Investment of Volunteer Firefighter Relief Associations

- There are 549 volunteer firefighter relief associations in Minnesota (as of 12/31/2019).
  - Provide retirement benefits to 16,468 volunteer firefighters
  - $636.2 million in assets
- Retirement benefits are taxpayer funded.
  - Combination of taxpayer funded contributions and investment earnings
    - 2019 contributions totaled $29.5 million ($23.8 million from state aid and $5.7 million from local governments).
    - 2019 investment earnings totaled $99.7 million.
- The governing board of each relief association decides how to invest its retirement assets.
  - Since 1993 relief boards have had the option to invest assets in investment options offered by the State Board of Investment (SBI):

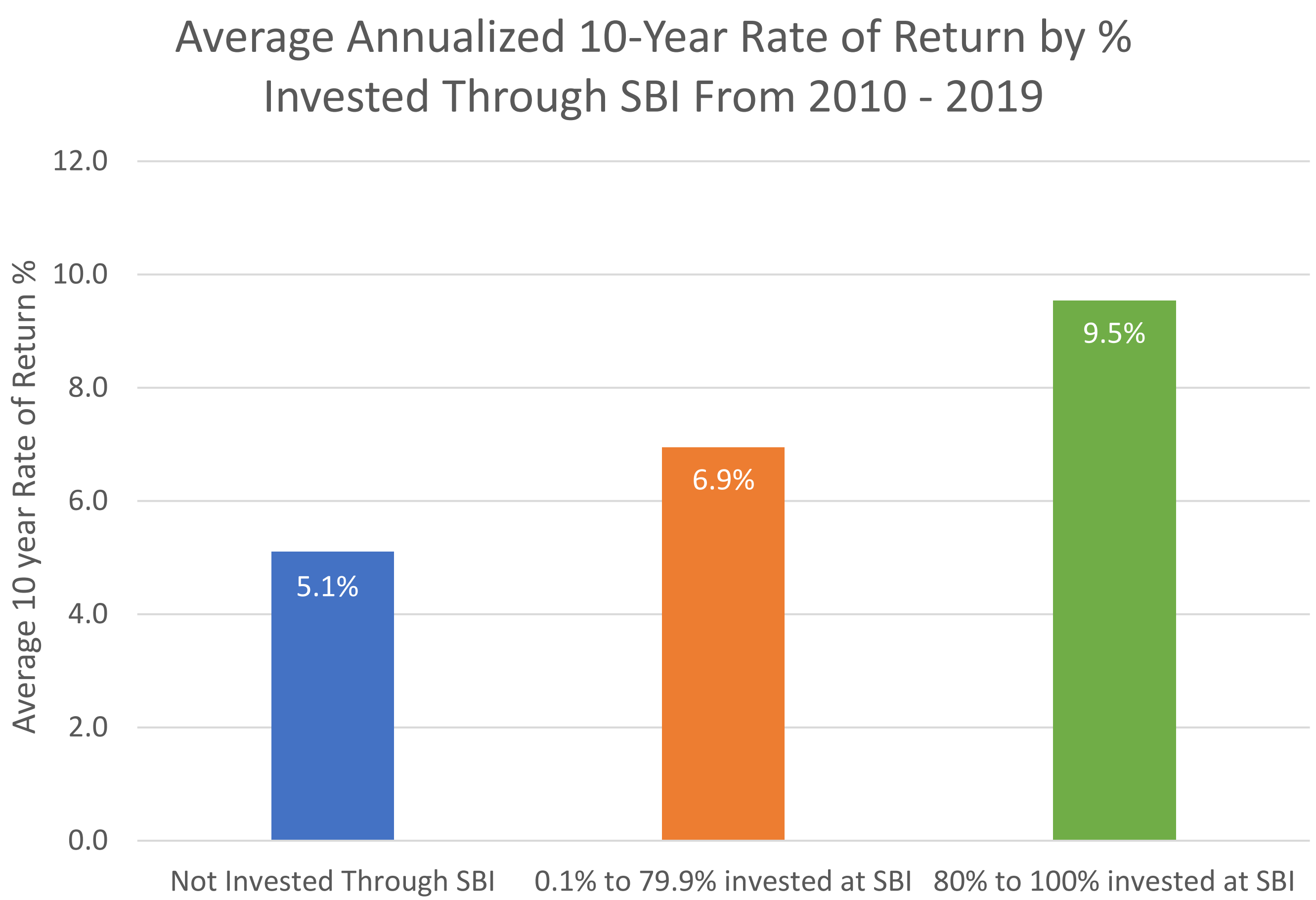
• Broad Int'l Stock Fund	• U.S. Stock Act. Managed Fund	• U.S. Stock Index Fund
• Balanced Fund	• Bond Fund	• Money Market Fund

- About 25% of relief associations have 50% or more of their assets invested through the SBI.

