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OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

EVALUATION REPORT

Pensions for Volunteer Firefighters

JANUARY 2007

PROGRAM EVALUATION DIVISION
Centennial Building – Suite 140
658 Cedar Street – St. Paul, MN 55155
Telephone: 651-296-4708 • Fax: 651-296-4712
E-mail: auditor@state.mn.us • Web site: http://www.auditor.leg.state.mn.us
Through Minnesota Relay: 1-800-627-3529 or 7-1-1

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Evaluation Staff

James Nobles, *Legislative Auditor*

Joel Alter
Valerie Bombach
David Chein
Catherine Dvoracek
Jody Hauer
Adrienne Howard
Daniel Jacobson
Deborah Parker Junod
Carrie Meyerhoff
John Patterson
Judith Randall
Jan Sandberg
Jo Vos
John Yunker

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OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA • James Nobles, Legislative Auditor

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Members of the Legislative Audit Commission:

Minnesota uses a decentralized system to administer pensions for approximately 20,000 volunteer firefighters statewide. Over 700 volunteer firefighter relief associations are responsible for setting benefit levels and investing pension funds for their members. In April 2006, the Legislative Audit Commission directed OLA to evaluate how well this system is working.

Overall, we found that Minnesota's decentralized pension system for volunteer firefighters creates problems and challenges. Most significant is that most relief associations have, over time, earned low rates of return on their investments. While some elements of local control should remain, we recommend that the Legislature require all volunteer firefighter relief associations to invest their pension funds through the State Board of Investment (SBI). This would likely increase their rates of return, which could lead to higher pension benefits for their members or decreased mandatory contributions by local government. To help relief associations make prudent investments within the options offered by SBI, we also recommend that they develop investment policies that incorporate best practices.

This report was written by Jo Vos (project manager) and David Chein. We would like to thank staff at the Office of the State Auditor for their assistance during the course of our study.

Sincerely,

Jim Nobles

James Nobles
Legislative Auditor

Room 140 Centennial Building, 658 Cedar Street, St. Paul, Minnesota 55155-1603 • Tel: 651-296-4708 • Fax: 651-296-4712
E-mail: auditor@state.mn.us • Website: www.auditor.leg.state.mn.us • Through Minnesota Relay: 1-800-627-3529 or 7-1-1

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Major Findings:

- In 2004, 713 volunteer firefighter relief associations were responsible for determining eligibility, setting benefit levels, and investing funds for volunteer firefighter pension plans within broad parameters set in state law (p. 7).
- Most volunteer firefighter relief associations—84 percent—have defined benefit pension plans and make one large "lump sum" payment to retiring firefighters based on their years of service (pp. 14-15).
- For volunteer firefighters with 20 years of service, these lump sum payments averaged $16,000 in 2004, but ranged from $500 to $140,000—which reflects differences in state aid and, indirectly, differences in the activity levels of individual fire departments (pp. 18-21).
- In 2004, most volunteer firefighter pension plans had sufficient funds to pay their anticipated future pension obligations (p. 21).
- However, the vast majority of relief associations—96 percent—would have earned higher rates of return and had lower investment costs if they had invested through the State Board of Investment (SBI) from 1997-2004 (pp. 24-26).
- During fiscal years 2003-2005, less than one-third of volunteer firefighter relief associations invested through SBI; 41 percent of relief association officials responding to an OLA survey said that they were "not familiar at all" with SBI (p. 31).
- From 1997-2004, volunteer firefighter relief associations paid a higher percentage of their funds on administrative costs than did large public pension plans in Minnesota; however, their costs were not unreasonable given their inability to take advantage of economies of scale (pp. 32-34).
- Most relief association and local government representatives responding to our survey oppose centralizing volunteer firefighter pension plans at the state level or requiring relief associations to invest through SBI (pp. 46, 53).

Key Recommendations:

- The Legislature should require that all volunteer firefighter relief associations invest their pension funds through the State Board of Investment (p. 56).
- The Legislature should require volunteer firefighter relief associations to develop investment policies that incorporate best practices (p. 57).

Report Summary

Today, more than 700 different pension plans cover nearly 20,000 volunteer firefighters statewide.

Like most states, Minnesota has a strong tradition of relying on volunteers to provide fire protection services. As a reward for their service, the state allows them to receive pension benefits upon retirement. Today, there are more than 700 pension plans covering nearly 20,000 volunteer firefighters statewide. Each plan is administered by a nonprofit corporation known as a volunteer firefighter relief association.

Relief associations must administer pension plans within broad parameters set by state law.

Each volunteer firefighter relief association is responsible for determining eligibility, setting benefit levels, and investing funds for its pension plan. State law requires that a relief association be governed by a nine-member board of trustees, with three of the trustees appointed by the city or town operating the local fire department with which the relief association is affiliated.

In 2004, the median lump sum benefit paid out to a firefighter retiring after 20 years of service was $16,000.

In addition to board membership, statutes also regulate maximum levels for pension benefits; minimum requirements regarding vesting and retirement age; allowable investments for association pension funds; local government pension contribution requirements; auditing and reporting requirements; and allowable administrative expenses.

To help pay for pension benefits, the state levies a tax on certain insurance premiums. Other major sources of revenue include investment income and local government contributions—some mandatory and some voluntary.

Benefit levels vary widely, which reflect differences in state fire aid and, indirectly, fire calls.

Most relief associations offer defined benefit "lump sum" plans to retirees. Under such a plan, eligible firefighters receive a set amount of money for each year of service, paid out in one large payment at retirement. In 2004, the median lump sum benefit was $800 per year of service. Thus, a firefighter retiring with 20 years of service would receive one payment of $16,000. Benefit levels ranged from $25 to $7,000 per year of service, resulting in lump sum payments after 20 years of service ranging from $500 to $140,000.

Benefit levels depend on state fire aid as well as local contributions and investment income. We found a strong relationship between state fire aid and the number of fire-related calls a fire department responds to each year. For example, associations that received less than $9,000 in state fire aid in 2004 averaged 7 fire-related calls per year from 1999 through 2004. In contrast, relief associations that received more than $21,000 in state aid responded to an average of 43 fire calls per year.

Most volunteer firefighter pension plans have sufficient funds to cover future liabilities.

"Funding ratios" measure relief associations' net assets as a percentage of their accrued liabilities. In short, they help explain whether pension plans have enough money to cover future spending needs.

Most volunteer firefighter relief associations use a simplified formula set forth in statutes to annually determine their funding ratio. A funding ratio of 100 percent means that a pension fund has just enough assets to pay anticipated future benefits. In 2004, the median funding ratio was 106 percent. Sixty-five percent of relief associations with defined benefit plans had funding ratios of 100 percent or more; 17 percent had funding ratios of less than 90 percent.

From 1997-2004, SBI's Income Share Account earned a 7.7 percent average annual rate of return, compared with 4.8 percent earned by relief associations.

SBI has lower management and investment fees than most mutual funds.

Most relief associations would have earned higher rates of return if they had invested through SBI.

From January 1997 through December 2004, pension funds invested by relief associations earned an average annual rate of return of 4.8 percent. Earnings ranged from a loss of 2.7 percent per year to a gain of 13.7 percent per year. During the same time frame, the State Board of Investment's Income Share Account—a "medium" risk account consisting of stocks, bonds, and cash equivalents that relief associations can invest in—had an average annual rate of return of 7.7 percent.

Data suggest a variety of reasons that might explain relief associations' low rates of return, including poor stock selection, inconsistent investment strategies, and excessive investments in cash equivalents. In our survey of volunteer firefighter relief associations, many representatives from associations earning low or average rates of return said that they needed more investment-related training.

Although volunteer firefighter relief associations have the option of investing some or all of their pension funds through SBI, less than one-third did so in fiscal year 2005. Part of the problem could be lack of knowledge. In our survey of relief associations, 41 percent said that they were "not familiar at all" with the investment options offered through SBI.

In addition to its "proven track record" in terms of investment performance, SBI charges low investment fees. Most mutual funds usually charge annual management fees and operating expenses that total between 1 and 2 percent of assets. For 2006, the State Board's fees for the Income Share Account were 0.01 percent of assets; none of the SBI accounts open to volunteer firefighter relief associations had fees exceeding 0.25 percent.

Though high, relief associations' administrative costs are not unreasonable.

Between 1997 and 2004, pension benefits made up over 90 percent of relief associations' total annual disbursements, with administrative expenditures ranging between 6 and 9 percent of total disbursements. In 2004, 7 percent of relief association expenditures, or 0.42 percent of total pension assets, went for administration.

This level of spending is significantly higher than those for the state's three largest pension funds. Administrative expenses made up 0.07 percent of the Public Employee Retirement Association's total fund assets in fiscal year 2004. Administrative expenses for the Teacher's Retirement Association and the Minnesota State Retirement System were 0.08 and 0.07 percent of assets, respectively, for fiscal year 2004.

At the same time, relief association spending on administration has not been excessive. In 2004, 53 percent of relief associations' administrative expenditures were for actuarial, audit, and legal services. Fifty-eight percent of the associations did not spend anything on board salaries and 19 percent reported no administrative expenses at all. Given the need to keep accurate records to determine eligibility, calculate pension benefits, and comply with state auditing and reporting requirements, economies of scale likely explain why larger pension plans spent proportionately less on administration than did volunteer firefighter relief associations.

Maintaining some elements of local control has advantages over complete centralization.

Minnesota's decentralized pension system for administering volunteer firefighter pensions creates problems and challenges, especially in relation to investments. To address these problems, we considered several options that ranged from maintaining the status quo to completely centralizing all pension-related responsibilities at the state level.

Some elements of local control should be maintained.

There are several reasons for maintaining some elements of the current local control framework. First, relief associations have been generally conservative in setting benefits and most have sufficient resources to cover anticipated future liabilities. Second, the Legislature has implemented a system of checks and balances that appears to be working—pensions are funded and paid according to law. Third, local control may produce other benefits, such as increased community involvement, personal service, and civic pride. Fourth, there is little support for widespread structural changes among the relief associations and local governments that we surveyed. Finally, the primary purpose of offering pensions to volunteer firefighters is to reward them for community service, not to provide retirement income. It is generally assumed that firefighters will rely primarily on other sources of income to finance their retirement.

The Legislature should require volunteer firefighter relief associations to invest through SBI.

However, requiring relief associations to invest through SBI would likely increase their rates of return and lower their investment costs.

Minnesota statutes currently allow, but do not require, volunteer firefighter relief associations to invest some or all of their pension funds through SBI. To improve overall investment performance, the Legislature should make investing through SBI mandatory.

Doing so has several advantages. First and foremost, almost all relief associations could likely expect higher rates of return and lower investment costs. We estimated that relief associations would have earned about $56 million more had they invested almost all of their pension funds through SBI from 1997-2004. The additional revenue could be used to increase pension benefits or decrease mandatory contributions by local governments. Second, relief associations would still have some input in how they invest their funds. The State Board of Investment offers a variety of investment options that allow relief associations to design portfolios that reflect their individual needs. Third, the change would simplify association reporting requirements somewhat and reduce board members' need for investment-related training. Fourth, because SBI already has procedures in place for relief associations to use, requiring the associations to invest through SBI should not increase state costs.

