



April 2009

Pension Division Newsletter

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Maximum Benefit Worksheet

The Pension Division periodically receives questions about the purpose of the Maximum Benefit Worksheet (MBW). The MBW is a form that is required under state law to be completed annually by lump sum plans, monthly plans, and monthly/lump sum combination plans. The form must be certified to the affiliated municipality or independent nonprofit firefighting corporation by August 1 of each year, and must also be submitted to the Office of the State Auditor with your relief association's other annual reporting forms for the year. The 2009 Maximum Benefit Worksheet must be certified to the affiliated municipality or firefighting corporation by August 1, 2009, and must be submitted to the Office of the State Auditor by March 31, 2010 or by June 30, 2010, depending upon your relief association's reporting deadline.

The MBW calculates an average amount of available financing based on your relief association's revenues and number of active members over the most recent three-year period. The average available financing amount corresponds to maximum lump sum and monthly benefit levels, which are the maximum benefit levels that your relief association may establish for the year pursuant to state law. The MBW form DOES NOT calculate the maximum benefit level that can be set without causing a deficit or a required contribution. Because the calculations used to determine the maximum allowable benefit levels are based primarily on revenue data, your relief association's financial situation only indirectly affects the calculation. In fact, there is sometimes an inverse relationship between your relief association's financial situation and the allowable maximum benefit level. For example, if your relief association has a deficit and is receiving large required contributions from the municipality, your revenues increase, resulting in an increased maximum benefit amount. Increasing the benefit level in this situation would result in an even greater deficit and even larger required contributions.

Relief associations should be cautious when considering benefit level changes. When adopting a benefit level change, your relief association must be sure that the benefit level established does not exceed the maximum benefit level allowed for the year as shown on the MBW form. There are severe penalties under state law for paying pensions that exceed the maximum benefit level allowed, including the forfeiture of state fire aid. In addition, increasing your benefit level to the maximum level allowed may cause your relief association to be in a deficit situation and may result in large required contributions.

Market Concerns – FAQs

During our recent pension training sessions questions arose regarding municipal approval of relief association benefit increases. Specifically, the hypothetical situation was discussed in which a relief association voluntarily decreased its benefit level from a municipally-approved level, and whether municipal approval to return to the original benefit level would be required.

Relief associations are required under state law to obtain municipal approval of bylaw amendments that would “affect the amount of, the manner of payment of, or the conditions for qualification for” service pensions or ancillary benefits except under limited circumstances. The limited circumstances in which a relief association is not required to obtain municipal approval are when the municipality is not required to provide financial support, the benefit change does not result in the increase in liabilities to exceed 90 percent of the prior-year surplus, and the changes do not result in the financial requirements of the special fund to exceed the expected amount of the future state fire aid. All three conditions must be true in order for benefit changes to be implemented without municipal approval. If the relief association adopts or amends its bylaws without municipal approval and financial support from the municipality becomes required, the relief association is required to change its benefit level to the last level approved by the municipality.

One way to voluntarily decrease benefit levels could be for a relief association to draft its bylaws in such a way as to temporarily decrease its benefit level, and to return to the originally-approved benefit level after a specified period of time. For example, a relief association could voluntarily choose to decrease its benefit level and adopt a bylaw amendment doing so with a specific expiration date. The decreased benefit level would only be in effect until the expiration date, at which point the originally-ratified benefit amount would again become effective. Because the original bylaw amendment approving the higher benefit level remains in effect, this process would not require another bylaw amendment, so would not require municipal approval of the benefit level a second time.

It is important to note that members separating from active service while the benefit level is temporarily decreased would receive service pensions based on the decreased benefit level, not the municipally-approved level. In addition, this approach could not apply to relief associations that have already voluntarily decreased their benefit level. Please remember that benefit level changes must be initiated by the relief association. Municipalities do not have authority to initiate a benefit level change or to unilaterally change a relief association’s benefit level.

The Office of the State Auditor cannot provide legal advice. The information provided in this newsletter is a general response to the hypothetical situation discussed and should not be relied upon as legal advice. Your relief association should contact its attorney for help in drafting bylaw amendments.

Working Group Legislative Proposals

The 2009 Omnibus Retirement Bill (S.F. 191 Betzold, H.F. 723 Murphy, M.), which contains the Working Group’s legislative proposals, has been passed by the Pension Commission and several legislative committees. The bill is awaiting hearings by the Senate and House finance committees. A copy of the pension omnibus bill can be viewed at:

<http://www.commissions.leg.state.mn.us/lcpr/omnibus.htm>. We will continue to keep you updated on the bill’s progress.

2007 Financial and Investment Report

The Office of the State Auditor's 2007 Financial and Investment Report of Volunteer Fire Relief Association was released earlier this month. The report provides information on the benefits, finances and investment performance for calendar year 2007 of Minnesota's volunteer fire relief association pension plans and several local salaried police and fire pension plans. The complete report can be accessed at:

http://www.auditor.state.mn.us/Reports/pen/2007/vfra/vfra_07_report.pdf. Paper copies of the report are available upon request by contacting Gail Richie at (651) 282-6110 or at Gail.Richie@state.mn.us.

