REBECCA OTTO
STATE AUDITOR

STATE OF MINNESOTA
OFFICE OF THE STATE AUDITOR

SUITE 500
525 PARK STREET
SAINT PAUL, MN 55103-2139

(651) 296-2551 (Voice)
(651) 296-4755 (Fax)
state.auditor@osa.state.mn.us (E-mail)
1-800-627-3529 (Relay Service)

Statement of Position
Fire Relief Association Investment Policies

State law requires all volunteer fire relief associations to have an investment policy on file with the Office of the State Auditor (OSA).[1]

An investment policy is an important tool to help relief association trustees fulfill their roles as fiduciaries. Investment policies should define and assign investment decision-making and oversight roles, provide for review of investment transactions and strategies, encourage effective communication and reporting, identify the risk tolerance of the relief association members and trustees, and provide continuity to the investment program. Investment policies may be crafted to apply to all investments made by the fire relief association, or only to the investment of special fund assets.

The following items should be included in a relief association investment policy:

- Statement of Objectives (including benchmarks and target asset allocations);
- Internal Controls;
- Standards of Conduct;
- Investment Reporting;
- Ethics and Conflicts of Interest; and
- Investment Restrictions.

Statement of Objectives

In an investment policy, the statement of objectives identifies the main investment objectives and limitations. Usually, general objectives will be identified in order of priority. For example, an investment policy may identify the following goals:

1. Preservation of capital; and
2. A rate of return of at least as much as is assumed by statute (5%).

[1] Minn. Stat. § 356.219, subd. 3. Subdivision 3 also requires that changes to the policy and the effective date of each policy change be submitted annually to the OSA.

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In this example, not losing principal is the primary objective. This primary objective may guide investments toward Certificates of Deposit, or other principal guaranteed investments. The second objective of obtaining a rate of return at least as high as that assumed by statute may keep the relief association out of riskier investments.

There are other general objectives consistent with the fiduciary role of relief association trustees. Each association should determine the risk level it feels comfortable with and develop two or three general goals consistent with that risk.

In addition, relief association trustees have a fiduciary duty to ensure that investments are diversified to minimize the risk of substantial investment losses. Diversification can be achieved through purchasing investments of different durations, investing in different types of asset classes and sub-classes, and establishing maximum and minimum investment percentages in certain sectors of the economy.

It is also helpful for the relief association to adopt specific standard indices consistent with its general investment objectives in an investment policy. For example, a relief association may specify that the investment objective is to earn an annual rate of return that is at least equal to the rate earned by the Wilshire 5000 Index for equities and the Barclays Capital Aggregate Index for fixed income.

Specific benchmarks included in the investment policy help measure investment performance by comparing the relief association's portfolio with various market indices. A benchmark is a reference portfolio against which a similar portfolio may be measured. Some relief associations create custom benchmarks that are based on multiple indices corresponding to the target asset allocations required in the investment policy. A custom benchmark provides a measure for the total investment portfolio of a relief association.

Target asset allocations should be included in investment policies to provide guidance to both fire relief association trustees and brokers. Asset allocations divide investments among markets to reduce risk and maximize return. Target asset allocations set forth suggested ranges for asset classes based on a percentage of the relief association's total assets. For example, a relief association may specify in its investment policy that it targets 55 percent of the portfolio to be invested in equities, 40 percent to be invested in fixed income securities, and 5 percent to be held in cash. Examples of more specific classifications include large or small capitalization stocks, sector-specific equity investments, or developed or emerging market international equity.

Target asset allocations should reflect the relief association's investment objectives. As the relief association receives contributions and makes disbursements, money can be deposited or withdrawn from particular asset classes to keep the asset allocations in line with the targets. A relief association's actual asset allocations will naturally deviate from the targets as markets fluctuate, but the relief association should strive to keep assets allocated in a manner consistent with the investment policy targets over time.

Most relief associations are required to invest a portion of their assets in authorized short-term debt obligations that can be immediately liquidated without a substantial penalty or loss. This requirement helps to ensure that the relief association has available assets to pay benefits as they come due. The short-term investments should have an average maturity of no more than 90 days. In general, all remaining assets should be invested in longer-term investments. Staggering investment maturity dates may help to provide for greater stability of income and liquidity. Relief associations should carefully review their expected cash flow needs and select investments that mature when the assets will be needed.

Internal Controls

Internal Controls are important to include in an investment policy. Internal controls may include:

- Establishing an investment committee and consulting with a private auditor;
- Separating functions;
- Separating transaction authority from the accounting and record keeping;
- Using qualified custodial safekeepers;
- Obtaining written confirmation of telephone transactions;
- Having transfer verifiers on file to confirm wire transfers;
- Maintaining supervisory control of employee actions;
- Minimizing the number of authorized investment officials; and
- Documenting investment transactions and strategies.

Standards of Conduct

Relief associations may find it helpful to establish and define a standard of conduct related to investment. By law, relief association trustees are held to the "prudent person standard," which is a requirement that fiduciaries act in good faith and exercise the "degree of judgment and care, under the circumstances then prevailing, that persons of prudence, discretion, and intelligence would exercise in the management of their own affairs, not for speculation, considering the probable safety of the plan capital as well as the probable investment return to be derived from the assets."[2]

Investment Reporting

Because the relief association board of trustees is ultimately responsible for investment performance, the board must be kept informed of investment gains and losses and recent market developments. An investment reporting section within the investment policy should specify how often investment professionals will provide the board of trustees with reports. The policy should also identify information that should be included in the reports.

[2] Minn. Stat. § 356A.04, subd. 2.

Ethics and Conflicts of Interest

Relief association trustees involved in the investment process should refrain from personal business activity that could conflict with the investment of relief association assets or that could reasonably cause others to question or doubt their ability to make impartial investment decisions. State law prohibits fiduciaries of relief associations from personally profiting, directly or indirectly, as a result of the investment or management of relief association assets.[3]

Investment Restrictions

Finally, Minnesota law restricts the types of investments in which relief associations can invest. A relief association may choose to restrict its investment options even more through its investment policy. For more information on Relief Association Investment Restrictions and Authority, see our Statement of Position on this topic at:

http://www.auditor.state.mn.us/default.aspx?page=20110527.006.

[3] Minn. Stat. § 356A.06, subd. 3.