S.F. 504
(Betzold)

H.F. 825
(Murphy, M.)

Executive Summary of Commission Staff Materials

Affected Pension Plan(s):	PERA and Volunteer Fire Relief Associations
Relevant Provisions of Law:	Minnesota Statutes, Chapters 11A, 69, 356, and 424A; New Minnesota Statutes, Chapter 353G
General Nature of Proposal:	Creation of a Voluntary Statewide Lump-Sum Volunteer Firefighters Retirement Plan
Date of Summary:	March 2, 2009

Specific Proposed Change(s)

Creates a voluntary statewide lump-sum volunteer firefighter retirement plan to be administered by the Public Employees Retirement Association (PERA) and a voluntary statewide lump-sum volunteer firefighter retirement fund to be invested by the State Board of Investment that would provide 16 alternative lump sum per year of service service pension amounts, to be selected by the entity operating the volunteer fire department after receiving a cost estimate from PERA of the financial requirements of one or more potential benefit levels, with service pensions payable after the termination of active firefighting service, at or after age 50, with a partial benefit with five years of service credit and a full benefit with 20 years of service.

Policy Issues Raised by the Proposed Legislation

1. Reception by the volunteer fire community.
2. Appropriateness of restricting the statewide plan to lump-sum relief associations only.
3. Appropriateness of the administration of the statewide plan by PERA.
4. Appropriateness of utilizing an agent multiple employer retirement plan.
5. Appropriateness of crediting firefighting service based on "good time" service; role of fire department chiefs.
6. Appropriateness of continuing long vesting period before 100 percent accrued service pension is payable.
7. Appropriateness of potentially simplifying the investment transfer process.
8. Unclear role and purpose of the voluntary statewide lump-sum volunteer firefighter retirement plan advisory board.
9. Appropriateness of the composition of the advisory board.
10. Appropriateness of the lack of deferred service pension interest.
11. Reliance on rudimentary quasi-actuarial work.

Potential Amendments

Technical Amendment

S0504-2A clarifies the alternative service pension provision and the bylaws applicable to a deferred retiree covered by the statewide plan.

PERA-Requested Amendment

S0504-1A is an amendment requested by PERA to modify the manner in which annual funding requirements are to be determined.

Other Substantive Amendments

S0504-3A makes prior investment in the Minnesota Supplemental Investment Fund a precondition to transferring retirement coverage to the voluntary statewide plan.

S0504-4A adds additional volunteer firefighter representation to the statewide plan advisory board and requires regional firefighter representation.

TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Lawrence A. Martin, Executive Director

RE: S.F. 504 (Betzold); H.F. 825 (Murphy, M.): Volunteer Firefighters; Creation of a Voluntary Statewide Lump-Sum Volunteer Firefighter Retirement Plan

DATE: March 2, 2009

General Summary of S.F. 504 (Betzold); H.F. 825 (Murphy, M.)

S.F. 504 (Betzold); H.F. 825 (Murphy, M.) amends portions of Minnesota Statutes, Chapters 11A, 69, 356, and 424A, proposes Minnesota Statutes, Chapter 353G, and proposes the creation of a voluntary statewide lump-sum volunteer firefighter retirement plan to be administered by the Public Employees Retirement Association (PERA) and a voluntary statewide lump-sum volunteer firefighter retirement fund to be invested by the State Board of Investment. The statewide plan would also have an advisory board drawn from local government associations and firefighting organizations. The statewide plan would provide 16 alternative lump sum per year of service service pension amounts, to be selected by the entity operating the volunteer fire department after receiving a cost estimate from PERA of the financial requirements of one or more potential benefit levels. Service pensions would be payable after the termination of active firefighting service, at or after age 50, with a partial benefit with five years of service credit and a full benefit with 20 years of service. No deferred service pension interest and no ancillary benefits other than a survivor benefit would be payable. For the initial five years after a fire department joins the plan, only a service pension equal to the pre-plan membership volunteer fire relief association service pension amount would be payable. Fire state aid related to the fire department would be transmitted to the statewide plan and deposited in the voluntary statewide lump-sum volunteer firefighter retirement fund to the credit of the applicable account to offset upcoming required funding requirements. Any unfunded actuarial accrued liability of an account is required to be amortized over a ten-year period. The funding requirements for the statewide plan would be prepared using an actuarial procedure developed by the consulting actuary retained by PERA and would be based on a six percent interest actuarial assumption rate. If coverage by the statewide plan is elected, the prior volunteer firefighters' relief association would be dissolved, with the assets and liabilities of the prior relief association transferred to the statewide plan.

Section-by-Section Summary

A section-by-section summary of S.F. 504 (Betzold); H.F. 825 (Murphy, M.) is attached.