Despite the obvious advantages to investing through SBI, relief associations and local governments express little support for doing so. In our surveys, 5 percent or less of respondents said that relief associations should be required to invest through SBI.

If the Legislature does not adopt this recommendation, we think that, at a minimum: (1) the State Board of Investment should provide more outreach and assistance to relief associations, including participating in investment-related training, and (2) the Legislature should require that relief associations provide annual "report cards" to their membership that summarize association investments relative to certain benchmarks.

Finally, regardless of whether relief associations are required to invest through SBI, the Legislature should require that associations develop long-term investment policies that incorporate industry best practices, and associations should use them. Our review of relief association investment policies found that most policies did not contain performance benchmarks or an overall strategy for achieving association goals.

Introduction

Minnesota has a strong tradition of relying on volunteer firefighters to provide fire protection services. As a reward for their service, the state allows volunteer firefighters to receive pension benefits upon retirement. It also helps fund those benefits. Today, there are more than 700 different pension plans covering nearly 20,000 volunteer firefighters statewide, with each plan administered by a nonprofit corporation known as a volunteer firefighter relief association.

Minnesota has a decentralized system for administering volunteer firefighter pensions.

Over the last few years, policy makers and others have raised concerns about the state's decentralized system for administering volunteer firefighter pensions. The most frequently heard complaint is that many of the locally-operated pension plans earn relatively low rates of return on their investments. There is also concern that these plans have high administrative costs because of their relatively small size. In addition, some people are concerned about the disparity in pension benefits among communities, while others take issue with the amount of administrative requirements placed upon local plan administrators. In April 2006, the Legislative Audit Commission directed the Office of the Legislative Auditor to evaluate Minnesota's system for administering volunteer firefighter pension plans. Our evaluation focused on the following questions:

- **How do pension benefits for volunteer firefighters vary across the state? Are benefits portable if firefighters move?**
- **How do the administrative costs and investment returns of volunteer firefighter pension plans compare with those of other pension plans in the state?**
- **How many other states provide pensions to volunteer firefighters? Do states offering pensions use a decentralized or statewide system?**
- **Is Minnesota's decentralized pension system for volunteer firefighters cost-efficient? Would a statewide system be more efficient and able to provide higher pension benefits?**

We used a variety of methods to address these questions. First, we examined Minnesota statutes and reviewed literature on pensions and fire services. Second, we interviewed staff in various state agencies, including the Office of the State Auditor, Legislative Commission on Pensions and Retirement, Public Employees Retirement Association, and the State Board of Investment. We also talked with representatives from various interest groups, such as the Minnesota State Fire Department Association, Minnesota State Fire Chiefs Association, League of Minnesota Cities, and the Minnesota Association of Townships. Third, we analyzed volunteer firefighter relief association financial and investment data collected by the State Auditor's Office from 1997 through 2004 (the most recent data available at the time of our evaluation) and data on fire-related activities collected by the Minnesota Department of Public Safety.[1] Fourth, we sent questionnaires to one board member from each volunteer firefighter relief association (usually the president, treasurer, or secretary) and to one local government official from the city or township that operated the fire department affiliated with the relief association (usually the city manager, city finance director, or town clerk). Fifth, we reviewed investment policies for a sample of relief associations. Finally, we reviewed pension-related statutes for other states and conducted telephone interviews with pension officials in select states about their programs.

Our evaluation did not examine some of the other benefit programs that relief associations often administer. For example, some associations offer funeral or disability benefits for firefighters killed or injured in the line of duty. We did not look at the extent to which relief associations comply with various statutory provisions that govern their activities. Also beyond the scope of our study was any examination of whether volunteer fire fighters should receive pensions in the first place. Likewise, we did not examine other forms of compensation for volunteer firefighters, such as local "pay per call" or "pay per hour" provisions. Finally, we did not look at pension benefits for salaried firefighters.

This report is divided into three chapters. Chapter 1 presents background information on fire services in Minnesota and the regulatory framework for administering volunteer firefighter pensions. Chapter 2 examines benefit levels, investments, and administrative costs for volunteer firefighter pension plans and relief associations' problems administering the pension plans. Chapter 3 summarizes how other states administer volunteer firefighter pension programs and discusses a variety of options that the Legislature could consider to address shortcomings in Minnesota's system.

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[1] In December 2006, the Office of the State Auditor released its 2005 report on 673 volunteer firefighter relief associations. While we did not have time to thoroughly review all of the 2005 data on association finances and investments, we have incorporated some of the overall data into our findings, when appropriate. Office of the State Auditor, *Financial and Investment Report for Volunteer Firefighter Relief Associations for the Year Ended December 31, 2005*, (St. Paul, December 2006).

1 Background

SUMMARY

Like most states, Minnesota has traditionally relied on volunteers to provide firefighting services. As a reward for their service, volunteer firefighters who meet certain eligibility requirements can receive pension benefits upon retirement. Local nonprofit corporations called volunteer firefighter relief associations administer these pension plans within broad parameters set forth in Minnesota statutes. In 2004, 713 relief associations were responsible for determining benefit levels, paying benefits, and investing pension funds for volunteer firefighters. To help pay for the pensions, the State of Minnesota levies a tax on certain insurance premiums, which is ultimately distributed to relief associations based on local property values and population. Other sources of revenue for volunteer firefighter pensions include investment income and local government contributions—some mandatory and some voluntary. In 2004, volunteer firefighter pension funds had revenues of $57.9 million, with year-end assets that totaled $356.8 million statewide.

Minnesota has had public pension plans since the early 1860s, when local governments—generally cities and towns—began offering them to help retain or reward individuals performing certain types of high-risk work, such as firefighting. State funding for firefighter relief programs dates back to 1885, when the Minnesota Legislature created the state fire aid program.[1] This chapter provides background information on Minnesota volunteer firefighters and the pension programs that cover them. More specifically, it focuses on the following questions:

- **How are fire services organized in Minnesota, and how does this compare with other states?**
- **How are pensions for Minnesota's volunteer firefighters administered and regulated?**
- **How are pensions for volunteer firefighters funded, and how much money does the State of Minnesota contribute toward them?**

To answer these questions, we reviewed Minnesota state statutes and the national literature on pensions. We interviewed staff at the Office of the State Auditor, Legislative Commission on Pensions and Retirement, and other state agencies, as well as representatives from the Minnesota State Fire Department Association, Minnesota State Fire Chiefs Association, League of Minnesota Cities, and the Minnesota Association of Townships. We also analyzed state and national data on fire services.

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[1] *Laws of Minnesota* 1885, chapter 187. See: Lawrence Martin, Executive Director, Legislative Commission on Pensions and Retirement, memorandum to members of the Legislative Commission on Pensions and Retirement, *Designated Commission Interim Study; Appropriate Basis for the Allocation of State Fire Aid (First Consideration)*, August 15, 2003.

FIRE SERVICES IN MINNESOTA

Volunteer fire departments are a long-standing tradition in Minnesota.[2] The local fire department, staffed by community volunteers, was often one of the first services that cities and towns organized. Today:

- **Minnesota, like most states, relies heavily on volunteers to provide firefighting services.**

Data collected by the Minnesota Fire Service show that 91 percent of Minnesota's 791 fire departments used only volunteer firefighters in 2004.[3] Another 5 percent had some salaried and some volunteer firefighters, while 3 percent had all volunteer firefighters with salaried fire chiefs and administrative staff. Only 1 percent of the state's fire departments had no volunteer firefighters in 2004 and instead used all salaried staff.[4]

In 2004, about 90 percent of Minnesota's firefighters were volunteers.

As shown in Table 1.1, most other states have similar staffing patterns for their fire departments. According to the United States Fire Administration, 88 percent of fire departments nationwide relied on volunteers in 2004—somewhat lower than Minnesota's average of 96 percent.[5] Minnesota's neighboring states were also more likely to rely on volunteers to staff their fire departments than were other states.

Fire departments in Minnesota vary considerably in size. United States Fire Administration data show that Minnesota had approximately 19,540 firefighters in 2004, 90 percent of them volunteers.[6] Overall, fire departments (volunteer and salaried) ranged in size from less than 10 to over 400 firefighters, averaging 29 firefighters per department.

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[2] Some volunteer firefighters receive compensation on an hourly or "per call" basis to help defray their costs. These stipends are generally small and are set up in a way that does not meet federal definitions for salaried personnel. According to a 1999 study, about two-thirds of Minnesota's volunteer fire departments offered some type of compensation to their volunteer firefighters. See: Office of the Legislative Auditor, *Fire Protection Services: A Best Practices Review* (St. Paul, 1999).

[3] Minnesota Fire Service, *Minnesota Fire Departments by Type* (September 13, 2004); http://www.dps.state.mn.us/fmarshal/Response/MNFireDepartmentTypes91304.pdf; accessed January 10, 2007.

[4] Fire departments that used only salaried firefighters in 2005 include: Cloquet, Duluth, Minneapolis, Minneapolis-St. Paul International Airport, Richfield, Rochester, Rochester Airport, South St. Paul, St. Paul, and Virginia. Pension programs for these firefighters are beyond the scope of this report. In 2006, St. Cloud dissolved the volunteer portion of its fire department and now operates exclusively with paid firefighters.

[5] Department of Homeland Security, United States Fire Administration, *National Fire Department Census Database*; http://www.usfa.fema.gov/applications/census/states.cfm (April 1, 2004); accessed May 23, 2006. United States Fire Administration data for Minnesota differ from data collected by the Minnesota Fire Service because fewer fire departments, especially small departments, reported data to the United States Fire Administration—671 departments compared with the 791departments that reported to the Minnesota Fire Service.

[6] Minnesota Office of the Legislative Auditor analysis of data downloaded from the Department of Homeland Security, United States Fire Administration, *National Fire Department Census Database*; http://www.usfa.fema.gov/applications/census/states.cfm (April 1, 2004); accessed May 23, 2006.

