, where new language is proposed to be added into the middle of a two-part clause, with the new language separation rendering the second portion of the clause unintelligible. The amendment repeats the language from the first portion of the clause that makes the second portion understandable.

Discussion and Analysis

H.F. 3938 (Murphy, M., by request); S.F. xxxx represents the proposals approved by the volunteer fire working group assembled by the Office of the State Auditor, including a requirement that public accountants report to the State Auditor any local Minnesota pension plan misconduct, an authorization for security broker-dealers to hold Minnesota public pension plan assets, permits the allocation of mutual fund investments into applicable components for the application of statutory limits on various investments, requires security broker-dealers to provide written acknowledgement of adequate investment insurance coverage, permits a local option in redefining "surviving spouse" for volunteer firefighter relief association death benefits, allows local option in the method for calculating deferred service pension interest, clarifies the existing ancillary benefit limitation, and eliminates funeral benefits paid from volunteer firefighter relief association special funds.

The proposed legislation raises several pension and related public policy issues for potential Commission consideration and discussion, as follows:

1. Appropriateness of Adding Pension Plan Activities to Public Accountant Misconduct Reporting Requirement (Section 1). The policy issue is the appropriateness of expanding to local retirement plans the current requirement that public accountants report to the State Auditor any financial misconduct that they encounter. The misconduct reporting requirement dates to 1957 and currently covers virtually the whole range of governmental entities within the jurisdiction of the State Auditor's Office, other than the various local retirement plans. With the number of local pension plans, especially volunteer firefighter relief associations, the growing size of their assets, and the number of volunteer firefighter relief association officials, the potential for financial misdeeds is increasing. The State Auditor's Office believes that if the accountants performing volunteer firefighter relief association audits were to notify it when the financial misdeeds are first found, it could remedy those misdeeds earlier, reducing the risk that the statute of limitations could run in any particular misdeed. The primary argument against the change would likely be that the additional reporting requirement would increase the burden on public accountants auditing volunteer firefighter relief associations and other local public pension plans and could increase the cost of those audits. Since the accountants

auditing local pension plans likely also audit municipalities, it is unlikely that any real additional burden from the proposed legislation is actually placed on the public accountants serving local government.

2. Appropriateness of Permitting Brokers-Dealers to Hold Public Pension Plan Assets (Section 2). The policy issue is the appropriateness of increasing the persons or entities who are authorized to hold public pension plan assets to include broker-dealers. Minnesota Statutes, Section 356A.06, Subdivision 1, permits public pension plan assets to be held only by the treasurer of the pension plan, the State Board of Investment, the depository agent of the plan, or the depository agent of the State Board of Investment. Apparently, many volunteer firefighter relief associations routinely have some or all of their assets held by brokerage firms and have followed that practice for some period of years and the Office of the State Auditor has not curbed that practice. By not utilizing national or state banks, credit unions, or thrift institutions as the depository agent as required by Minnesota Statutes, Section 356A.06, Subdivision 8a, the various public pension plans are foregoing the benefit of depository insurance from the Federal Deposit Insurance Corporation and comparable entities and from additional collateralization in the event of deposited assets in excess of the applicable insurance. The Securities Investor Protection Corporation (SIPC) appears to readily cover up to a maximum of \$500,000 in the event of theft or loss of a security and up to a maximum of \$100,000 in the event of theft or loss of cash, but pension plan assets can easily exceed those maximum amounts. SIPC coverage is less readily operable in the event of fraudulent trading or trading in excess of authorization, where the investor or pension plan must challenge the trade virtually immediately in order to be covered. Excess SIPC insurance is available only from a constrained market, currently limited to three vendors (one in Vermont, one in England, and one in Bermuda) and excess SIPC insurance may have problematic individual account or aggregate brokerage limits, notice requirements, and coverage exceptions that will require vigilance on the part of relief association officials, who are part-time firefighters and even more part-time pension officials. If the Commission has questions about the policy rationale for this inclusion of broker-dealers as authorized pension plan asset holders, it should consider taking testimony from the Office of the State Auditor or from volunteer firefighter relief association representatives.

If the Commission is hesitant to recommend this expansion, **Amendment H3938-3A** drops the expansion from the proposed legislation.

Since the insurance provided by the SIPC is limited and would not cover the assets of all but the smallest volunteer firefighter relief associations, a more specific requirement for excess SIPC insurance may be more appropriate, as provided in **Amendment H3938-4A**.

If the Commission desires to bolster the broker certification of sufficient investment fraud or default insurance, **Amendment H3938-5A** adds a requirement that the broker-dealer provide information on the various limitations on the insurance, provide information on any notice provisions in the insurance, and provide information on any coverage exceptions in the insurance.

