To: Members of the Work Group on Vesting and Emergency Medical Providers in Relief Associations and the SVF Plan

From: Susan Lenczewski, Executive Director

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Subject: Defined Contribution Plans:
- Relief Association Defined Contribution Plans
- Defined Contribution Plan Accounts in the Statewide Volunteer Firefighter (SVF) Plan
- PERA Defined Contribution Plan

The Work Group will need to have a basic understanding of defined contribution plans for two unrelated reasons:

1. As of December 31, 2024, out of 477 relief associations, 70 relief associations have retirement plans that are defined contribution plans (407 are defined benefit plans). See the State Auditor's Financial and Investment Report of Fire Relief Associations Pension Report for the year ended December 31, 2024. Vesting and membership changes impact defined contribution plans differently than defined benefit plans.

   I was not able to find information on the number of fire departments in the defined contribution component of the SVF Plan and have requested this information from PERA.

2. PERA administers the Defined Contribution Plan (DCP), which is a separate plan unrelated to the SVF Plan. According to the survey, 8 fire departments[1] out of the 296 fire departments that responded participate in the DCP. (Two of these fire departments reported that they also participate in the SVF Plan). If any emergency medical providers are members of the PERA DCP, that membership will likely need to cease when they are required to become members of a relief association retirement plan or the SVF Plan.

What is a defined contribution plan and how does it differ from a defined benefit plan?

The world of "qualified" retirement plans (more on "qualified" later) is divided into two categories:

Defined contribution (DC) plans
Defined benefit (DB) plans

[1] Austin (+P&F); Crosslake; Elgin (+SVF); Gibbon; Mankato (+P&F); Silver Lake; Viking (+SVF); Winger

Less common "hybrid" plans combine aspects of these two types of plans but is not covered by this summary.

DC Plans (sometimes called "individual account plans":

- Every member has an account that is the record of the contributions (can be employer, employee, or both) made by or on behalf of the member + earnings and losses on those contributions.
- Contributions (such as fire state aid) are deposited in the trust and must be completely allocated among member accounts at the end of the plan year.
- The benefit can be distributed generally anytime after leaving employment or otherwise ending active service.
- Distribution can be in a lump sum, installments, or an annuity.
- The benefit is equal to the value of the account as of a designated date (end of prior plan year, end of prior month, or end of the most recent business day).

DB Plans (sometimes called "pension plans"):

- Every member is accruing a benefit equal to a formula set forth in the statutes or plan document. Examples:
  Statewide pension plan benefit: Benefit = years of service X high five years' average annual pay X a multiplier (1.7%, 3%, etc.)
  Volunteer firefighter benefit: Benefit = years of service X benefit level ($1,250, $5,000, etc.)
- Contributions are deposited in the trust but not designated for any particular member. Investment earnings on these contributions do not impact the retirement benefit.
- With a few exceptions not relevant to the state's pension plans or volunteer firefighter plans, the benefit cannot be distributed before retirement.
- Distribution should be as an annuity or in installments, not as a lump sum.
  From Treasury Regulation 1.401-1 (b):
  A pension plan within the meaning of section 401(a) is a plan established and maintained by an employer primarily to provide systematically for the payment of definitely determinable benefits to his employees over a period of years, usually for life, after retirement.

What is a "qualified" retirement plan and why must relief association plans and the SVF Plan be qualified?

Defined benefit plans that provide a pension benefit for public employees in Minnesota are intended to be tax-qualified retirement plans, which means they are intended to comply with applicable requirements in Internal Revenue Code sections 401(a) through 415+. The MSRS Unclassified Plan, PERA Defined Contribution Plan, relief association defined contribution plans, and the defined contribution component of the SVF Plan are defined contribution plans that are also intended to be tax-qualified retirement plans and comply with applicable requirements in IRC sections 401(a) through 415+.

When money is set aside in trust for employees and is intended to be paid later for retirement, the money will be considered constructively received by the employee and federal and state income tax will have to be paid for the year the money was set aside, **UNLESS** the trust satisfies applicable requirements in IRC sections 401(a) through 415+. Satisfying these requirements allows participants, also referred to as members, to defer the payment of income tax on the money set aside until they actually receive the money.