Table 1.1: Volunteer and Career Fire Departments by State, 2004

	All Volunteer		Mostly Volunteer		Mostly Career		All Career		
	Number	Percent	Number	Percent	Number	Percent	Number	Percent	Total
Alabama	608	82%	61	8%	22	3%	53	7%	744
Alaska	82	59	42	30	1	1	15	11	140
Arizona	76	33	68	30	42	18	43	19	229
Arkansas	538	86	44	7	21	3	22	4	625
California	225	29	250	32	119	15	180	23	774
Colorado	170	53	96	30	22	7	31	10	319
Connecticut	149	61	60	25	8	3	27	11	244
Delaware	30	56	23	43	0	0	1	2	54
District of Columbia	0	0	0	0	1	33	2	67	3
Florida	155	35	69	15	76	17	146	33	446
Georgia	228	53	113	26	31	7	60	14	432
Hawaii	1	9	1	9	1	9	8	73	11
Idaho	109	63	48	28	6	3	9	5	172
Illinois	702	67	162	16	64	6	117	11	1,045
Indiana	475	73	91	14	22	3	60	9	648
Iowa	622	91	37	5	4	1	22	3	685
Kansas	349	78	48	11	23	5	27	6	447
Kentucky	501	77	99	15	23	4	29	4	652
Louisiana	183	55	108	33	15	5	24	7	330
Maine	228	75	64	21	6	2	7	2	305
Maryland	161	65	59	24	11	4	18	7	249
Massachusetts	94	27	103	30	64	18	88	25	349
Michigan	556	64	192	22	38	4	87	10	873
Minnesota	**593**	**88**	**57**	**8**	**7**	**1**	**14**	**2**	**671**
Mississippi	229	70	53	16	17	5	29	9	328
Missouri	509	73	98	14	33	5	62	9	702
Montana	206	87	17	7	3	1	10	4	236
Nebraska	290	91	16	5	4	1	7	2	317
Nevada	44	55	22	28	4	5	10	13	80
New Hampshire	122	59	63	30	14	7	8	4	207
New Jersey	476	76	84	13	22	3	47	7	629
New Mexico	185	80	22	10	9	4	14	6	230
New York	1,392	90	76	5	17	1	67	4	1,552
North Carolina	538	66	206	25	31	4	40	5	815
North Dakota	265	93	12	4	0	0	9	3	286
Ohio	706	63	232	21	62	6	118	11	1,118
Oklahoma	546	82	61	9	17	3	43	6	667
Oregon	121	43	134	47	14	5	15	5	284
Pennsylvania	1,474	90	104	6	11	1	45	3	1,634
Rhode Island	24	35	18	26	9	13	17	25	68
South Carolina	242	57	115	27	36	9	28	7	421
South Dakota	255	93	10	4	1	0	8	3	274
Tennessee	430	75	76	13	32	6	36	6	574
Texas	988	73	183	14	56	4	118	9	1,345
Utah	111	67	31	19	9	5	14	8	165
Vermont	155	90	13	8	3	2	2	1	173
Virginia	345	75	67	15	17	4	31	7	460
Washington	162	43	144	38	31	8	40	11	377
West Virginia	326	91	17	5	4	1	12	3	359
Wisconsin	564	80	85	12	14	2	41	6	704
Wyoming	74	73	15	15	1	1	12	12	102
Total	17,614	72	3,869	16	1,098	4	1,973	8	24,554

SOURCE: Department of Homeland Security, United States Fire Administration, *National Fire Department Census Database*; http://www.usfa.fema.gov/applications/census/states.cfm (April 1, 2004); accessed May 23, 2006.

Offering pension benefits to volunteer firefighters is meant to help discourage turnover.

While most states rely on volunteers to provide fire services, states have been finding it increasingly difficult to attract and retain volunteer firefighters.[7] Over the last 22 years, the number of volunteer firefighters nationwide declined from 885,000 in 1983 to 824,000 in 2005.[8] Researchers speculate that the overall decline is related to a variety of societal changes, including a more mobile workforce, population shifts, competing demands on people's time, more stringent firefighting training requirements, and a general decline in a sense of civic responsibility.[9]

One way to encourage volunteer firefighters to "stay on the job" is to offer them pension benefits upon retirement.[10] These pensions, though, differ in several important ways from the more traditional pensions offered to salaried public employees. First, unlike pensions for salaried public employees, volunteer firefighter pensions are not meant to provide volunteers with financial security after retirement. It is generally assumed that retired volunteer firefighters will rely primarily on other sources of income to finance their retirement. Second, volunteer firefighter pensions are not based on firefighters' earnings because they do not receive salaries.[11] Instead, they are typically based on years of service multiplied by a predetermined dollar amount. In contrast, traditional pensions are based on employees' actual earnings. Third, volunteer firefighters generally do not contribute toward their pensions, while most salaried public employees and their employers must each contribute a certain percentage of the employees' earnings toward retirement.

Offering pensions to volunteer firefighters has financial advantages for fire departments because it helps reduce costs associated with turnover. High turnover, especially among firefighters with more than five years of experience,

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[7] Some fire departments in Minnesota have also experienced problems recruiting volunteer firefighters who are available during the day. *Laws of Minnesota* 2006, chapter 179 required that the Department of Public Safety convene a task force to examine recruitment and retention problems for emergency responders, including volunteer firefighters. See: Recruitment and Retention Task Force for Volunteer Firefighters, Volunteer Ambulance Personnel, and Volunteer Emergency Responders in Minnesota, *Final Report* (St. Paul, December 2006).

[8] National Fire Protection Association, *Firefighters and Fire Departments (U.S.)* (National Fire Protection Association, Quincy, MA: November, 2006); http://www.nfpa.org/itemDetail.asp?categoryID=417&itemID=18246&URL=Research%20&%20Reports/Fire%20reports/Fire%20service%20statistics; accessed November 14, 2006.

[9] For example, see: National Fire Council and United States Fire Administration, *Recruitment and Retention in the Volunteer Fire Service* (Washington, D.C., December 1998); International Fire Chiefs Association, *A Call for Action: The Blue Ribbon Report Preserving and Improving the Future of the Volunteer Fire Service* (Fairfax, VA, March 2004); Center for Rural Pennsylvania, *Volunteer Firefighter Recruitment and Retention in Rural Pennsylvania* (Harrisburg, PA, May 2006); and Oregon Volunteer Firefighter Task Force, *Report and Recommendations to the Seventy-Second Legislative Assembly* (Salem, OR, December 2002).

[10] Individuals become and remain volunteer firefighters for a variety of reasons, including altruism, community commitment, and social relationships. Several national and state studies recommend that fire departments consider a range of methods, including offering pension benefits, to help increase volunteer firefighter retention rates. For example, see: National Fire Council and United States Fire Administration, *Recruitment and Retention in the Volunteer Fire Service*; International Fire Chiefs Association, *A Call for Action: The Blue Ribbon Report*; Center for Rural Pennsylvania, *Volunteer Firefighter Recruitment*; and Oregon Volunteer Firefighter Task Force, *Report and Recommendations*.

[11] As noted previously, some volunteer firefighters receive pay on a per-call basis.

not only results in a loss of experienced volunteers, but also forces fire departments to pay training and equipment costs for new volunteers—which can be costly. At a minimum, volunteer firefighters generally go through about 150 hours of basic firefighting and first responder training.[12] Some fire departments may also require additional training related to hazardous materials, emergency medical training, or fire truck operations and driving. In 2004, the International Fire Chiefs Association estimated that fire departments spend about $4,000 per person to orient, equip, and train new recruits. It further estimated the cost to maintain one volunteer firefighter for four years at approximately $1,000 per year.[13]

PENSION ADMINISTRATION

In 2004, 713 volunteer firefighter relief associations were responsible for administering pension plans for local firefighters.

For the most part, if cities and towns want to offer pension benefits to volunteer firefighters, they must do so through local nonprofit corporations known as volunteer firefighter relief associations.[14] Minnesota statutes define these associations as governmental entities that receive and manage public money to give retirement benefits to individuals providing firefighting and emergency first-response services.[15] Relief associations are not subdivisions of local government nor are they subdivisions of fire departments. However, each association must be "affiliated with" a fire department that has been either established by a city or town or organized as an independent nonprofit firefighting corporation.[16] According to data collected by the State Auditor's Office, 713 volunteer firefighter relief associations administered pension plans in 2004.[17]

Overall:

- **Minnesota statutes give volunteer firefighter relief associations broad latitude to determine pension eligibility, set benefit levels, and invest funds.**

Statutes require that each relief association be governed by a nine-member board of trustees. The city or town operating the fire department with which the relief

[12] Nyle Zikmund, Minnesota State Fire Department Association, e-mail to Jo Vos, Office of the Legislative Auditor, January 10, 2007.

[13] International Fire Chiefs Association, *A Call for Action: The Blue Ribbon Report*, 9.

[14] As we discuss later in this chapter, pensions for volunteer firefighters are funded primarily with state fire aid and investment income. State fire aid cannot be used to fund pensions unless a relief association exists to administer the pension plan.

[15] *Minnesota Statutes* 2006, 424A.001, subd. 4.

[16] Independent nonprofit firefighting corporations contract with one or more cities, towns, or counties to provide fire protection and fire suppression services. In 2004, there were 63 independent nonprofit firefighting corporations. In this report, we use the term "fire department" to include nonprofit firefighting corporations.

[17] This figure includes the Bloomington Fire Department Relief Association. Although the Bloomington Fire Department is staffed by volunteer firefighters, their pensions are based on police officer salaries. The State Auditor's Office reports the finances and investments of the Bloomington Fire Department Relief Association in its annual report on the state's large public pension plans.

association is affiliated must appoint three of the trustees.[18] The board is responsible for: receiving and investing pension funds; determining benefits and funding requirements; maintaining administrative records; paying benefits; and reviewing expenditures. Trustees must meet the "prudent person standard" in carrying out their responsibilities—which means that they must act in good faith and exercise the degree of judgment and care that persons of prudence, discretion, and intelligence would exercise in managing their own affairs.[19] In addition, they must make a reasonable effort to obtain the knowledge and skills necessary to perform their responsibilities and comply with the continuing education programs that boards must develop and periodically revise.[20]

Minnesota statutes set forth broad parameters regarding the operation of relief associations. In addition to establishing the size and composition of the board of trustees, statutes regulate maximum levels for pension benefits; minimum requirements regarding vesting and retirement age; allowable investments for association pension funds; local government pension contribution requirements; audit and reporting requirements; and allowable administrative expenses.[21]

Although relief associations operate somewhat independently of state and local government:

- **The Legislature has implemented a system of checks and balances to help ensure that relief associations spend pension funds properly.**

Each year, relief associations must report certain financial and investment information to the State Auditor's Office.

The Office of the State Auditor provides oversight over volunteer firefighter relief associations in three major ways. First, all associations must annually file several financial and investment reports with the State Auditor's Office. The State Auditor uses these data to issue an annual report to the Legislature on the general financial condition of each volunteer firefighter relief association.[22] Second, relief associations with assets or liabilities of $200,000 or more in any given year must file an audited financial statement, attested to by a certified public accountant, with the State Auditor.[23] Relief associations with assets and liabilities less than $200,000 must file a more abbreviated annual financial statement, which requires certification by a public accountant.[24] Third, the State Auditor's Office must withhold state fire aid from relief associations that fail to comply with various statutory requirements, including those related to audits and

[18] *Minnesota Statutes* 2006, 424A.04, subd. 1. Due primarily to their remote locations, eight volunteer firefighter relief associations were affiliated with a county rather than a city or township in 2004.

[19] *Minnesota Statutes* 2006, 356A.04, subd. 2.

[20] *Minnesota Statutes* 2006, 356A.13.

[21] Vesting refers to the number of years firefighters must volunteer before they are eligible to receive full or partial pension benefits.

[22] *Minnesota Statutes* 2006, 6.72.

[23] *Minnesota Statutes* 2006, 69.051, subd 1.

[24] *Minnesota Statutes* 2006, 69.051, subd. 1a.

financial reports, bonding, investments, administrative expenses, and actuarial studies.[25]

Local governments also have some oversight responsibilities for firefighter pensions.