Commission Staff Technical Amendment

Amendment S0504-2A is a technical amendment suggested by the Office of the State Auditor relating to the alternative service pension amount determination, applicable for the five years after a fire department elects statewide plan coverage, clarifying that for deferred members of a former volunteer fire relief association who are transferred to the statewide plan before drawing a service pension, the governing service pension provisions are the bylaws in effect on the transfer or the termination of firefighting services, whichever is earlier, and applies to total service credit.

Amendment Requested by PERA

Amendment S0504-1A is an amendment requested by the Public Employees Retirement Association (PERA) to modify the manner in which annual funding requirements are to be determined. An email from Dave DeJonge of PERA explains the rationale for the amendment.

Discussion and Analysis

S.F. 504 (Betzold); H.F. 825 (Murphy, M.) establishes a voluntary statewide lump-sum volunteer firefighter retirement plan as an alternative to or replacement for local relief associations, to be governed and administered by the Public Employees Retirement Association (PERA), and to provide a lump-sum service pension at age 50 with at least five years of good time service credit at the completion of a firefighting career as selected by the entity operating the volunteer fire department.

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

1. Attractiveness; Reception by the Volunteer Fire Community. The policy issue is the attractiveness of a statewide lump-sum volunteer firefighter retirement plan to the volunteer fire community and the reception that the plan is likely to have. Minnesota historically has utilized a decentralized public pension arrangement, especially for public safety employee retirement coverage. There are currently about 700 volunteer firefighter relief associations in the state, with most plans providing lump-sum service pensions. If there is not substantial interest in the volunteer fire community in replacing their local relief associations with the statewide retirement plan, the legislative effort consumed in enacting it and the administrative effort expended in establishing it may be substantially in vain. A statewide plan has the potential of greater investment efficiencies, has the potential for administrative economics of scale, could utilize a greater risk pool for funding eventual retirement benefits, and will provide pension portability for firefighters who may move from place to place across the state. The statewide plan notion also has engendered some controversy among firefighters in the past and may be viewed by some portion of the volunteer fire community as a threat. The Commission may wish to solicit testimony from representatives of the volunteer fire community about its likely reception statewide.

2. Appropriateness of Restricting the Statewide Plan to Lump-Sum Relief Associations Only. The policy issue is the appropriateness of the restriction of the proposed voluntary statewide volunteer firefighter retirement plan to the provision of lump-sum service pensions only. That restriction excludes the five current volunteer firefighter relief associations that provide only monthly service pensions and excludes most or all of the 18 combination (alternative lump-sum or monthly service pension) volunteer firefighter relief associations. It also would likely eliminate from potential coverage the 86 volunteer firefighter relief associations that provide defined contribution service pensions, which are paid in a lump sum, but are determined based solely on individual account balances. If the desirability from a policy standpoint of a statewide retirement plan lies in the large risk pool economics of scale and efficiencies that come with a statewide plan, those economies of scale and efficiencies also could benefit the members of monthly benefit, combination, and defined contribution volunteer firefighter relief associations. If there is a long-term goal with respect to monthly benefit, combination, and defined contribution relief associations on the part of the proponents of the statewide volunteer firefighter retirement plan, it may be helpful to the Commission in considering the potential retirement plan if those goals were revealed. If there is no intention to ever include other volunteer firefighter relief association types in potential coverage by the statewide volunteer firefighter retirement plan, the Commission may wish to request that the proponents of the plan indicate what improvements in the investment and administrative practices of monthly, combination, and defined contribution volunteer firefighter relief associations should be mandated or encouraged to make those relief associations function more efficiently and more economically.

3. Appropriateness of the Administration of the Statewide Plan by PERA. The policy issue is the appropriateness of assigning the responsibility of performing the administrative duties related to the proposed statewide volunteer firefighter retirement plan to the board and executive director of PERA. The PERA board and executive director currently manage three statewide retirement plans, the PERA General Employee Retirement Plan (PERA-General), the Public Employees Police and Fire Retirement Plan (PERA-P&F), and the PERA Local Government Correctional Employees Retirement Plan (PERA-Correctional) and also operate as the administration of Social Security coverage for public employees in Minnesota. PERA has experience in handling local public safety retirement plan consolidations, with 43 local police or paid firefighter relief associations consolidating into PERA between 1987 and 1998. The potential consolidation of almost 600 local volunteer firefighters' relief associations, with varying funded conditions, investment portfolios, financial capacities, and record retention practices, could consume considerable PERA staff time. The PERA board, historically oriented towards career public employees, may have some difficulty in focusing on the particular needs of volunteer firefighters and the nature of their service.

