

# Work Group on Relief Association Conversions and Dissolutions

## Second Meeting

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AUGUST 16, 2018

CAPITOL CONFERENCE ROOM G-23



# Work Group Objectives

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- I. Study conversion from defined benefit to defined contribution and propose legislation
- II. Study disposition of surplus assets and propose legislation
- III. Survey fire departments transitioning from volunteer to full-time
- IV. Consider related issues and propose legislation

# Relief Association ≠ Retirement Plan

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The relief association sponsors the retirement plan—they are separate entities

- The relief association is a nonprofit corporation
- The retirement plan is a qualified retirement plan

Both are subject to state and federal law, but the laws governing relief associations are different than the laws governing retirement plans

The state statutes we are dealing with (in Chapters 424A and 424B) could be amended to better distinguish one from the other

# Objective I

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What procedures will be required in order to convert from a defined benefit plan to a defined contribution plan?

# Outcomes

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Study the statutes on conversions from defined benefit to defined contribution: **There are none.**

Explore alternatives for:

- conversion procedures
- determining accrued benefits, vesting, and surplus assets upon conversion
- allocating surplus assets

Propose legislation

# Conversion from Defined Benefit to Defined Contribution or vice versa

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There are no state statutes addressing this topic, so the statutes neither prohibit nor permit a conversion.

Any concerns with adding statutes to permit conversions?

Any oversight of conversion process needed?

Is OSA review of bylaws changes, which could be months after the conversion takes effect, sufficient?

# **Requirement to state whether DC or DB**

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Only one requirement in state law relevant to type of plan (DC and DB):

Articles or bylaws must state whether the relief association is a defined contribution plan or a defined benefit plan.  
(Section 424A.002)

# Federal law requirements

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Applicable federal law is the Internal Revenue Code.

If a governmental plan complies with the few requirements in Section 401(a) of the Internal Revenue Code, the plan will be considered a “qualified plan.”

Requirements include:

- Annual additions (DC plans) and annual benefits (DB plans) are subject to limits (IRC 415(b) or (c))



# Federal law requirements

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Additional requirements include:

- Full vesting at normal retirement age (IRC 401(a)(7));
- Full vesting upon plan termination, to the extent funded (IRC 401(a)(7));
- Distribution must begin by the “requirement beginning date,” i.e., age 70½ (IRC 401(a)(9)); and
- Direct rollover of a lump sum distribution must be offered by the plan (IRC 401(a)(31)).

# Example of an IRC Requirement in the MN Statutes Governing Relief Associations

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## Section 424A.015

### **Subd. 4. Transfer to individual retirement account.**

A relief association that is a qualified pension plan under section 401(a) of the Internal Revenue Code, as amended, and that provides a single payment service pension, at the written request of the applicable retiring member or, following the death of the active member, at the written request of the deceased member's surviving spouse, may directly transfer on an institution-to-institution basis the eligible member's lump-sum pension or the survivor benefit attributable to the member, whichever applies, to the requesting person's individual retirement account under section 408(a) of the Internal Revenue Code, as amended.

# Value of Complying with Federal Law

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If the retirement plan is a “qualified plan”:

- No income tax is imposed on vested benefits until the lump sum is distributed to the former firefighter.
- A former firefighter’s lump sum benefit will be able to be rolled or transferred in a direct rollover to an IRA, another retirement plan, or the Minnesota Deferred Compensation Plan.

# Designing a Procedure for Conversions

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A conversion needs to comply with applicable federal law (i.e., Internal Revenue Code) if the relief association plan is to remain qualified.

Under the IRC, a conversion from DB to DC is treated as:

- (1) a termination of the DB plan and
- (2) the establishment of a DC plan to which the defined benefits are transferred.

# Termination of the DB Plan under the IRC

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Full (100%) vesting of all active firefighters, to the extent funded, is required

- Example:

Relief association plan provides for lump sum benefits equal to \$5,000 per year of service. A firefighter with 11 years of service is 64% vested in a lump sum pension benefit of \$55,000 (\$35,200). On the plan termination date, the firefighter's benefit becomes 100% vested and \$55,000 is transferred to the new DC plan and deposited in an account in the firefighter's name.

# Termination of the DB Plan under the IRC

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Plan assets in excess of all benefit liabilities (“surplus”) may be paid to the “employer” (municipality or state?) or allocated to active firefighters’ new DC accounts

- What should proposed legislation provide or require?

Allocation to actives’ accounts could be equally allocated among actives or weighted in favor of age or service

- What should proposed legislation provide or require?