Statutes also provide for local government oversight. As previously discussed, each relief association's board of trustees must have three local government appointees (one elected official, one elected or appointed official, and the fire chief) to represent the city or town's interests, especially as they relate to benefit levels. In addition, statutes require that local governments help eliminate any shortfalls when pension plans are not sufficiently funded, as determined by procedures specified in statutes.[26]

In addition to appointing three board members, cities and town also have some indirect control over benefit levels. Cities and towns must approve changes in benefit levels if pension plans are not sufficiently funded or if the local government is making mandatory pension contributions.[27] If plans are sufficiently funded, relief associations do not have to obtain city or town approval to change benefit levels. However, if cities and towns do not specifically approve a benefit change and the pension fund later requires a local government contribution, benefits must be "rolled back" to the level last approved by local government. (Local government could approve the current benefit level though, which may result in a mandatory local government contribution.)

FUNDING

State fire aid, investment income, and local government contributions fund pensions for volunteer firefighters.

Three major sources of revenue fund volunteer firefighter pensions: state fire aid, investment income, and local government contributions. Of these, state fire aid is the most stable. The Legislature has used state fire aid to fund firefighter relief programs since it created the aid in 1885.[28] State aid is funded through an annual appropriation that is mostly paid for by a tax on insurance premiums for fire, lightning, sprinkler leakage, and extended coverage.[29] The Department of Revenue allocates state fire aid to cities, towns, and independent nonprofit firefighting corporations using a statutory formula based on the population and market values of property in their fire district or service area. Smaller or less developed communities may also receive an additional allocation to ensure a minimum level of state aid for pensions.

To qualify for state fire aid, fire departments must have (a) at least ten firefighters, including a fire chief and assistant fire chief; (b) regularly scheduled

[25] *Minnesota Statutes* 2006, 69.771, subd 3.

[26] In determining whether local governments must contribute toward firefighter pensions, relief associations must consider their total assets and accrued liability (given their current benefit levels and members' lengths of service), administrative expenses, and anticipated revenue from investments and state aid, among other items. *Minnesota Statutes* 2006, 69.772, subd. 3, and 69.773, subd. 4.

[27] *Minnesota Statutes* 2006, 69.772, subd. 6 and 69.773, subd. 6.

[28] *Laws of Minnesota* 1885, chapter 187.

[29] *Minnesota Statutes* 2006, 69.021, subd. 5. In each of the last three calendar years, total state fire aid averaged about $31 million statewide. Minnesota Department of Revenue, *State Fire Aid Distributions for Calendar Years 1982-2006* (St. Paul, September 25, 2006).

meetings and frequent drills; (c) a fire truck meeting certain specifications and firefighting clothing and equipment; (d) a fire station; and (e) a fire alarm system.[30] In order to use fire aid to fund pensions, fire departments must use a volunteer firefighter relief association to administer the pension program.

Returns on relief association investments also serve as an important source of funding for volunteer firefighter pensions. Investment income can vary considerably from year to year, depending largely on the types of investments that relief associations make (stocks, bonds, or cash), as well as the particular stocks, bonds, and cash instruments that they select.

As noted previously, cities and towns are not required to contribute toward firefighter pensions unless their particular pension plan is not sufficiently funded. As we discuss later in Chapter 2, many cities and towns also make voluntary contributions toward firefighter pensions.

According to data collected by the State Auditor's Office on 707 volunteer firefighter relief associations (excluding the Bloomington Fire Department Relief Association):

- **Volunteer firefighter pension funds had total revenues of $57.9 million in 2004, with assets that totaled $356.8 million.**

As shown in Table 1.2, income from investments made up the largest share of revenue in 2004—45 percent, followed by state fire aid at 41 percent. Local government contributions—both mandatory and voluntary—comprised 14 percent of 2004 revenue.[31]

Statewide, volunteer firefighter relief associations controlled several hundreds of millions of dollars in pension funds. Year-end assets for 2004 (the most recent year for which data were available) totaled about $356.8 million.[32]

[30] *Minnesota Statutes* 2006, 69.011, subd. 4. In addition, relief associations must comply with various administrative requirements to remain eligible for state fire aid. *Minnesota Statutes* 2005, 69.771, subd. 3. Cities, towns, and independent nonprofit firefighting corporations that have not established a volunteer firefighter relief association can receive fire aid, but it can only be spent on fire equipment, not pensions.

[31] Total revenues for 673 relief associations (excluding the Bloomington Fire Department Relief Association) for 2005 were $48.4 million. State fire aid comprised 47 percent of the total, income from investments comprised 39 percent, and local government contributions comprised 14 percent. Total revenues for the Bloomington Fire Department Relief Association for 2005 were $6.8 million, with 68 percent from investments, 23 percent from local government contributions, and 5 percent from state fire aid. Office of the State Auditor, *Financial and Investment Report of Volunteer Fire Relief Associations for the Year Ended December 31, 2005*, (St. Paul, December 2006), 28; and Office of the State Auditor, *Bloomington Fire Department Relief Association Bloomington, Minnesota for the Year Ended December 31, 2005*, (St. Paul, 2006), 7.

[32] This figure excludes the Bloomington Fire Department Relief Association, which had year-end assets for 2004 of $101.4 million. Year-end assets for 2005 for 673 relief associations (excluding Bloomington) totaled $374.3 million; year-end assets for the Bloomington Fire Department Relief Association were $105.3 million. Office of the Legislative Auditor analysis of data obtained from the Office of the State Auditor, 2006; Office of the State Auditor, *Financial and Investment Report for 2005*, 28; and Office of the State Auditor, *Bloomington Relief Association for 2005,* 7.

Table 1.2: Volunteer Firefighter Pension Fund Revenue, 2004

Source of Revenue	Amount	Percentage of Total
State		
Fire Aid	$23,103,060	40%
Supplemental Fire Aid[a]	538,139	1
Subtotal	$23,641,199	41%
Local Government	$7,943,377	14%
Investments		
Interest	$6,579,223	11%
Capital gains	20,579,525	36
Investment expenses[b]	(1,225,193)	2
Subtotal	$25,933,555	45%
Miscellaneous		
Membership dues	$39,000	<1%
Fundraisers	89,482	<1
Donations	43,729	<1
Other	251,781	<1
Subtotal	$423,992	1%
Total Revenue	$57,942,123	100%

NOTE: The table is based on data from 707 volunteer firefighter relief associations. It excludes three relief associations that did not file reports with the State Auditor's Office and forfeited their state fire aid and two relief associations that were too new to have data for 2004. It also excludes data from the Bloomington Fire Department Relief Association, which, for a variety of reasons—including its size—are reported separately. The Bloomington relief association had total revenues of $12.3 million in 2004, including $0.6 million in state aid (5 percent), $3.0 million in municipal contributions (24 percent), and $8.7 million in investment earnings (71 percent). Percentages may not total 100 due to rounding.

[a] Relief associations that provide a one-time "lump sum" payment to retirees must also pay them a one-time, supplemental benefit equal to 10 percent of the pension or $1,000, whichever is less. This benefit, paid from supplemental fire aid, is meant to help offset any taxes retirees might incur as a result of receiving a lump sum payment at retirement.

[b] Investment expenses are management fees that are sometimes reported separately by relief associations. Management fees not reported separately are generally embedded in the capital gains earned by investments. Thus, the line item "investment expenses" understates the total amount of management fees that relief associations incur in managing pension funds.

SOURCES: Office of the Legislative Auditor analysis of data obtained from the Office of the State Auditor, 2006; and Office of the State Auditor, *Bloomington Fire Department Relief Association Bloomington, Minnesota for the Year Ended December 31, 2004*, (St. Paul, 2005), 7.

2 Benefits, Investments, and Administration

SUMMARY

Pension benefits for volunteer firefighters vary considerably among relief associations. Although the median lump sum benefit for a volunteer firefighter with 20 years of service was $16,000 in 2004, benefits ranged from $500 to $140,000. This variation reflects differences in state fire aid, which, in turn, are related to differences in the activity levels of individual fire departments. Overall, relief associations have been cautious in setting benefit levels and most have sufficient funds to pay anticipated future benefits. At the same time, investment earnings could be higher. From January 1997 through December 2004, relief associations, on average, earned 4.8 percent per year on their investments. This was well below the rates of return of the state's major public employee pension plans and other funds managed by the State Board of Investment. Relief associations also had higher administrative and investment expenses, on average, than the large state retirement plans, partly because they cannot take advantage of economies of scale.

As noted in Chapter 1, Minnesota uses a decentralized system to administer volunteer firefighter pensions. State law gives volunteer firefighter relief associations freedom to determine pension type, benefit levels, eligibility, payment schedules, and investment strategy. This chapter examines the reasonableness of pension benefits, investment earnings, administrative costs, and other issues of concern to relief associations. It focuses on the following questions:

- **How do pension benefits for volunteer firefighters vary across the state? What accounts for the variation?**
- **Are pension benefits "portable" if firefighters move from one fire department to another?**
- **How do administrative costs and investment returns for volunteer firefighter pension funds compare with those of other public employee pension funds?**
- **What concerns do relief association and local government officials have about administering volunteer firefighter pensions?**

To answer these questions, we analyzed 2004 financial and investment data compiled from reports that 707 volunteer firefighter relief associations filed with the Office of the State Auditor in 2005.[1] We mailed questionnaires to one board member from each of the 713 relief associations and to one local government official from the city or township that operated the fire department affiliated with the relief association.[2] We received responses from 75 percent of the relief associations and 80 percent of the local government officials (although not all responses were useable). We also reviewed investment policies for 60 relief associations, and we interviewed staff from the State Auditor's Office, State Board of Investment, Public Employees Retirement Association, various firefighter associations, and other interested organizations. Finally, we obtained data from the State Fire Marshal in the Department of Public Safety on fire department activity levels.

We begin this chapter with a discussion of pension benefits, including the types of plans offered, retirement age, vesting requirements, portability, and benefit levels. We then consider the extent to which pensions have adequate funds to pay expected pension benefits. Next we compare the rates of return that volunteer firefighter pension funds have earned with the earnings of pension funds managed by the State Board of Investment and other benchmarks. Finally, we discuss several aspects of pension plan administration, including administrative expenses, reporting requirements, and the relationship that relief associations have with cities and towns.

SETTING PENSION BENEFITS

Relief associations determine pension benefits for volunteer firefighters within broad statutory parameters.

In Minnesota, volunteer firefighter relief associations are generally responsible for determining the pension benefits that their members receive, within broad parameters set by the state. Consequently, pension plans can differ in several ways, including the type of plan offered ("defined benefit" versus "defined contribution"), the timing of payments (one single "lump sum" payment or "monthly" lifetime payments), the age at which a person may collect retirement benefits, the minimum years of service to be eligible for full or partial pension benefits, and the amount or level of benefits paid.

Types of Pension Plans

As shown in Table 2.1, there are four types of volunteer firefighter pension plans in Minnesota. Overall:

- **Most volunteer firefighter relief associations have defined benefit plans and make one large "lump sum" payment to retiring firefighters based on their years of service.**

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[1] Of the 713 relief associations that managed volunteer firefighter pension funds in 2004—the most recent data available at the time of our evaluation—3 relief associations did not file reports with the State Auditor's Office and forfeited their state aid, and 2 associations were too new to have data for 2004 or prior years. We excluded data from the Bloomington Fire Department Relief Association from our analyses because the pensions of its volunteer firefighters are based on the salaries of paid police officers. In addition, its pension fund assets far exceed the assets of other volunteer firefighter relief associations.

