

**Revisor #20-8022 puts into bill form the recommendations of the Work Group on Relief Association Conversions and Dissolutions regarding converting from a defined benefit plan to a defined contribution plan, as set forth on pages 7-15 of the:**

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**Report of the Work Group on  
Firefighter Relief Association  
Conversions and Dissolutions**

**February 21, 2019**

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The number of respondents who checked each response are as follows:

- Adding more firefighters: 33
- Reducing reliance on non-career firefighters: 18
- Increasing the per hour or per call rate for non-career firefighters: 87
- Changes similar to the above: 28 (See Exhibit C, page 23, for respondents' specific descriptions.)
- Of the 276 respondents whose departments have non-career firefighters, 89%, or 246 respondents, reported that the retirement plan for firefighters is a defined benefit plan, while 11%, or 30 respondents, reported that the plan was a defined contribution plan. (Note: According to the 2017 data on volunteer firefighter relief associations collected by the State Auditor, 85 out of 579 reporting relief associations, or 15%, are defined contribution plans.)
- Of the 246 respondents with defined benefit plans, 2%, or 5 respondents, reported that the relief association board had considered converting from a defined benefit plan to a defined contribution plan; 10%, or 25 respondents, reported "I don't know."

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## Converting from Defined Benefit to Defined Contribution

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### ***Objective***

The work group framed the objective for this task as follows:

*Propose legislation alternatives regarding conversion from a defined benefit plan to a defined contribution plan.*

The focus of the work group was on conversions from a defined benefit plan that pays a lump sum benefit at retirement to a defined contribution plan. The work group agreed that proposed legislation should also address conversions (1) from a defined benefit plan that pays monthly annuities at retirement or offers both monthly

annuities and lump sums to a defined contribution plan; and (2) from a defined contribution to a defined benefit plan. Time constraints, however, limited discussion on the details of these conversions. LCPR staff notes that proposed legislation could include procedures for these conversions, but may be short on details, and represent more of a placeholder for future fine-tuning.

***Applicable federal law***

LCPR staff had previously provided information regarding applicable federal law. Many relief associations are attempting to maintain status as a “qualified plan” under the Internal Revenue Code to ensure that firefighters (i) will not be taxed on benefits as they are earned or as contributions are allocated to retirement accounts and (ii) will be able to further defer paying taxes on a distribution of the benefit by rolling it into an individual retirement account (“IRA”) or another retirement plan. Under Minnesota Statutes, Section 424A.015, Subdivision 4, a firefighter is provided the opportunity to direct a rollover of his or her lump sum pension payment to an individual retirement account (IRA) if the relief association retirement plan is a “qualified pension plan under section 401(a) of the Internal Revenue Code, as amended.” The work group agreed that any conversion process to be included in legislation should comply with applicable federal laws and regulations relating to qualified retirement plans.

On the issue of conversion from defined benefit to defined contribution, applicable federal law treats the conversion as a two-step process: (1) the termination of the defined benefit plan, which requires full vesting of all members, active and inactive, as of the date of termination, and (2) the establishment of a new defined contribution plan, to which active firefighters’ benefits are transferred for depositing in an account in each firefighter’s name. Assets in excess of fully vested accrued benefits can be transferred to the employer or to the firefighters or a combination thereof.

***Applicable state law***

The work group considered whether state statutes currently provided any guidance on conversions. As reported by LCPR staff:

- There is nothing currently in statutes regarding how to do a conversion from one plan type to another.
- The only mention of type of plan (defined contribution or defined benefit) is the requirement in current law, at Minnesota Statutes, Section 424A.002, which requires relief association articles or bylaws to identify the type of plan (defined benefit or defined contribution) being offered by the relief association.

***Step I: Board of trustees resolutions — approving the conversion and optional benefit level increase***

The work group formulated the following conversion process:

The relief association board of trustees must adopt resolutions that include the following:

1. Approval of the conversion from a defined benefit plan to a defined contribution plan;
2. Approval of the conversion effective date (“Conversion Date”);
3. Adoption of a new defined contribution plan document, which specifies eligibility, annual allocations to accounts, vesting, distributions, ancillary benefits, and otherwise complies with Section 424A.016;
4. Approval of full (100%) vesting of all firefighters (active and inactive) in their accrued benefits under the current defined benefit plan as of the Conversion Date, to the extent of the plan’s assets (as required by federal law);

The board may approve an increase in the benefit level to reduce the surplus. (The “benefit level” is the dollar amount identified in the relief association bylaws, which is multiplied by years of service to arrive at each firefighter’s lump sum pension amount.) The new benefit level need not be limited to the current statutory limit of \$10,000. (See the “Note,” below, regarding amending the statutory limit on the benefit level.) If an increase is approved:

- The board needs to include a decision regarding whether the increased benefit level will be applied to only active firefighters or to both active and inactive firefighters.