3. The Accuracy and Appropriateness of "Other Investment" Limitation Determination Refinements (Section 4). The policy issue is the accuracy and the appropriateness of modifying the various "other investment" limitations of Minnesota Statutes, Section 356A.06, Subdivision 7, to allow for mutual fund investments to be allocated into their respective security types for the application of the statutory limits. The change is apparently necessitated by one or more relief associations that invest in mutual fund products that include more than one security category and that invest in "other investments" in amounts that very closely approach the statutory maximums on other investments. The Commission may wish to request additional testimony from the Office of the State Auditor about the number of relief associations that have this problem, the types of mutual funds where these limitation application problems arise, the ease for the State Auditor's Office to allocate these mutual fund investments into security types, and the extent to which self-help alternative remedies other than a statutory change exist.
4. Appropriateness of Redefining "Surviving Spouse" for Volunteer Fire Benefit Coverage Purposes and the Appropriateness of Allowing Local Definition Options (Section 7). The policy issue is the appropriateness of the proposed redefinition of the term "surviving spouse" for volunteer firefighter relief associations and the appropriateness of including in the definition of "surviving spouse" local options as to the timing when that status is obtained. The current definition of the term "surviving spouse" has been unchanged since 1978, other than a change in its placement from Minnesota Statutes 1980, Section 424A.05, Subdivision 5, to a newly created definition section, Minnesota Statutes, Section 424A.001, in 1983 (Laws 1983, Chapter 219, Section 4). The 1978 definition (Laws 1978,

Chapter 201, Section 15) was a simplification and revision of the definition in place since before 1957, reducing the minimum length of marriage to the firefighter before retirement from three years to one year and eliminating the disqualification of desertion. Most volunteer firefighter relief associations, as lump sum plans, pay a benefit to a surviving spouse only if the firefighter or former firefighter dies before receiving a relief association benefit. Exceptions would be volunteer firefighter relief associations that provide solely for monthly benefits or provide monthly benefits with lump sum benefits as an alternative. The proposed change would eliminate the dependency requirement of the current definition, would eliminate the minimum period of marriage requirement of the current definition, and would add the option of determining the status either as of the time of ending active firefighting service or the time of death if the volunteer firefighter relief association bylaws do not specify the time of service termination. The Commission may wish to take testimony on the topic, especially the policy reason why there should be a local option in defining the term. There are no other local options in any volunteer firefighter relief association law definition.

If the Commission wishes to eliminate the local option in the surviving spouse definition and to keep that status based on the date of separation from active firefighting, **Amendment H3938-6A** implements a single definition based on the status when active service ends.

If the Commission wishes to eliminate the local option, but base the status determination on the date of death, whether in active service or while deferred, **Amendment H3938-7A** makes that change.

5. Appropriateness of Replacing a Single Method for Calculating Deferred Service Pension Interest with Local Options on Methods (Section 8, Paragraph (d)). The policy issue is the appropriateness of moving away from the current law standardization of the method by which local volunteer firefighter relief associations calculate the interest to be credited to deferred service pensions during the period of deferral and permitting any method of deferred service pension interest calculations provided for in the bylaws of the volunteer firefighter relief association. The standardization of a volunteer firefighter deferred service pension interest calculation method was introduced in 2005 (First Special Session Laws 2005, Chapter 8, Article 9, Section 12), when additional interest rate setting options were added to the volunteer firefighter relief association provision, replicated the interest crediting provision of the various statewide retirement plans, and was intended to assist the volunteer firefighter community and Office of the State Auditor enforcement by gaining some uniformity in the practice. From discussions of the State Auditor's Volunteer Firefighter Working Group, it is clear that volunteer firefighter relief associations have different notions about whether deferred service pension interest should be credited in the initial year of deferral or not and whether it should be credited monthly or only for full years of deferral. Eliminating standardization will recognize and validate that diversity of view. Allowing local variations in interest crediting will risk the introduction of computation errors, since volunteer firefighter relief associations are not necessarily well equipped to handle variable interest crediting procedures, and will complicate the work of the State Auditor's Office in attempting to monitor divergent interest crediting procedures.

If the Commission wishes to retain a standardized deferred service credit interest crediting procedure, **Amendment H3938-8A** would drop the local option on interest crediting methods.

6. Appropriateness of Ancillary Benefit Clarification (Section 9). The policy issue is the appropriateness of the proposed ancillary benefit clarification. The limits on ancillary benefits (i.e. benefits other than the volunteer firefighter relief association service pension) were introduced in 1979 with the general revision of the volunteer firefighter relief association laws in order to protect the funding of relief associations solely providing lump sum service pensions, since the simplified liability and funding cost determination procedures in statute for lump sum volunteer firefighter relief associations only encompasses the service pension and does not include ancillary benefits. The elements of regulation of ancillary benefits since the 1979 revision of volunteer firefighter relief association laws are:
 - (a) relief associations may pay ancillary benefits, but are not required to pay ancillary benefits;
 - (b) lump sum plans may only pay a single benefit on account of any relief association member;
 - (c) all relief associations are limited in the payment of ancillary benefits to the total accrued value of a relief association member's service pension without vesting schedule-related reductions; and
 - (d) all relief associations may provide an enhanced survivor/death benefit for short service relief association members, which a benefit based on five years of service for members with less than five years of service.