[2] For the 63 relief associations organized as independent corporations, we mailed the local government survey to the largest city or town served by the corporation.

Table 2.1: Types of Volunteer Firefighter Pension Plans in Minnesota, 2004

Type of Plan	Brief Definition	Number	Percentage
Defined Benefit Lump Sum	A pension plan that promises retirees a specific, predetermined amount in one large payment.	592	84%
Defined Benefit Monthly	A pension plan that promises retirees a specific, predetermined amount each month.	5	1
Defined Benefit Monthly or Lump Sum Choice	A pension plan that gives retirees the choice of receiving a specific, predetermined amount all at once or in monthly payments.	21	3
Defined Contribution Lump Sum	A pension plan that gives retirees a one time payment that depends on pension fund contributions and growth over time.	89	13
		707	100%

SOURCE: Office of the Legislative Auditor analysis of data provided by the Office of the State Auditor, 2006.

Most volunteer firefighter relief associations offer defined benefit lump sum pension plans.

About 84 percent of volunteer firefighter relief associations offer defined benefit lump sum plans. These plans pay retired firefighters a set amount of money for each year of service, with the entire amount paid upon retirement.[3] Another 13 percent offer defined contribution plans, where retirees receive a lump sum payment equal to the total amount contributed on their behalf plus the amount of investment earnings attributed to those contributions.[4]

Retirement Age

Although relief associations are responsible for determining the minimum age at which volunteer firefighters can collect their pensions, state law requires that retirees be at least 50 years old.[5] In fact:

- **The vast majority of relief associations allow volunteer firefighters to receive their pensions at age 50.**

As shown in Table 2.2, 95 percent of Minnesota's relief associations allow firefighters to receive their pensions at age 50, provided that they also meet service requirements. Only 5 percent of relief associations require retirees to be 55 years old before they can collect pension benefits.

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[3] Although relief associations vary in how they define years of service, they generally require firefighters to attend a certain percentage of meetings and training sessions and to go out on a minimum number of fire or emergency runs in a year to receive credit for that year.

[4] *Minnesota Statutes* 2006, 424A.02, subd. 4. If relief association bylaws permit, defined benefit or defined contribution lump sum payments may, upon the retiree's request, be paid in installments, with interest on the unpaid portion accumulating at 5 percent per year. *Minnesota Statutes* 2006, 424A.02, subd. 8.

[5] *Minnesota Statutes* 2006, 424A.02, subd. 1.

Table 2.2: Age and Service Requirements of Volunteer Firefighter Pension Plans, 2004

	Number of Relief Associations	Percentage
Minimum Retirement Age		
50	671	95%
51	1	<1
55	32	5
60	3	<1
	707	100%
Minimum Years of Service		
5	145	21%
6-9	2	<1
10	530	75
11-14	2	<1
15	8	1
20	20	3
	707	100%

SOURCE: Office of the Legislative Auditor analysis of data provided by the Office of the State Auditor, 2006.

Service Requirements

About three-fourths of relief associations allow firefighters to retire with partial pension benefits after ten years of service.

"Vesting" refers to the number of years retirees must work before being eligible for full or partial pension benefits. State law requires that most volunteer firefighters serve 20 years before receiving full pension benefits, but it allows relief associations to award partial benefits after five years of service if they so choose.[6] We found that:

- **Most relief associations require firefighters to serve ten years to be eligible to receive partial pension benefits.**

As shown in Table 2.2, three-fourths of relief associations require volunteer firefighters to serve at least ten years before they are eligible to receive partial benefits. Three percent do not award partial benefits, requiring instead that firefighters serve 20 years to qualify for any pension benefits. Relief association officials we talked to told us that it takes time and money to train volunteer firefighters, so they would like them to stay longer than five years.

[6] Volunteer firefighters with defined contribution retirement plans must serve 10 years before receiving full pension benefits. If provided in its bylaws, a relief association may award partial benefits up to a maximum amount determined by a statutory formula. For example, a retiring firefighter with five years of service in a defined benefit plan could receive up to 40 percent of the amount his or her relief association pays for five years of service (for example, benefit level per year x 5 x 40 percent). A retiring firefighter with 15 years of service could receive up to 80 percent of the amount payable for 15 years of service. *Minnesota Statutes* 2006, 424A.02, subd. 2.

Pension Portability

"Portability" refers to the practice of crediting prior service in another fire department when determining pension benefits for firefighters who have moved from one community to another. Without portability, a firefighter who leaves a department before being partially vested would not receive credit for those years of service.

State law allows a firefighter with service in more than one fire department to use the total years served for the purpose of vesting if the bylaws of the relief associations so provide. Each relief association would pay a pro-rata share based on its own benefit level.[7] However, we found that:

- **Although a majority of survey respondents said that pensions should be portable, few volunteer firefighter relief associations have given credit for service in another fire department.**

We asked several questions about pension portability in our survey of relief associations. Nearly two-thirds of survey respondents "agreed" or "strongly agreed" that pension benefits should be portable, with support strongest among relief associations with the fewest assets. According to our survey, however, only 10 percent of relief associations have had requests for prior service credit and only 1 percent have counted years served in another fire department when calculating pension benefits for retirees.

Most relief associations that we surveyed said that requiring a uniform five-year vesting period would ease portability concerns.

An alternative to having portability would be for volunteer firefighter relief associations to have shorter vesting periods, making more firefighters eligible for partial benefits. For example, a volunteer firefighter who served five years each in two different fire departments would receive no benefits if the minimum vesting periods for both relief associations exceeded five years and the new relief association did not count service with the former fire department. But if both relief associations allowed partial vesting after five years, the firefighter would receive partial retirement benefits from each. Fifty-two percent of the relief associations responding to our survey "agreed" or "strongly agreed" that requiring firefighters to become partially vested after five years would help alleviate some of the concerns about pension portability.

Benefit Levels

"Benefit level" refers to the amount of money that is multiplied by years of service to determine the lump sum or monthly benefit that a retiree in a defined benefit plan receives. Under state law, benefit levels must be within statutory maximums that are tied through a complex formula to the three-year average of state aid, municipal contributions, active membership, and 10 percent of the pension fund's surplus of assets over liabilities.[8] As shown in Table 2.3, we found that:

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[7] *Minnesota Statutes* 2006, 424A.02, subd. 13. Staff from the State Auditor's Office told us that very few relief associations have this provision in their bylaws.

[8] *Minnesota Statutes* 2006, 424A.02, subd. 3.

Table 2.3: Variability in Lump Sum and Monthly Benefits per Year of Service, 2004

Benefit Levels per Year of Service	Number	Percentage
Lump Sum Plans		
$1-$430	117	19%
$450-$680	121	20
$700-$1,000	136	22
$1,050-$1,600	124	20
$1,6450-$7,000	115	19
	613	100%
Average	$1,180	
Median	$800	
Monthly Plans		
$4-$18	7	35%
$21-$27	7	35
$29-$45	6	30
	20	100%
Average	$22.86	
Median	$24.50	

NOTE: This table excludes defined contribution plans. For relief associations that offer a choice, lump sum benefit schedules are included with the lump sum plans and monthly benefit schedules are included with the monthly plans.

SOURCE: Office of the Legislative Auditor analysis of data provided by the Office of the State Auditor, 2006.

The median retirement benefit for a volunteer firefighter retiring after 20 years of service was $16,000 in 2004.

- **Pension benefit levels vary considerably among volunteer firefighter relief associations.**

As shown, the median lump sum benefit was $800 per year of service in 2004. Thus, a firefighter with 20 years of service would, upon retirement, receive a lump sum payment of $16,000 (20 x $800). Benefit levels ranged from $25 to $7,000 per year of service, resulting in lump sum payments after 20 years of service ranging from $500 to $140,000.[9] Monthly benefit levels ranged from $4 to $45 per month per year of service, with a median benefit level of $24.50 per month per year of service, or $490 per month for a firefighter with 20 years of service.

According to our surveys, 49 percent of relief association and 54 percent of local government respondents “agreed” or “strongly agreed” that “pension benefits should be more uniform across the state.” Furthermore, 67 percent of respondents from relief associations with assets under $150,000 said this, compared with 28 percent of respondents from relief associations with assets over $330,000. These opinions reflect the fact that relief associations with more

[9] Two relief associations with lump sum benefits of $1 and $5 per year of service were established in 2004 and purposefully set their initial benefit levels low with plans to increase them after they accumulated some assets. The lowest lump sum benefit offered by an established relief association in 2004 was $25 per year of service.

assets tend to pay higher benefits than smaller relief associations. For example, the average lump sum benefit for relief associations that ended 2004 with assets over $330,000 was $2,226 per year of service compared with $439 per year of service for relief associations with less than $150,000 in assets.

Some policy makers and relief association representatives have expressed concern over the wide variation in volunteer firefighter pension benefits. We found that:

- **Variation in volunteer firefighter pension benefits reflects differences in state aid, which, in turn, is related to differences in the activity levels of individual fire departments.**

As shown in Table 2.4, relief associations that pay higher benefits can afford to do so because they receive more state aid. For example, relief associations that pay lump sum benefits of $1,200 or more per year of service received, on average, almost $1,600 per member in state fire aid, whereas those with lump sum benefits under $600 received, on average, $391 in state aid per member.[10]

Table 2.4: Pension Benefits and State Fire Aid, 2004

Pension Benefits per Year of Service	Number of Relief Associations	State Fire Aid per Relief Association	State Fire Aid per Relief Association Member
Lump Sum Plans			
$600 or less	207	$8,627	$391
$650-$1,175	190	16,313	617
$1,200 and higher	202	66,901	1,597
All plans with lump sum benefits	599	$30,716	$869
Monthly Plans			
Less than $24.50	10	$123,092	$2,296
$24.50 and higher	10	260,710	3,613
All plans with monthly benefits	20	$191,901	$2,955

NOTE: This table excludes defined contribution plans. For relief associations that offer a choice, lump sum benefit schedules are included with the lump sum plans and monthly benefit schedules are included with the monthly plans.

SOURCES: Office of the Legislative Auditor analysis of data provided by the Office of the State Auditor and the State Fire Marshal, 2006.

[10] For lump sum defined benefit plans, the correlation between state aid per relief association member and benefits per year of service was .88. The correlation between monthly benefits and state aid per member was .72. Benefits were also related to municipal contributions. The average municipal contribution for lump sum plans with high benefits was $665 per member compared with $236 for lump sum plans with medium benefits and $78 for plans with low benefits. The correlation between 2004 lump sum benefits per year of service and municipal contributions per member was .63.

Although state fire aid is based on population and property values, there is a strong relationship between state aid and the number of fire calls.