Information on this page is from the OFFICE OF THE STATE AUDITOR *Financial and Investment Report of Volunteer Fire Relief Associations for the Year Ended December 31, 2019.*

** Laws of Minnesota 1993, Ch. 300, Sec. 9.*

Relief Associations Invested Through the SBI Outperform Those Invested Privately

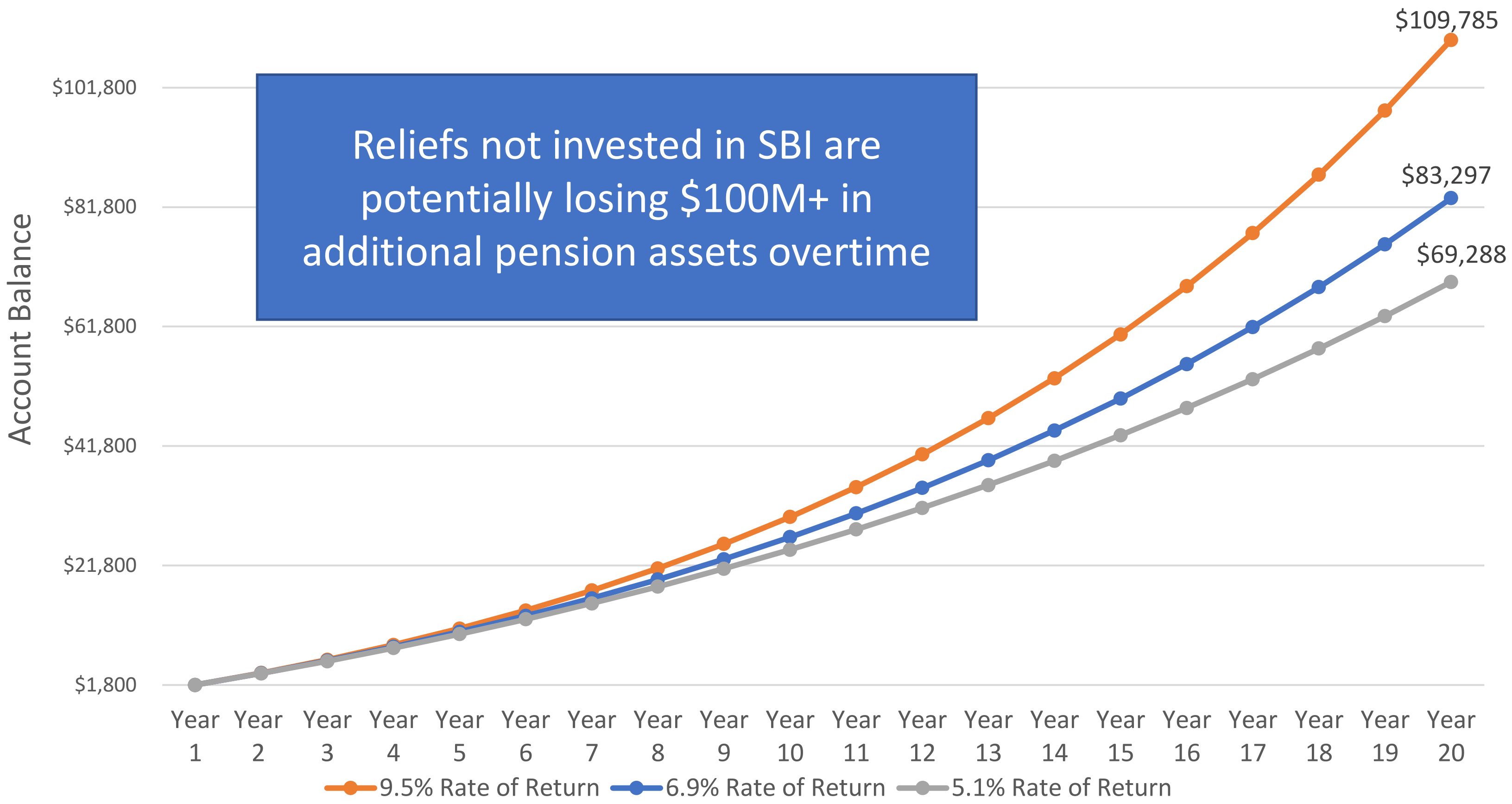


This graph shows averaged 10-year annualized rates of return from 2010 to 2019 by the 549 relief associations that reported rates of return to the State Auditor in 2019. The "% invested at SBI" is the average % of assets invested through SBI during the 10-year period. Of those 549 reliefs, during the 10-year period:

- 347 reliefs were not invested through the SBI at all;
- 104 reliefs had an average of between 0.1% and 79.9% of their assets invested through SBI;
- 69 reliefs had an average of between 80% and 100% of their assets invested through the SBI; and
- 29 reliefs did not report a rate of return for one or more years.

Data for this page is from the Office of the State Auditor's annual report titled *Financial and Investment Report of Volunteer Fire Relief Associations* for the years ending in 2010 through 2019. Compilation and analysis of that data was performed by the staff of the Legislative Commission on Pensions and Retirement.

Firefighter Defined Contribution Account Balance Over a 20-Year Career – Comparing Rates of Return



Assumes firefighter's account receives a contribution of $1800 the first year and subsequent contributions increase at a rate of 1.75% per year.

OLA recommendation

- In a 2007 OLA report, Legislative Auditor Jim Nobles recommended the following:

> Overall, we found that Minnesota's decentralized pension system for volunteer firefighters creates problems and challenges. Most significant is that most relief associations have, over time, earned low rates of return on their investments. While some elements of local control should remain, we recommend that the Legislature require all volunteer firefighter relief associations to invest their pension funds through the State Board of Investment (SBI). This would likely increase their rates of return, which could lead to higher pension benefits for their members or decreased mandatory contributions by local government. To help relief associations make prudent investments within the options offered by SBI, we also recommend that they develop investment policies that incorporate best practices.

- The returns gap between SBI and relief associations has been **persistent for decades**

Reasons for performance gap