Allocation of surplus to each active’s DC account cannot exceed the annual limit under IRC section 415(c):

- Lesser of (i) 100% of the firefighter’s pay for the year or (ii) \$55,000 (for 2018)

# Termination of the DB Plan under the IRC

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This same question arises in Part II of the work group's decision-making:

- What to do with assets in excess of benefit liabilities (“surplus”)?
  - Pay to the municipality?
  - Pay to the state?
  - Allocate to firefighters?
  - Some combination of the above?

# Termination of the DB Plan under the IRC

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Neither benefits nor surplus can be distributed directly to active firefighters because of the plan termination.

- Separation from service and at least having reached age 50 is still required to be eligible for a distribution from a DB plan.

The relief association is permitted to file an application for a determination letter with the IRS.

- A determination letter will state that the relief association's retirement plan documents (statutes and bylaws), as a terminated plan, comply with IRC requirements and the plan, in form, is "qualified."
- Should proposed legislation require applying for a determination letter?



# Establishment of a DC Plan

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At the same time that the DB plan is terminated, a DC plan would be established by the relief association, by adoption of a new plan document and/or a bylaws amendment.

Section 424A.016 governs relief association DC plans.

- What amendments to this statute should be considered?

The relief association is permitted to file an application for a determination letter with the IRS.

- A determination letter will state that the relief association's retirement plan documents (statutes and bylaws) comply with IRC requirements and the plan, in form, is "qualified."
- Should proposed legislation require applying for a determination letter?

# Establishment of a DC Plan

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Lump sum benefits would then be transferred from the terminated DB plan directly to the DC plan and deposited in accounts in the name of each firefighter (actives and inactives).

Lump sum benefits may be immediately distributed to each inactive (former) firefighter or directly rolled to the firefighter's IRA or another retirement plan. The consent and a direct rollover election from the former firefighter is needed.

- Consider amending statute to allow for immediate distribution, even if prior to age 50, as long as firefighter is inactive

# Objective II

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What to do with surplus assets when an overfunded relief association defined benefit plan is terminated?

# Outcomes

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Study the statutes on dissolution of relief associations and transfer of surplus assets:

Section 424B.20 and .21

Explore alternatives for dissolution of relief associations, termination of retirement plans, and allocation of surplus assets

Propose legislation

# Dissolution of the Relief Association and Disposition of Surplus Assets

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Statutes address this, but important issues not addressed

Again, helpful to distinguish between “dissolution” of the relief association and “termination” of the retirement plan

- Proposed legislation could separate the treatment of dissolution from termination

# Minnesota law on “Dissolution without Consolidation” (Section 424B.20)

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This statute applies in two situations:

- When the fire department dissolves or is eliminated by the municipality or firefighting corporation.
- When the relief association is dissolved or eliminated with municipal approval, but the fire department is not dissolved or eliminated.

# “Dissolution without Consolidation”

## (Section 424B.20)

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Statute does not address:

- Termination of the retirement plan where fire department is ongoing and relief association is ongoing
- Dissolution or elimination of the relief association without municipal approval
- Forced termination of the retirement plan when there are no more volunteer firefighters

# Dissolution Procedures

## (Section 424B.20, subd. 2-5)

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Current law provides:

### 1. Relief association board must:

- calculate assets, accounts payable, pension benefit liabilities
- liquidate enough special fund assets to pay “legal obligations”
- prepare a schedule of firefighters with each firefighter’s pension amount, service, and pension payment date



# Dissolution Procedures

## (Section 424B.20, subd. 2-5)

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### 2. Relief association board must:

- transfer remaining assets to the CFO of the municipality for deposit into a trust that is invested in compliance with 424A.095 (same statute that governs investment of special fund, generally)

OR

- Purchase annuity contracts that will pay out pension benefits at retirement age (424B.21)

(Consider legislation to revise the last sentence of 424B.21, which requires title to annuity contracts to be transferred to the trust. Since no trust will be necessary when annuity contracts are purchased, title should instead be required to be transferred to the municipality.)