Relief associations receive state fire aid based on the population and property values of the territory that fire departments serve.[11] The formula assumes that more populous communities with more property will require more fire protection than communities with fewer people and less developed property. Although the state fire aid formula is not based directly on fire department activity, we found a strong relationship between the state fire aid that a relief association received in 2004 and the average number of fire calls made per year from 1999 to 2004, as shown in Table 2.5.[12]

Table 2.5: State Fire Aid and Calls Responded to by Volunteer Fire Departments, 2004

2004 State Fire Aid per Relief Association	Number of Relief Associations	Average Number of Fire Calls per Year, 1999-2004	Average Number of Total Calls per Year, 2003-2004
Less than $9,000	228	7.2	28.0
$9,000-$20,999	235	12.6	40.7
$21,000 and higher	227	43.1	346.6
Total	690	20.8	138.6

NOTE: Total calls include fires, rescue and emergency medical service calls, overpressure ruptures, hazardous conditions, aid to other fire departments, false alarms, and other service calls.

SOURCES: Office of the Legislative Auditor analysis of data provided by the Office of the State Auditor and the State Fire Marshal, 2006.

Since benefits are based, in part, on the amount of state aid a community receives, and state aid, in turn, is related to the number of fire-related calls to which fire departments respond, it follows that relief associations with higher benefits were associated with fire departments that responded to more calls than relief associations with lower benefits. As shown in Table 2.6, relief associations that offered lump sum benefits of $1,200 or more per year of service in 2004 represented fire departments that responded to 36.3 fire-related calls per year compared with 7.9 fire calls per year for departments whose relief associations offered $600 or less per year of service.[13]

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[11] *Minnesota Statutes* 2006, 69.021, subd. 7.

[12] The correlation between state aid and the number of fire runs per relief association was .86. We did not attempt to analyze the needs of different communities to determine whether the fire aid distribution formula is fair. A strong relationship between the number of fire calls and state fire aid does not necessarily mean that it is the appropriate relationship. For example, fire calls vary in the amount of time, technical skills, and equipment required for an appropriate response. In addition, there may be other measures of workload that should be considered.

[13] The correlation between lump sum benefits and the number of fire runs per year was .83.

Table 2.6: Pension Benefits and Calls Responded to by Volunteer Fire Departments, 2004

Pension Benefits per Year of Service, 2004	Number of Relief Associations	Average Number of Fire Calls per Year, 1999-2004	Average Number of Total Calls per Year, 2003-2004
Lump Sum Plans			
Low ($600 or less)	207	7.9	19.5
Medium ($650-$1,175)	190	14.4	51.3
High ($1,200 and higher)	202	36.3	277.3
All plans with lump sum benefits	599	19.5	116.2
Monthly Plans			
Low (less than $24.50)	10	52.2	391.7
High ($24.50 and higher)	10	90.2	705.1
All plans with monthly benefits	20	71.2	548.4

NOTE: This table excludes defined contribution plans. For relief associations that offer a choice, lump sum benefits are included with the lump sum plans and monthly benefits are included with the monthly plans. Total calls include fires, rescue and emergency medical service calls, overpressure ruptures, hazardous conditions, aid to other fire departments, false alarms, and other service calls.

SOURCES: Office of the Legislative Auditor analysis of data provided by the Office of the State Auditor and the State Fire Marshal, 2006.

FUNDING RATIOS

"Funding ratios" measure relief associations' net assets as a percentage of their accrued liabilities. Accrued liabilities represent the present value of the total benefits relief associations would have to pay all of their firefighters when they retire and are calculated according to a statutory formula that considers members' length of service and current benefit levels.[14] A funding ratio of 100 percent or more is an estimate that a pension fund will likely have sufficient assets to pay its anticipated future obligations.[15]

Overall, we found that:

- **In 2004, most volunteer firefighter pension plans had sufficient funds to pay their future anticipated pension obligations.**

As shown in Table 2.7, 65 percent of the state's volunteer firefighter relief associations had funding ratios over 100 percent in 2004; 17 percent had funding ratios below 90 percent.[16] The median funding ratio was 106 percent.

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[14] *Minnesota Statutes* 2006, 424A, subd. 2. The formula assumes that all current firefighters will work 20 years and that the benefit level will not change. It is not based on an actuarial analysis, which would consider retirement patterns, mortality, and other pertinent factors.

[15] A relief association with a funding ratio below 100 percent will still be able to meet its obligations in the short run, but a pattern of funding ratios below 100 percent suggests possible future insolvency unless the relief association increases revenue or decreases expenditures.

[16] This was an improvement over 2003, when 53 percent of volunteer firefighter pension funds had funding ratios of 100 percent or more and 25 percent had funding ratios below 90 percent. Recently released data for 2005 show further improvement, as 70 percent of the volunteer firefighter pension funds had funding ratios of 100 percent or more, and 17 percent had funding ratios below 90 percent.

Table 2.7: Distribution of Volunteer Firefighter Relief Association Funding Ratios, 2004

Funding Ratio	Number	Percentage
Less than 80%	40	6%
80-89%	69	11
90-99%	108	18
100-124%	266	43
125-149%	75	12
150% or more	59	10
	617	100%

NOTE: The table excludes defined contribution plans which, by definition, have a funding ratio of 100 percent.

SOURCE: Office of the Legislative Auditor analysis of data provided by the Office of the State Auditor, 2006.

Maintaining a healthy funding ratio is largely a function of keeping growth in benefit levels in line with growth in state aid, local government contributions, and investment income—the three main sources of volunteer firefighter pension fund revenue. State law provides some safeguards to keep relief associations from becoming insolvent. Relief associations that are sufficiently funded (as determined by a statutory formula) are not required to obtain city or town approval before increasing benefit levels. Relief associations not sufficiently funded, however, must obtain local government approval before increasing benefits. In addition, cities and towns may require relief associations not sufficiently funded to roll back any benefit increases that the local government had not approved.[17] Ultimately, local government must contribute an amount adequate to restore the relief association to sufficient funding.[18] Thus, there is a built in incentive for local governments to be prudent when approving requests by relief associations to increase benefits.

Relief associations not sufficiently funded must obtain local government approval before increasing benefit levels.

Our analysis of available data suggests that:

- **Volunteer firefighter relief associations have generally been cautious in increasing pension benefits, which has helped them maintain healthy funding ratios.**

During 2004, 164 relief associations—27 percent of those with defined benefit plans—increased their benefit levels, including 60 associations with funding ratios below 100 percent. On the other hand, some relief associations have not increased benefits even though they may be able to afford higher benefits. For example, as shown in Table 2.7, 59 relief associations had funding ratios over 150 percent at the end of 2004, including 16 relief associations with funding ratios over 200 percent.

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[17] *Minnesota Statutes* 2006, 424A.02, subd. 10

[18] *Minnesota Statutes* 2006, 69.772, subd. 4.

In recent years, pension benefits have increased less than either fund assets or the Consumer Price Index. Between 2000 and 2004, the median lump sum benefit per year of service increased 6.7 percent and the median monthly benefit increased 2.1 percent. During this period, the Consumer Price Index increased 13 percent.

In recent years, pension benefits have increased less than fund assets.

Between 2000 and 2004, the amount of state fire aid distributed to relief associations increased 83 percent and local government contributions increased 81 percent. Some relief associations might have been reluctant to raise benefit levels due to poor investment earnings though, which likely offset increases in state aid and local government contributions. Financial markets performed poorly between 2000 and 2002 before recovering in 2003 and 2004. As a result, the average assets of volunteer firefighter pension funds increased 14 percent from 2000 to 2004, compared with a Consumer Price Index increase of 13 percent.

INVESTING PENSION FUNDS

Volunteer firefighter relief associations in Minnesota are responsible for investing pension funds. This includes developing investment policies for allocating investments among different types of investment categories, such as stocks, bonds, and cash, as well as selecting the specific instruments in which to invest.

Investment Policies

Investment policies are written statements that lay out the results that an organization seeks to achieve with its investments and a strategy directed toward achieving those goals. Industry best practices recommend that investment policies: (a) contain enough detail to implement a specific investment strategy; (b) outline the duties and responsibilities of all parties involved; (c) set forth diversification, rebalancing, and risk guidelines; and (d) incorporate specific, measurable investment objectives.[19]

We reviewed the investment policies for 60 relief associations.[20] We found that:

- **Only a few volunteer firefighter relief associations have developed investment policies that incorporate industry best practices.**

Only 12 of the 60 policies reviewed (20 percent) described how assets were to be divided among the different types of investments (stocks, bonds, and cash) and

[19] Model investment polices are available from various national organizations, including the Foundation for Fiduciary Studies and the Government Finance Officers' Association. For example, see: Hatton, Tim, *The New Fiduciary Standard* (Bloomberg Press: Princeton, NJ, 2005); The Foundation for Fiduciary Studies, *Prudent Investment Practices* (Pittsburgh, PA: University of Pittsburgh Katz Graduate School of Business, 2003); and Government Finance Officers Association, *GFOA Recommended Practice: Pension Investment Policies* (Washington, D.C., 2003).

[20] Our review did not judge the appropriateness of relief associations' investment strategies or performance objectives. Rather we looked for certain policy components, including whether associations had an investment and evaluation strategy in place to judge their performance.

contained clear, measurable performance objectives.[21] A little more than a fourth of the investment policies contained one or more benchmarks, such as a major stock index or the Consumer Price Index, for comparing the performance of some or all of their portfolio. Only 22 percent of the policies explicitly required trustees (or an investment committee) to periodically review the association's investment policy.

Rates of Return

Relief associations have a fiduciary responsibility to earn the best possible rate of return within an acceptable level of risk.

Rates of return measure investment earnings or losses as a percentage of the amount invested. Relief association trustees have a fiduciary responsibility to earn the best possible rate of return within a level of risk that is acceptable to association members. In making investment decisions, relief associations have to determine the proportion of their investments to allocate to different investment categories such as stocks, bonds, and cash.[22] Statutes require that pension plan assets be diversified to minimize the risk of substantial investment losses "unless the circumstances at the time an investment is made clearly indicate that diversification would not be prudent."[23] When they exist, good investment policies provide guidance for diversifying investments.

Because there is considerable variation in year-to-year investment performance, we examined rates of return over time rather than for a single year. The State Auditor's Office calculates rates of return for each volunteer firefighter pension fund from annual reports that relief associations must file.[24] Using these data for 688 relief associations, we found that:

- **Most volunteer firefighter pension funds earned lower rates of return from 1997-2004 than comparable pension funds managed by the State Board of Investment.**

From January 1, 1997, through December 31, 2004, pension funds invested by volunteer firefighter relief associations earned an average compound annual rate

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[21] Having well-defined investment criteria did not appear to compensate for poor investment decisions. The 20 relief associations that earned the lowest overall rates of return from 1997-2004 generally spelled out their investment expectations more explicitly than the 20 associations earning the highest rates of return or the 20 associations whose rates of return were closest to average. We discuss rates of return in the next section.

[22] Stock (or "equity") represents a share of ownership in a company. Owning stock is riskier than cash or bonds because stock prices fluctuate more than bonds or cash. Bonds are fixed-term loans used by governments and corporations to raise funds. Although bond prices can fluctuate as interest rates change and there is a small chance that an issuer will default on a bond, bonds are generally less risky than stocks. Cash investments include bank accounts, certificates of deposit, short-term government obligations, money market mutual funds, and similar investments. They have very little risk and, depending on the instrument, can be easily and quickly accessed should the need arise.