4. Appropriateness of Utilizing an Agent Multiple Employer Retirement Plan. The policy issue is the appropriateness of designing the new voluntary statewide lump-sum volunteer firefighter retirement plan as an agent multiple employer retirement plan rather than as a cost-sharing multiple employer retirement plan. An agent multiple employer retirement plan is an aggregation of single employer retirement plans, with pooling limited to assets for investment and to plan administration, but with separate accounts for each employer/coverage group and separate benefit determinations, asset accumulations, actuarial liability calculations, and funding costs. An agent multiple employer retirement plan is in contrast to a cost-sharing multiple employer retirement plan, where there is a single retirement plan, a single retirement fund, and the pooling of all liabilities and funding costs and the sharing of the resulting liabilities and funding costs among all employers/coverage groups. The three statewide retirement plans administered by PERA are all cost-sharing multiple employer retirement plans, although the 43 former local police and paid fire firefighter consolidation accounts previously administered by PERA were part of an agent multiple employer retirement arrangement until the 1999 merger, which folded the various accounts into a cost-sharing multiple employer

retirement plan, PERA-P&F. Agent plans rather than cost-sharing plans make benefit portability more difficult to achieve, lose considerable potential economies from pooling, and increase the administrative complexity of the retirement system. If the goal of the statewide plan is to gain significant economies and maximize the benefit to be obtained from the current flow of fire state aid, the choice of an agent retirement plan rather than a cost-sharing retirement plan largely replicates the inefficiencies of the current volunteer firefighters' relief association structure and is at variance with the apparent statewide plan goal.

5. Appropriateness of Crediting Firefighting Service Based on "Good Time" Service; Role of Fire Department Chiefs. The policy issue is the appropriateness of basing service credit for firefighters covered by the statewide retirement plan on undefined "good time" as certified by the fire chief of each fire department. "Good time" is not a statutory term of art, but apparently is a recognized concept in the fire service. The certification of "good time" is to be based on the particular requirements of the fire department, but the person or entity in or associated with the fire department who would be setting those requirements is not specified and is not clear. For municipal fire departments, it is not clear whether or not the municipal governing body has any role in setting "good time" requirements. For fire departments that are not associated with one municipality, the body empowered to set the requirements is wholly unclear. The "good time" certifications would be required annually, although service credit in the proposed legislation is contemplated to be provided monthly. The reporting requirements that fire departments and fire chiefs would have to adhere to in certifying "good time" are not specified. The extent of judgment to be employed by the fire chief in certifying good time service and the extent to which a particular fire chief could substitute personal opinion for other methods of documenting service is an open question.

6. Appropriateness of Continuing Long Vesting Period Before 100 Percent Accrued Service Pension is Payable. The policy issue is the appropriateness of the retention of a feature of the current volunteer firefighters' relief association benefit provisions, the vesting schedule, that only provides the full service pension amount with 20 years of service credit. The lengthy vesting schedule, providing 40 percent of the accrued benefit with five years of service credit and scaling up four percent per year until reaching 100 percent at 20 years, promotes the retention of firefighters for future service once they have five years of service, but may discourage the recruitment of new firefighters because of the lengthy commitment of time needed to obtain the full benefit. For defined contribution volunteer firefighter relief associations, a shorter vesting period currently is permitted, which was a modification made at the request of representatives of those relief associations. The creation of a new pension plan provides an opportunity to reconsider whether or not very long vesting periods used historically are still beneficial in recruiting and retaining volunteer firefighters.

7. Appropriateness of Potentially Simplifying the Investment Transfer Process. The policy issue is the potential problem involved in handling asset transfers accompanying statewide retirement plan coverage elections and the appropriateness of the addition of a procedure to simplify the investment transfer process. Under the proposed legislation, a municipality or other fire department operator can elect a retirement coverage change for its firefighters after receiving a cost estimate for the coverage change, but the assets of the volunteer firefighters' relief association associated with that fire department need to be reviewed and scrutinized if the relief association holds securities that are not permitted or are inappropriate for the State Board of Investment. The review process slows the coverage change approval process and the liquidation of impermissible or inappropriate investment securities could impede or threaten the coverage change if liquidation is problematic. The process of considering a coverage change under the document could be made easier if any fire department considering a coverage change would be required to invest all of the volunteer firefighters' relief association assets in the special statewide lump-sum volunteer firefighter account in the Minnesota Supplemental Investment Fund in advance of initiating the coverage change election process, thereby eliminating the need for the investment review and the adverse consequences of any mandated liquidation.

   Amendment S0504-3A requires the volunteer fire relief association associated with a fire department electing a retirement coverage change to invest in the Minnesota Supplemental Investment Fund as a precondition.