These federal IRC requirements override any state law or in the case of relief associations, bylaws that are in conflict. As applied to Minnesota's DB and DC plans for public employees, IRC requirements include the following:

- The individual must be allowed to elect a direct rollover of a lump sum distribution from the trust.
- Distributions must begin by the "required beginning date" (now age 75).
- Pre-1974 vesting requirements must be followed, which includes full vesting upon termination of the trust or conversion of the plan from one type of plan to another (for example, from a DB Plan to a DC Plan).
- Contributions and net earnings must be held in trust for the exclusive benefit of members and the benefit cannot be used as collateral or otherwise assigned to another.
- There is a limit on the benefit payable from a DB Plan.
- There is a limit on the amount that can be contributed to a DC Plan.

The MSRS Deferred Compensation Plan is a defined contribution plan but is not generally referred to as a "qualified" retirement plan because it is intended to comply with a different section of the Internal Revenue Code, section 457(b). School districts offer yet another type of defined contribution arrangement that is intended to comply with a different section of the Internal Revenue Code, section 403(b).

How does the type of plan affect the impact of shorter vesting schedules or coverage of emergency medical providers?

Comparing the impact of a shorter vesting schedule on DC Plans versus DB Plans:

DC Plans:

- Liability and funded status are not relevant to a defined contribution plan because there is no obligation to fund a particular amount of benefit upon retirement. A DC Plan is always 100% funded.
- Since every member account already has credited to it an allocation of the contributions each year, a change in vesting impacts only the percentage of an account a firefighter will receive. A member will receive more or less of the member's account depending on the extent vested.
- Shorter vesting means fewer dollars forfeited, which means fewer forfeiture dollars allocated to accounts at the end of the year. When a member leaves service at a time when not fully

vested, the non-vested portion of the member's account is forfeited (no longer credited to that member's account) and must be allocated to the remaining member accounts at the end of the year. This means that longer service firefighters will receive an allocation of fewer forfeiture dollars when the vesting schedule is shortened.

DB Plans:

- The pension benefit is determined by formula and does not depend on the amount of state aid, municipal contributions, and forfeitures invested by the relief association or the State Board of Investment.
- A shorter vesting schedule will result in larger benefits being paid, because firefighters will vest more quickly and be entitled to receive a larger benefit. This will increase the plan's liabilities and adversely affect its funded status.
- If a plan is overfunded, this will result in less overfunding.
- Per federal law, forfeitures cannot increase benefits in a defined benefit plan. It is acceptable to increase the benefit level because the plan has more assets thanks to the forfeitures, but forfeitures cannot be designated to increase any particular member's benefit.

Comparing the impact of adding coverage of emergency medical providers and giving them credit for past service under DC Plans versus DB Plans:

DC Plans:

- Adding EMPs to a relief association plan or a fire department account in the SVF Plan has the same impact as adding new firefighters: there will be more accounts among which the annual state aid, municipal contribution, and forfeitures are allocated.
- It is not administratively feasible to provide past service credit to new EMP members in a DC Plan in the same way it can be done in a DB Plan. All state aid, municipal contributions, and forfeitures are allocated in their entirety each year so there is no unallocated account from which to allocate money to a new EMP account. Already allocated amounts would have to be pulled from member accounts and re-allocated to the new EMP account, an unpalatable solution.
- Options for catching up a new EMP member who did not receive allocations of state aid, municipal contributions, and forfeitures for years of service prior to joining the plan:
    - Amend the relevant allocation statute to allow more dollars to be allocated to the account of a new EMP member for a year or a specified number of years.
    - Require the municipality to make an additional contribution for one or more years and amend the relevant statute to allow the contribution to be allocated only to the new EMP account.
    - Determining the appropriate amount to allocate to a new EMP account for years of service the EMP was not covered by the plan will be complicated. Amounts previously allocated will have net investment earnings (or net investment losses), which will need to be taken into account in determining the appropriate amount.