[23] *Minnesota Statutes* 2006, 356A.06, subd. 2.

[24] The State Auditor's Office calculates rates of return using the same methodology that the State Board of Investment uses to compute rates of return for all major public employee pension plans in Minnesota. See *Minnesota Statutes 2006*, 11A.04(11) and 69.775(f). The calculation is complex because investments are purchased and sold several times during the course of the year. For a comprehensive explanation of this methodology, see Richards and Tierney, Inc., *The R&T Approach to Plan Sponsor Performance Evaluation, Part I: Performance Measurement* (Chicago, IL: Richards and Tierney, Inc., January 1993).

From 1997-2004, volunteer firefighter pension funds had an average annual rate of return of 4.8 percent.

of return of 4.8 percent.[25] Investment returns ranged from a loss of 2.7 percent per year to a gain of 13.7 percent per year. Over the eight-year period, the average investment portfolio increased in value by 46 percent.

Volunteer firefighter relief associations with more assets tended to earn slightly higher rates of return than associations with fewer assets. Table 2.8 shows average annual rates of return for 1997-2004 for large, medium, and small pension funds as measured by their 2004 end-of-year assets. As shown, rates of return for large funds averaged 5.4 percent per year, compared with 4.9 percent per year for medium-sized funds and 4.1 percent per year for small funds.[26]

Table 2.8: Average Annual Rates of Return by Volunteer Firefighter Pension Fund Size, 1997-2004

2004 End-of-Year Assets	Number of Pension Funds	Average Annual Rate of Return, 1997-2004
Less than $150,000	219	4.1%
$150,000-$330,000	232	4.9
Over $330,000	237	5.4
Total	688	4.8%

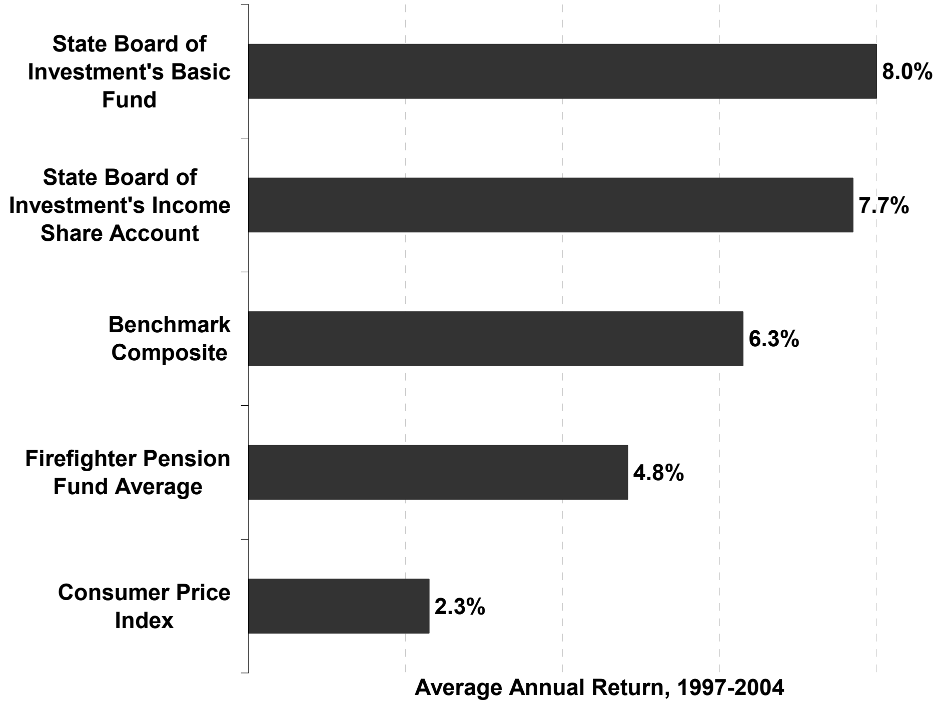
SOURCE: Office of the Legislative Auditor analysis of data provided by the Office of the State Auditor, 2006.

Figure 2.1 compares the eight-year compound annual rate of return for the average firefighter pension fund with the returns earned by two State Board of Investment funds—the Basic Fund and the Income Share Account. The Basic Fund includes the retirement funds of the active employees of the state's three major public employee pension funds (the Minnesota State Retirement System, the Teacher's Retirement Association, and the Public Employee Retirement Association) and other state funds. It earned an 8.0 percent average annual return from 1997-2004, well above the average annual return for most volunteer firefighter relief associations over that time period.

[25] The average excludes the Bloomington Fire Department Relief Association's pension fund, which had a 5.5 percent compound annual rate of return for the eight-year period. Compound annual rates assume that investment earnings are added to the original investment and the total amount is reinvested at the end of each year. The State Auditor's Office recently published rates of return for 2005. The average volunteer firefighter pension fund earned a 4.7 percent return on its investment in 2005, resulting in a nine-year average rate of return for 1997-2005 of 4.8 percent, virtually the same as the eight-year return that we used in our analysis. See Office of the State Auditor, *Financial and Investment Report of Volunteer Fire Relief Associations for the Year Ended December 31, 2005*, (St. Paul, December 2006), 9, 12.

[26] The correlation between the eight-year rate of return and 2004 end-of-year assets was .21.

Figure 2.1: Average Annual Rates of Return for Firefighter Pension Funds, State Board of Investment Funds, and Other Benchmarks, 1997-2004



NOTE: The benchmark composite index is a portfolio consisting of 44 percent invested in the Russell 3000 Index, 17 percent in the Lehman Brothers U.S. Aggregate Bond Index, and 39 percent invested in six month certificates of deposit, less 0.5 percent for management fees. All rates shown are compound average annual rates of return for 1997-2004.

SOURCE: Office of the Legislative Auditor analysis of rates of return for 1997-2004.

SBI's Income Share Account earned an average annual rate of return of 7.7 percent for 1997-2004.

The Income Share Account is one of several accounts in the State Board of Investment's Supplemental Investment Fund, which is open to volunteer firefighter relief associations and several other public employee groups. As discussed later in this chapter, the Income Share Account is a "medium-risk" option that volunteer firefighter relief associations use most often when investing through SBI. It earned an average annual return of 7.7 percent for 1997-2004, almost three percentage points higher than the average return for volunteer firefighter pension funds during that period. Moreover, only 28 firefighter pension funds (4 percent) had average annual rates of return of 7.7 percent or higher over that period. An investment with the Income Share Account for the entire eight-year period would have earned a total return of 81 percent, or 35 percentage points above the average total return of 46 percent earned by volunteer firefighter pension funds. According to our estimates, the total amount of investment earnings for all firefighter pension funds would have been about

Relief associations would have earned about $56 million more had they invested through SBI from 1997-2004.

$56 million more had they invested almost all of their assets in SBI's Income Share Account from 1997-2004.[27]

Figure 2.1 also compares the rate of return earned by volunteer firefighter pension funds with a "benchmark composite." This is a hypothetical portfolio that we developed consisting of 44 percent invested in the Russell 3000 Stock Index, 17 percent in the Lehman Brothers U.S. Aggregate Bond Index, and 39 percent invested in six-month certificates of deposit. These indices are commonly used benchmarks that represent an unmanaged portfolio of stocks, bonds, and cash investments.[29] The percentage that we allocated to each index is the average year-end allocation of volunteer firefighter pension fund investments in stocks, bonds, and cash from 1999–2004. If a volunteer firefighter relief association had invested its pension fund in this manner on January 1, 1997, reinvested all dividends and interest, and did not alter that investment mix, it would have earned about 6.3 percent per year, or about 69 percent for the total eight-year period, compared with the 46 percent actually earned by the average volunteer firefighter pension fund.[30] Total investment earnings for all firefighter pension funds would have been about $18 million more had they invested almost all of their assets in the composite index described above.

Finally, some relief associations had investment policies with the modest goal of keeping pace with or outperforming the Bureau of Labor Statistics' Consumer Price Index (CPI). As shown in Figure 2.1, the CPI increased 20 percent from 1997-2004—an average of 2.3 percent per year. Forty-seven volunteer firefighter pension funds (7 percent) had average annual rates of return below 2.3 percent, thereby failing to keep up with inflation. Eight of these funds had negative rates of return, meaning they actually lost money over the eight-year period.

Our data analyses suggest three reasons that might explain relief associations' low rates of return: excessive investments in cash instruments, inconsistent investment strategies, and poor stock selection. Table 2.9 shows rates of return for relief associations depending on the percentage of their assets during 1999-2004 that they invested in stocks, bonds, and cash.

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[27] To meet local cash flow needs, we assumed that 99 percent of pension fund assets could have been invested through SBI.

[29] For example, the Russell 3000 Index includes the 3000 largest publicly traded domestic companies in terms of market value. The index accounts for 98 percent of the total U.S. stock market capitalization. See Frank Russell Company, *Russell Index Performance*; http://www.russell.com /us/Indexes/us/CorePerformance.pdf; accessed September 22, 2006.

[30] This is based on average annual rates of return from 1997-2004 of 8.1 percent for the Russell 3000 stock index, 7.0 percent for the Lehman Brothers Aggregate Bond Index, and 3.9 percent rate for six-month certificates of deposit. The 6.3 percent annual rate of return is net of a 0.5 percent estimated management fee that relief associations would probably have to pay to purchase shares in these indices from a mutual fund company. We reviewed the prospectuses of index funds from several mutual fund companies and found that management fees ranged from 0.09 percent to 1.39 percent, with most under 0.5 percent. Index funds typically have lower management fees than other mutual funds because they do not require hiring experts to select stocks.

Table 2.9: Average Annual Rates of Return by Investment Mix, 1997-2004

Average Percentage of Assets Invested Year End 1999-2004 in:	Number of Relief Associations	Average Annual Rate of Return, 1997-2004
Stocks		
Less than 36%	223	4.5%
36-56%	214	4.6
Over 56%	225	5.4
Bonds		
Less than 8%	226	4.3%
8-22%	211	4.8
Over 22%	225	5.3
Cash		
Less than 19%	219	5.6%
19-44%	224	4.6
Over 44%	219	4.2
Total	662	4.8%

NOTE: Data on investment mix were not available for 1997 and 1998; data for 1999-2004 were available for 662 relief associations. The investment mix reported here is based on end-of-year allocations and does not consider the extent to which changes were made during the year, nor does the table identify differences in the types of stocks, bonds, and cash investments.

SOURCE: Office of the Legislative Auditor analysis of data provided by the Office of the State Auditor, 2006.

As shown:

- **Volunteer firefighter relief associations that invested more heavily in stocks and bonds earned higher rates of return than those that held more of their assets in cash instruments.**

Relief associations that invested over 56 percent of their assets in stocks earned an average annual rate of return of 5.4 percent over the eight-year period, compared with an average return of 4.5 percent for associations with less than 36 percent of their assets invested in stocks.[31] On the other hand, associations with over 44 percent of their assets invested in cash instruments earned, on average, rates of return of 4.2 percent per year, compared with annual returns averaging

[31] Financial experts generally agree that over time stocks have higher rates of return than bonds or cash. Otherwise, there would be no incentive for investors to buy stocks, given their greater volatility and potential for loss. From 1965 to 2005, stocks, as measured by the Standard and Poor's 500 Index, had a compound annual rate of return of 11.3 percent, compared with 7.5 percent for 30-year Treasury Bonds and 4.2 percent for six-month Treasury Bills. Damodaran, Aswath, *Annual Returns on Stock, T-Bonds and T-Bills: 1928–Current;* http://www.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histret.html (updated January 2006); accessed December 18, 2006.