- The board needs to include a statement that the increased benefit level cannot cause the funded status of the plan to fall below 100%.
- The board’s approval of an increase in the benefit level must be considered conditional on there being sufficient assets to fund the increase. If, as of the date benefits are transferred to the defined contribution plan or paid to inactive firefighters directly or in a direct rollover, there are not sufficient assets to cover all benefit liabilities at the new higher benefit level, the board must state that the benefit level will be reduced until assets equal or are greater than liabilities. The board must state that the new lower benefit level will be considered approved by the board of trustees without further action by the board.

Notes:

- (1) To remove any statutory impediment to board approval of an increase in the benefit level, Minnesota Statutes, Section 424A.02, Subdivision 3, Paragraph (d), will be amended to provide that the maximum lump sum amount does not apply to any increase in connection with a conversion where the relief association has a surplus over full funding.
- (2) To remove any statutory impediment to applying the benefit level increase to inactive firefighters in addition to active firefighters, Minnesota Statutes, Section 424A.015, Subdivision 6, will be amended to permit the retirement benefit payable to inactive firefighters to be calculated using the new higher benefit level and not be subject to the current statutory requirement that the benefit be calculated using the benefit level in effect on the date on which the firefighter separated from active service.

***Step I continued:  
Board of trustees  
resolutions —  
disposition of  
surplus assets***

If it is possible that the plan will have assets in excess of liabilities as of the Conversion Date (a “surplus”), even after taking into account any increase in the benefit level, the board of trustees must approve a procedure for allocating this surplus. Alternatives from which the board may choose are the following:

- Per capita method: Each firefighter’s account receives the same dollar amount.

OR

- Service-based method: Each firefighter’s account receives a share of the surplus based on this ratio:

$$\frac{\text{Firefighter's years of service}}{\text{Total years of service for all active firefighters}}$$

OR

- Firefighter/ municipality-sharing 2-step method:

First step: Municipality receives a share of the surplus based on this ratio:

$$\frac{\text{Municipal contributions since [year]}}{\text{Total of fire state aid + municipal contributions since [same year]}}$$

Second step: Remaining surplus is allocated to accounts of firefighters using the per capita, service-based, or another method.

OR

- Firefighter/ municipality-sharing 2-step method:

First step: Municipality receives a share of the surplus based on the ratio above and the board sets conditions on its use. Examples of conditions that may be imposed on the use of the surplus by the municipality:

- It must be contributed back to the relief association defined contribution plan over the next five (or other number) years, for allocation to the accounts of future firefighters, or
- It must be used by the municipality to buy firefighting equipment or other specified firefighting related purposes.
- It must be used by the municipality to provide health insurance or other welfare benefits for its firefighters.

Second step: Remaining surplus is allocated to accounts of firefighters using the per capita, service-based, or another method.

Note: The board of trustees will need to determine whether only active firefighters will share in the surplus or whether both active and inactive firefighters will share.

***Step I continued:  
Board of trustees  
action — if plan  
has fewer assets  
than liabilities***

The work group considered the possibility that a relief association wishing to convert its defined benefit plan to a defined contribution plan may not be more than 100% funded, such that the value of its assets are not sufficient to cover the cost of all pension benefits (sometimes referred to as an “underfunded” plan or a “shortfall”). The work group determined that the legislation should prohibit conversion by an underfunded plan, unless the board of trustees offers either of the following alternatives:

- A resolution amending the relief association bylaws to decrease the benefit level to the extent necessary to reduce benefit liabilities to the point that the assets were sufficient to fund the pension benefits of all firefighters, taking into account the need to fully vest the pension benefits of all active and inactive firefighters; or
- An agreement with the municipality that it would fund the shortfall by making a contribution in an amount sufficient to cover all benefit liabilities at the current benefit level, taking into account the need to fully vest the pension benefits of all active and inactive firefighters.

Note: If the board of trustees elects the first alternative and approves a bylaws amendment, current law requires the bylaws amendment be approved by the municipality. Minnesota Statutes Sections 424A.02, Subdivision 10; 424A.092, Subdivision 6; and 424A.093, Subdivision 6, require that a bylaws amendment be approved by the affiliated municipality if the plan does not have a “surplus over full funding” and the amendment “increases or otherwise affects the retirement coverage provided by or the service pensions or retirement benefits payable from the special fund...”