8. Unclear Role and Purpose of the Voluntary Statewide Lump-Sum Volunteer Firefighter Retirement Plan Advisory Board. The policy issue is the lack of clarity about the role and purpose of the voluntary statewide lump-sum volunteer firefighter advisory board in the proposed legislation. The advisory board is given the charge to "provide advice to the board of trustees of the Public Employees Retirement Association about the retirement coverage needs of volunteer firefighters who are members of the plan and about the legislative and administrative changes that would assist the retirement plan in accommodating volunteer firefighters who are not members of the plan." The advisory board is not required to meet any minimum number of times and the PERA board is not

mandated to meet with the advisory board. Thus, the advisory board is intended to be an information conduit to the PERA board, but the advisory board is not the only (or even the best) information conduit, never is required to function as an entity, and is not guaranteed that its advice will ever reach the PERA board. As time passes, the need for the information transmission would likely be reduced, thus reducing the need for an advisory board. If the proponents of the statewide plan have a clear idea of the short-term and long-term purpose and function of the advisory board, the proposed legislation would be improved if the advisory board's role and function were more clearly delineated.

9. Appropriateness of the Composition of the Advisory Board. The policy issue is the appropriateness of the composition of the voluntary statewide lump-sum volunteer firefighter retirement plan advisory board. The advisory board has seven members, three representing employers of volunteer firefighters, one representing the fire chiefs, two representing volunteer firefighters, and one representing the Office of the State Auditor. If the advisory board exists wholly or primarily as a conduit for information about firefighters' pension needs, the employer representation on the board is disproportionately large and the inclusion of a representative of the Office of the State Auditor seems inconsistent. More representation of volunteer firefighters and the addition of a requirement for some geographic diversity of advisory board members who are volunteer firefighters would seem to serve an information-gathering and transmission function better. The proponents of the current retirement plan design could be requested by the Commission to clarify their view of the ongoing role and function of the advisory board and to indicate how the advisory board composition emphasizes and advances that role and function.

   Amendment S0504-4A adds at least one additional active volunteer firefighter to the advisory board and requires at least three non-metropolitan active firefighter representatives, with at least one from the southern portion of the state, at least one from the western portion of the state, and at least one from the northern portion of the state.

10. Appropriateness of the Lack of Deferred Service Pension Interest. The policy issue is the appropriateness of omitting from the voluntary statewide lump-sum volunteer firefighter retirement plan a feature common to volunteer firefighters' relief association benefit plans, the crediting of interest on deferred lump-sum service pensions. A firefighter who terminates active service prior to age 50 with at least five years of good time service credit will be eligible to receive the volunteer firefighter retirement plan service credit on or after attaining age 50, but the amount of the service pension will not be larger than it was when active service ended, even if the deferral period is 10 or 15 years long. Although the volunteer fire community had little apparent interest in encouraging firefighters to terminate active firefighting before age 50 and to take a deferred service pension in the 1970s, changes in society at large and in the volunteer fire community since the 1970s appear to have created a substantial interest in retaining adequacy and value in deferred service pensions. The lack of any interest to be credited to deferred service pensions appears to be a significant omission in the new retirement plan and may dissuade various fire departments from joining the new statewide retirement plan.

11. Reliance on Rudimentary Quasi-Actuarial Work. The policy issue is the appropriateness of not requiring regular actuarial valuation liability and funding requirement determinations for the statewide plan and the reliance on rudimentary quasi-actuarial work. As formulated by PERA, apparently to reduce the administrative expense of the new plan, actuarial valuations of the new statewide plan would occur periodically, if the PERA board elected to have a valuation made, and the funded condition and ongoing funding contribution requirements of the plan are to be determined by the PERA administration staff based on procedures to be developed by, and certified as accurate by, the consulting actuary retained by PERA, using a six percent interest assumption as the sole actuarial assumption. In doing so, PERA is recommending to replicate the broad design of the current volunteer fire relief association lump-sum relief association funded condition and funding requirements process, developed by the consulting actuary retained by the Legislative Commission on Pensions and Retirement in 1970 and incorporated into Minnesota Statutes, Section 69.772. In the PERA-sponsored amendment, Amendment S0504-1A, developed with the assistance of the Office of the State Auditor, the specificity of that broad design is further streamlined, placing hopes for the adequacy of the actual funding cost determinations on the care and competence of the PERA consulting actuary rather than statutory regulation of the actuary's function. In either event, the resulting process is likely to sacrifice precision and accuracy for currently unknown or inestimable administrative expense savings. Since generally accepted accounting principles require periodic actuarial valuation for defined benefit plans, this reliance on rudimentary quasi-actuarial work may cause an exception note in future PERA Comprehensive Annual Financial Reports by the Legislative Auditor.