1. **Fees:** SBI has an administrative fee of 0.006% vs. 1-2% for many independent investment advisors (OLA Report)
2. **Fund construction & market discipline:** SBI constructs funds for long-term performance and uses diversification to manage risk
3. **Not investing at all:** 7.3% of reliefs invested solely in cash (2019 OSA Report)

- **Takeaway:** According to the OSA, **SBI has outperformed 96% of relief associations** over the long-term
- In addition, outperforming SBI may be indicative of inappropriate portfolio construction or risk levels (e.g. overweighting equities)

What HF 2610 does

- Requires Relief Associations to invest pension funds with SBI
  - Trustees will still have local control to pick among SBI offerings and other pension parameters
  - Reliefs will have a diverse set of SBI-managed funds to invest in (including money markets)
- Gives adequate flexibility and time to transition assets to SBI
  - Exception process for illiquid assets
- Still permits Relief Associations to hire financial advisors if they wish (fees must be disclosed)

Benefits:

1. Potentially provides **<u>$100M+ in more generous pension benefits to attract and retain volunteer fire fighters</u>**
2. Helps mitigate conflicts of interest and helps Relief trustees meet fiduciary responsibilities
3. Encourages responsible management of state taxpayer money

Volunteer Fire Relief Association Working Group Position

- Working Group took position opposed to SBI investment requirement (below from Nov. 2020 meeting)

Local Control – The current statutes are permissive, and allow relief associations options on how and where to invest their pension funds. A relief association can choose to invest some or all of its pension assets through the State Board of Investment, but are not required to do so. There is strong support among relief association trustees to maintain these options. Currently, there is no evidence that having choice on how and where to invest relief association funds is problematic. Differences in investment performance among relief associations have not threatened the viability of the relief association pension funds, which overall are very well funded.

- I respectfully disagree with the Working Group - $100M+ in lost investment returns that could be used to increase benefits to volunteer fire fighters is problematic
- Local trustees will still be able to make decisions on pension parameters and investments – they will simply be required to select from SBI fund options
- Working Group cited no benefits to status quo beyond “local control”