Pension Training Thank You!

The Office of the State Auditor would like to thank all of the relief association officers, trustees and consultants that attended our training sessions this spring. Our Pension staff had the chance to connect face-to-face with nearly 450 training participants. We appreciate having the opportunity to discuss your questions and concerns, and encourage you to contact our office any time questions arise. If you have suggestions for future training sessions, please contact Rose Hennessy Allen at (651) 296-5985 or at Rose.Hennessy-Allen@state.mn.us.

Investment Basics – Investment Fees

A document is attached entitled "Investment Basics – Investment Fees." This is another installment in our ongoing series that we hope will provide education on investment topics. This document provides definitions and basic explanations of different types of investment fees that may be charged to a relief association. If you have suggestions for future Investment Basics topics please contact Luke Hinz at (651) 296-6279 or at Lucas.Hinz@state.mn.us.

If you have questions please contact us:

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Investment Basics

Investment Fees

Relief association trustees should be aware of the different types of fees that investment securities may be subject to before purchasing an investment. Investment fees can make up a significant portion of a portfolio's annual return, and they can add to even bigger investment losses during difficult financial cycles like we have seen over the past year. Trustees should look for investments and financial institutions that try to limit fees passed along to the investor. With good research, relief associations can find investments and financial services companies that charge low fees but still offer comparable or even better services than their counterparts that charge higher fees. Relief associations can also purchase shares in mutual funds directly from the mutual fund company. Relief association trustees should ask their brokers to explain the fees that are included in current and prospective investments. Some typical investment fees that a relief association may see are listed below.

Wrap Account Fees

The wrap account fee is a flat fee that covers money management, broker advice, brokerage firm support, and trading. The fees for these types of accounts typically range from one percent to three percent of the total value of the investments. Inside a wrap account, investments can be bought and sold without having to pay the transaction fees. This may not benefit the average investor who buys and holds investments or is involved in limited trading. There are also mutual fund wrap accounts where the money manager invests assets in a diversified mix of mutual funds. Fees for mutual fund wrap accounts generally range from one percent to 1.5 percent of the total investment value. Additional operating expenses may also be charged.

Investment Management/Advisory Fees

Investment management and advisory fees are charged as a percentage of the assets being managed for a particular investor by a particular investment firm. These fees are charged for handling the investor's account and giving financial advice. For example, a one percent management fee on a \$10,000 investment is \$100.

Transaction Fees

A transaction fee is charged when a broker buys or sells a stock or mutual fund for an investor. These fees are flat fees and can range from \$7 to over \$50, depending on the investment firm.

Annual Account Fee/Custodian Fee

Annual account and custodian fees can be charged by mutual funds and by brokerage firms. These fees can reach \$100 per year.

Mutual Fund Expense Ratios

The expense ratio reflects the cost of owning a mutual fund, and the operating expenses that mutual funds charge investors. This ratio covers the operating expenses, investment advisory

fees, administrative costs, and the 12b-1 distribution fees for certain mutual funds. Mutual funds incur transaction expenses every time the fund buys and sells stocks or bonds within the mutual fund. These expenses are passed along to investors. The expenses paid by a mutual fund can be determined by analyzing the expense ratio.

The expense ratio is not deducted from the investor's account; rather the investment return that is reported to the investor for the year is net of these fees. For \$1,000 invested, an expense ratio of 0.90 percent means that \$9 per year will go toward expenses. The lower the expense ratio for a mutual fund, the lower the fees will be. Index funds generally have the lowest expense ratios, because activity within the fund is limited. Index funds have expense ratios that typically range from 0.18 to 0.50 percent. In contrast, actively-managed mutual funds often have expense ratios around 1.5 percent. The expense ratio does not include the cost of buying a mutual fund through a broker. The expense ratio fees apply to the management of the mutual fund and are charged by the mutual fund company itself.

“Load” vs. “No-Load” Mutual Funds

- “Front-end load mutual funds” charge a fee based on a percentage of the initial amount invested in the mutual fund. These fees are in addition to the operating expenses of the mutual fund. For example, if you purchase \$1,000 of a five percent front-end load mutual fund, the amount deducted when your money is initially invested in that particular mutual fund is \$50. The initial amount that is actually invested is \$950 as opposed to \$1,000.
- “No-Load mutual funds” do not charge an initial fee to purchase shares of the mutual fund and do not charge a percentage of the total amount when the shares are eventually sold. No-load mutual funds are still subject to the annual operating expenses of the mutual fund.
- “Back-end load mutual funds” charge a percentage fee when the mutual fund shares are sold. This fee can be as high as five percent, and is based on the total amount for which the mutual fund shares were sold. The fee oftentimes is reduced by the length of time that the mutual fund was held. For example, if a mutual fund was only held for one year, a five percent fee may be applied, whereas a three percent fee may be applied if the mutual fund shares were held for three years. This back-end fee is in addition to the annual operating expenses of the mutual fund.

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