# Dissolution Procedures

## (Section 424B.20, subd. 2-5)

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### 3. Relief association board must:

- Transfer the records of the relief association to the CAO of the municipality
- Notify the Commissioner of Revenue, State Auditor, and Secretary of State within 30 days of the dissolution

# Transfer of Surplus to Municipality

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After treasurer of the municipality pays out all pension benefits according to the schedule, “any remaining assets in the trust fund cancel to the general fund of the municipality.” (424B.20, subd. 4(b))

Under Article 14, Section 25 of the 2018 pension bill, relief associations that paid a lump sum benefit of \$9,500 or more per year of service as of May 8, 2018:

1. Surplus must be transferred to the municipality if it made any required contributions during the 10-year period from May 8, 2008, through May 8, 2018
2. If (1) doesn't apply, surplus must be transferred to the general fund of the state

# Transfer of Surplus

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Alternatives for payment of the surplus:

- Only to the municipality (current law)?
- Only to the firefighters?
- Only to the state?
- To a combination of any of the above?
- Does the answer change depending on whether the municipality made required or voluntary contributions?
- If to the state, should there be a direction that the surplus be paid to
  - underfunded relief associations?
  - relief associations that receive minimal fire state aid and have a DC plan (for easy one-time allocation to DC accounts)?

# Need for legislation to address other scenarios?

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Termination of the retirement plan where fire department is ongoing and relief association is ongoing

Dissolution or elimination of the relief association without municipal approval

Forced termination of the retirement plan when there are no more volunteer firefighters

Anything else?

# Objective III

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Survey of fire departments transitioning from volunteer to full-time

# Outcomes

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Study the prevalence of overfunded defined benefit relief associations and the status of transitions underway at fire departments from using the services of volunteer firefighters to employing salaried firefighters

# Conduct Survey

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PERA has email list of contacts at cities (about 1,000) and can help with the survey through SurveyMonkey.

LCPR staff can cross check city list against OSA's list of relief associations.

Could the Minnesota State Fire Department Association or Minnesota State Fire Chiefs Association be able to help with this?



# Subcommittee of the Work Group

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Subcommittee needed to prepare questions:

- 3 to 5 members
- Questions would be used in surveying fire departments regarding transition plans, if any, to reduce volunteers and add full-time staff
- Subcommittee would meet via telephone conference in the next couple weeks

# Objective IV

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Any related issues the work group would like to consider?

# Outcomes

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Consider other issues related to conversions and surplus assets

Propose legislation

# Related Issues

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Should proposed legislation provide for conversion from DC to DB?

Should DC plans be made more attractive to relief associations?

- From the firefighter's perspective, what's the difference between a lump sum pension plan and a DC plan?
- Allow immediate distribution of DC accounts upon separation from firefighter service?

# Related Issues (continued)

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When a municipality terminates the services of its volunteer firefighters:

- Federal law (i.e., the Internal Revenue Code) requires the relief association retirement plan to consider that a “partial termination” of the plan:
  - Partial termination requires full vesting of all affected firefighters.
  - Should proposed legislation incorporate this federal requirement so it is known?
- Should a relief association be required to terminate the retirement plan and dissolve the relief association when the municipality terminates the services of its volunteer firefighters?

# Related Issues (continued)

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Should proposed legislation allow more flexibility in vesting?

- Long vesting schedules have a punitive affect, by making short service pensions even smaller—is that good policy?
- Under federal law, forfeitures can't be used to increase pension benefits, so what's the advantage of forfeitures, especially in an overfunded plan?
- Might it be easier to attract new firefighters if they could feel confident about getting the full lump sum pension amount they accrue for each year of service?
- In private sector pension plans, the longest vesting schedules permitted are:
  - 5-year cliff (0% for first 5 years, 100% starting in year 6) or
  - 3 to 7 years graded (20% after year 3, increasing 20% each year until 100% in year 8)

# Related Issues (continued)

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The 2018 pension bill eliminated deferred interest (called “augmentation”) prospectively as of July 1, 2018, for all current and former employees under the statewide pension plans.

- Should deferred interest be eliminated effective July 1, 2019, for the relief association pension plans?
- Consider whether it is good policy to continue to increase the benefits of former firefighters with state money, when no other former public employees (including public safety employees under PERA and MSRS) receive this benefit

# Related Issues (continued)

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Should consideration be given to other ways to reduce surplus, to end the perception that surplus may create an incentive for municipalities to terminate their use of volunteers?

Alternatives for reducing surplus:

- Encourage relief associations to increase their lump sum amount
  - If the “minimum amount of available financing per firefighter” would permit a relief association to increase the lump sum amount, why not do so, even without municipal approval, if the relief association is required to reduce the risk of investment losses by reserving enough assets in principal-protected investments to cover the entire cost of the increased lump sum benefits?
- Encourage the conversion of all DB plans to DC plans
- Transfer a portion of the surplus to the municipality or the State each year