DB Plans:

- Adding EMPs to a relief association plan or a fire department account in the SVF Plan will prospectively increase the liabilities of the relief association retirement plan or the fire department account in the SVF Plan in the same way that adding a new firefighter to the plan will.
- Providing credit for past service to EMPs will increase the liabilities of the relief association plan or SVF account but if the plan or account has a surplus (assets in excess of liabilities), the impact of the increase in liabilities will be a reduction in the surplus. Whether that reduction in surplus will mean nearing 100% funded or falling below 100% funded will vary depending on the specifics of each relief association and fire department account.
- Options for providing past service credit to EMPs:
    - Require the relief association or fire department account in the SVF to provide past service credit and absorb the cost. The past service credit to be provided could be limited to a specified number of years or liability amount, which could vary depending on the funded status of the relief association or fire department account.
    - Require the municipality to contribute an amount necessary to fund the cost of the past service credit, subject to limits noted in the previous bullet.

PERA Defined Contribution Plan

The PERA Defined Contribution Plan is governed by Chapter 353D and eligibility is defined in section 353D.01. From PERA's website:

> *DCP participation is optional for eligible public officials, physicians, city managers, and other specific classes of positions listed under Minnesota Statutes Chapter 353D. If you meet eligibility requirements, you have 30 days from the start of your employment with the governmental subdivision to make a one-time, permanent election to participate in the DCP.*

Relevant to the Work Group, these are the positions eligible for the DCP:

- Basic and advanced life-support emergency medical service personnel who are employed by any public ambulance service;
- Municipal rescue squads associated with City of Litchfield in Meeker County and county rescue squads associated with Kandiyohi County, who perform emergency management services;
- Volunteer or emergency on-call firefighters providing service in a municipal fire department or an independent nonprofit firefighter corporation who are not eligible for PERA's Police & Fire Plan, the Statewide Volunteer Firefighter Plan or a municipal fire relief association. Specific statutory language from Section 353D.01, subdivision 2, clause (8):

    > *… volunteer or emergency on-call firefighters serving in a municipal fire department or an independent nonprofit firefighting corporation who are not covered by the police and fire retirement plan and who are not covered by a firefighters relief association and who elect to participate in the public employees defined contribution plan; ….*

Contribution rates are determined by the employer, but must be at least 7.5% of pay contributed by the member only or by the member and the member's employer. DCP members can designate a percentage of total contributions to be placed in one or more of seven investment options in the Minnesota Supplemental Investment Fund managed by the State Board of Investment.

Members may take a distribution of their account in the form of a lump sum after the termination of DCP–covered employment, disability, or death.

My guess is that EMPs in the DCP are not, in fact, eligible to participate in the DCP either because they also perform firefighting service, which means they participate in another plan (relief association, SVF Plan, or the Police & Fire Plan) or, if they are solely providing only emergency medical services, they are not employed by an ambulance service. Therefore, they do not fit into the categories of individuals eligible to participate in the Plan. This error can be corrected by ceasing their active participation in the DCP as soon as possible.

A change in the statutes that requires EMPs to be covered by the affiliated relief association or the SVF Plan will also require changes to the statutes in Chapter 353D for EMPs covered by the DCP, even if the EMP should not have been covered under Section 353D.01. Statutes in Chapter 353D will need to be amended to state that, if an EMP is required to be covered by a relief association or SVF Plan as a result of a law change that requires coverage, and the EMP has an account in the DCP:

(1) the DCP account will remain in the DCP and continue to be invested,
(2) no new contributions will be made to the EMP's account in the DCP, and
(3) when the EMP leaves service with the fire department, the EMP will be eligible to take a lump sum distribution of the EMP's DCP account.

For the same reasons that relief association and SVF Plan statutes are being amended to require coverage of EMPs who solely provide emergency medical services, the DCP's eligibility provision that is currently limited to firefighters would also be amended to include EMPs who solely provide emergency medical services. This will have the added bonus of aligning the statutory language with how this provision has apparently been administered. Using language drawn from Chapter 424A governing relief associations, the eligibility provision at Section 353D.01, subdivision 2, clause (8), could be revised as follows:

> … (8) volunteer or paid on-call firefighters or emergency medical personnel solely providing emergency medical duties or supervising emergency medical response activities who:
>
> (i) are serving in a municipal fire department or an independent nonprofit firefighting corporation;
> (ii) ~~who~~ are not covered by the police and fire retirement plan, a firefighter relief association, or the statewide volunteer firefighter plan; and
> (iii) ~~who~~ elect to participate in the plan; ….