Accordingly, work group members agreed that proposed legislation include a requirement that the relief association must obtain the consent of the municipality to the conversion and all related bylaws amendments if the relief association plan does not have a surplus, that is, assets do not exceed benefit liabilities. Proposed legislation would include a provision stating that, if the relief association plan has a surplus, that is, assets exceed benefit liabilities, any requirement of municipal consent to bylaws amendments is

waived and the conversion could proceed and bylaws amendments take effect without the consent of the municipality.

**Step II:  
Determination of  
the value of  
pension benefits**

Step II in the conversion process is to determine the value of pension benefits (plan “liabilities”). Proposed legislation would provide that the board of trustees will determine the estimated value of each firefighter’s fully vested accrued benefit as of the Conversion Date.

The board must determine estimated value in one of two ways:

- By using the method at Minnesota Statutes, Section 424A.092, Subdivision 2, which is used to determine a plan’s funded status by calculating the value of each firefighter’s accrued benefit using a table set forth in the statute; or
- As determined by an actuary retained by the relief association, who meets the definition of “approved actuary” at Minnesota Statutes, Section 356.215, Subdivision 1, Paragraph (c).

**Step III: Notice  
to firefighters**

Step III of the conversion process is notice to firefighters. Proposed legislation will require the board of trustees to provide notice to all affected firefighters, that is, both active and inactive, at least 90 days in advance of the Conversion Date.

Legislation will require that the notice include the following:

- An explanation that the plan is to be converted from a defined benefit plan to a defined contribution plan and what those terms mean; the reasons for the conversion; the conversion effective date (called the “Conversion Date”); and the procedure to be followed, including fully vesting all firefighters;
- A summary of the terms of the newly adopted defined contribution plan;
- Information about any increase in the benefit level and whether the increase applies to only active firefighters or both active and inactive firefighters;

- A section tailored to each firefighter, which provides an estimate of the value of the firefighter’s accrued benefit (fully vested) and the method used to calculate that value;
- An estimate of any anticipated surplus (assets in excess of liabilities), and an explanation of how the surplus will be paid, that is, whether it will be allocated among only firefighter accounts or whether the municipality will receive any of the surplus and any conditions on its use; and
- Contact information (phone and email) for one or more members of the board of trustees who will answer questions and provide a copy of the new defined contribution plan document or a summary, if requested (or directions to a website for viewing and printing the plan document or summary).

***Step IV: Notice to municipality and State Auditor***

Proposed legislation will also require that the relief association provide notice to both the municipality affiliated with the relief association and the State Auditor. This notice must include all the same information as provided to the firefighters, except that the individualized information will be provided as a spreadsheet listing the name of each firefighter and the corresponding accrued benefit amount.

***Step V: Implement the conversion***

The board of trustees must implement the conversion, as described in the board resolutions and in compliance with the new statutory requirements. Implementation will require:

- Preparation of a new defined contribution plan. The work group suggested that the State Auditor make available sample bylaws for this purpose. LCPR staff may be able to provide assistance with the preparation of plan documents and legal compliance.
- A recordkeeping account must be established for each firefighter under the defined contribution plan to which is recorded the value of the firefighter’s fully vested accrued benefit as determined as of the Conversion Date, and any allocation of surplus.

**Example:  
Simplified  
conversion and  
impact on a  
firefighter**

*A relief association defined benefit plan has 20 active firefighters and is 170% funded, with assets of \$1,700,000 and benefit liabilities of \$1,000,000. The bylaws provide for a pension benefit equal to \$5,000 per year of service.*

*A firefighter will have 11 years of service at the end of 2020 and will have accrued a pension benefit of \$55,000 (\$5,000 x 11 years of service). However, with 11 years of service, the firefighter is only 64% vested, which means the firefighter would be entitled to a lump sum pension benefit of \$35,200, if the firefighter were eligible to retire at the end of 2020.*

*During 2019, the board approves a conversion to a defined contribution plan and an increase in the benefit level to \$7,000, which will reduce the surplus from approximately \$700,000 to approximately \$300,000. The board designated December 31, 2020, as the conversion date. The board determined that the surplus is to be allocated on a per capita basis so each of the 20 firefighters receives the same amount.*

*As of December 31, 2020, the conversion date, the firefighter's benefit has been recalculated, applying the new \$7,000 benefit level and 100% vesting. Instead of a 64% vested benefit at \$5,000 per year of service (\$35,200), the firefighter's benefit as of the conversion date is \$77,000 (\$7,000 x 11 years of service at 100% vested). The firefighter's share of the surplus is \$15,000 (\$300,000 / 20).*

*On December 31, 2019, \$92,000 (\$77,000 accrued benefit + \$15,000 share of the surplus) is credited to a new account in the firefighter's name in the new defined contribution plan. The firefighter is 100% vested in this amount. Future contributions will be subject to whatever vesting schedule has been approved by the board of trustees for the new defined contribution plan.*