5.6 percent per year for associations with less than 19 percent of their assets invested in cash.[32]

Thirty-two relief associations invested entirely in cash between 1999 and 2004.[33] These funds earned an average annual rate of return of 4.4 percent per year from 1997 to 2004, below the state average but above the returns earned by 38 percent of relief associations.

To gain more insight into how investment patterns affected investment performance, we examined the 20 relief associations with the highest and lowest rates of return from 1997-2004 in greater detail. Relief associations with the highest rates of return tended to invest about 60 percent of their assets in stocks, and they maintained that percentage during stock market upswings and downswings. Relief associations with the 20 worst-performing funds tended to react to stock market swings by changing their investment mix. They increased their stock holdings in the late 1990s and experienced above average losses when stock prices fell in 2000, 2001, and 2002. Perhaps in reaction to the losses, many of those relief associations reduced their stock holdings in 2002, thereby missing out on the stock market rebounds of 2003 and 2004.

Relief associations that earned the highest rates of return generally maintained about 60 percent of their investments in stocks.

It is also possible that the best-performing relief associations invested in stocks that earned above-average rates of return, and the worst-performing relief associations selected stocks with below-average rates of return. We did not have data on specific investments so we could not test that hypothesis. However, our earlier finding that volunteer firefighter pension funds, on average, earned lower rates of return than they would have earned had they invested in broad market indices suggests that many of them did not do a particularly good job selecting stocks.

Finally, we asked relief associations whether they had difficulty making investment decisions and found that:

- **Volunteer firefighter relief associations earning lower rates of return reported having more difficulty making prudent investments than associations earning higher rates of return.**

Nineteen percent of survey respondents from relief associations whose 1997-2004 average annual rate of return ranked in the bottom two-thirds of all relief associations (annual returns below 5.59 percent) said that making prudent investments that maximize returns was "extremely difficult," 47 percent said it was "difficult but doable," and 33 percent said it was "relatively easy." In contrast, 9 percent of respondents from relief associations with returns ranked in the top one-third said that making such investments was "extremely difficult," 38 percent said it was "difficult but doable," and 54 percent said it was "relatively easy."

[32] Correlations between eight-year rates of return and the percentage of pension funds invested in stocks, bonds, and cash were .19, .26, and -.26, respectively.

[33] More precisely, they ended each year with 100 percent of their assets in cash. It is possible that they held some stocks and bonds during the year.

In addition, 13 percent of association respondents with the lowest rates of return said that setting investment objectives was "extremely difficult," 46 percent said it was "difficult but doable," and 41 percent said it was "relatively easy." Among respondents from relief associations with the highest rates of return, 7 percent said that setting investment objectives was "extremely difficult," 35 percent said it was "difficult but doable," and 58 percent said it was "relatively easy."

Investing Through the State Board of Investment

The State Board of Investment (SBI) is responsible for investing the assets of the state's major public employee pension plans and other state funds.[34] In addition, it manages the Supplemental Investment Fund, which is open to volunteer firefighter relief associations and several other public employee groups. As shown in Table 2.10, the Supplemental Investment Fund has several accounts that provide a variety of investment choices.

Table 2.10: Investment Options Available to Volunteer Firefighter Relief Associations Through the State Board of Investment

Risk Level	Investment Option	Portfolio
High	International Share	100% non-U.S. stocks
	Growth Share	100% U.S. stocks
	Common Stock Index	100% U.S. stocks
	Income Share	60% stocks, 35% bonds, and 5% short-term cash
	Bond Market	Corporate and government bonds
Low	Money Market	Short-term certificates

NOTE: The Supplemental Investment Fund also contains a Fixed Interest Account that is not available to volunteer firefighter relief associations.

SOURCE: Minnesota State Board of Investment, *Minnesota Supplemental Investment Fund: Investment Options* (St. Paul, July 2005).

[34] The State Board of Investment is comprised of the Governor, the State Auditor, the Attorney General and the Secretary of State. *Minnesota Constitution* Article XI, section 8. It employs an executive director and a staff of about 20 investment analysts, accountants, and administrative assistants. Minnesota State Board of Investment, *Minnesota Supplemental Investment Fund: Investment Options* (St. Paul, July 2005), 3.

Despite the availability of these options, we found that:

- **Less than one-third of volunteer firefighter relief associations invested their pension funds through the State Board of Investment during fiscal years 2003-2005.**

As of July 2005, 217 relief associations (31 percent) invested some or all of their pension funds in various SBI accounts—a number that has changed little over the last three years. In 2004, these relief associations invested, on average, 57 percent of their assets through SBI, allocating about 38 percent of their SBI investments to the Income Share Account. As discussed previously, that account earned an average annual return of 7.7 percent from 1997-2004.

SBI has lower management and investment fees than most mutual funds.

One advantage of using SBI is its low cost. Most mutual funds charge annual management fees and operating expenses that total between 1 and 2 percent of assets. The board's management and investment fees for the Income Share Account are 0.01 percent of assets; none of its Supplemental Investment Fund accounts have fees exceeding 0.25 percent.

To help ensure that relief associations are aware of its investment options, SBI mails an "information package" to all volunteer firefighter relief associations each year. It describes the available investment options, the rates of return earned by each, and benchmark comparisons. The information also includes a list of participating relief associations, and it discusses procedures for opening an account and depositing and withdrawing funds. Upon request, board staff will meet with volunteer firefighter relief associations to discuss the investment options, but they will not offer investment advice.[35] Despite these efforts:

- **Forty-one percent of volunteer firefighter relief association survey respondents said that they were not familiar with the State Board of Investment.**

In responding to our survey, only 22 percent of relief associations said that they were "very familiar" with the investment option offered through SBI; another 36 percent said that they were "somewhat familiar" with SBI.

We asked relief associations why they invested the amount they did through the SBI. As shown in Table 2.11, the major reasons for not investing more through SBI were: unfamiliarity with the board, a belief that relief associations could earn the same or better rate of return, and a desire to invest locally. On the other hand, relief associations that invested at least half of their investments through SBI said they did so because: it was low cost and easy to use, board staff was more knowledgeable about investments, and the board's investment options met their needs.

[35] According to State Board of Investment staff, few relief associations have made such requests in recent years.

Table 2.11: Volunteer Firefighter Relief Associations' Reasons for Investing or Not Investing Through the State Board of Investment

	Number	Percentage
Reasons for Investing with the State Board of Investment		
Low cost and easy to use	35	38%
Investment options meet our needs	20	22
SBI more knowledgeable about investments	20	22
Earn a high rate of return	10	11
Other	8	9
	93	100%
Reasons for Not Investing with the State Board of Investment		
Not familiar with SBI	87	24%
Can earn the same or a better return than SBI	80	22
Want to invest locally	73	20
Limited investment options	35	19
Do not trust SBI or the state with our money	34	9
Not enough investment advice or feedback provided	28	8
Other	29	8
	366	100%

NOTE: Respondents who said they invested "all" or "more than half" of their pension funds through the State Board of Investment were asked to indicate the main reason they invested with SBI. Respondents who said they invested "none" or "half or less" of their pension funds through the State Board of Investment were asked to indicate the main reason they did not invest more with SBI.

SOURCE: Office of the Legislative Auditor analysis of surveys of volunteer firefighter relief associations, 2006.

PENSION FUND ADMINISTRATION

Volunteer firefighter relief associations are responsible for several administrative tasks, including paying benefits, keeping records, submitting reports, and communicating with members, local government, and state officials.

Administrative Expenses

While all pension plans have administrative expenses, we found that:

- **From 1997-2004, volunteer firefighter relief associations spent a higher percentage of their funds on administration than did large public pension plans.**

Between 1997 and 2004, pension benefits made up over 90 percent of relief associations' total disbursements, and administrative expenditures ranged between 6 and 9 percent of total disbursements. In 2004, 7 percent of total relief association expenditures, or 0.42 percent of total pension assets, was for administration.[36]

In 2004, total spending by volunteer firefighter relief associations for administration averaged .42 percent of pension assets.

Table 2.12 compares volunteer firefighter relief association spending on administration as a percentage of end-of-year assets for 2004 with administrative expenditures of the state's large public employee pension plans. Administrative expenses for most of the state's public employee pension plans were 0.10 percent or less of pension assets. Administrative expenses for the Minneapolis Firefighters' Relief Association and the Minneapolis Police Relief Association, two associations with total assets closer to the total assets of volunteer firefighter relief associations, were 0.23 and 0.22 percent of assets, respectively. As a percentage of assets, this was about half the amount spent by volunteer firefighter relief associations on administration.

Table 2.12: Administrative Expenses of Volunteer Firefighter and Public Employee Pension Plans, 2004

Pension Plan	Administrative Expenditures (000s)	2004 End-of-Year Assets (Millions)	Percentage of 2004 End-of-Year Assets
All Volunteer Firefighter Pension Funds[a]	$1,512	$357	0.42%
Minneapolis Fire Relief Fund	577	254	0.23
Minneapolis Police Relief Fund	770	349	0.22
Duluth Teachers' Retirement Fund	449	259	0.17
Minneapolis Teachers' Retirement Fund[b]	731	763	0.10
Teachers Retirement Fund	12,179	15,096	0.08
Minnesota State Retirement Fund	6,057	8,380	0.07
Public Employees' Retirement Fund	9,805	14,230	0.07
Bloomington Fire Relief Fund	64	101	0.06
St. Paul Teachers' Retirement Fund	516	872	0.06
Minneapolis Employees Retirement Fund	718	1,283	0.06

[a] These data exclude the Bloomington Fire Department Relief Association, which are reported separately.

[b] The Minneapolis Teachers' Retirement Fund merged with the Teachers' Retirement Association in 2006.

SOURCES: Office of the State Auditor, *Large Public Pension Plan Investment Report for the Year Ended December 31, 2004* (St. Paul, December 2005), 46; and Office of the Legislative Auditor analysis of data provided by the Office of the State Auditor, 2006.

In our opinion, volunteer firefighter relief association spending on administration is not excessive under the current organizational framework. In 2004, 53 percent of firefighter relief association administrative expenditures were for actuarial, audit, and legal services and 28 percent went to pay the salaries of relief association officers and staff—all allowable expenditures under *Minnesota Statutes*.[37] Over half of the associations (58 percent) did not spend anything on salaries and 19 percent reported no administrative expenses. On average,

[36] This figure is a weighted average. The unweighted average of each volunteer firefighter pension fund's administrative expenditures as a percentage of its assets was 0.52 percent for 2004.

[37] *Minnesota Statutes* 2006, 69.80.

Economies of scale likely explain why large public pension plans spent less on administration than did volunteer firefighter relief associations.

administrative expenses were a greater percentage of assets for smaller relief associations than for larger ones.[38]

In our view, economies of scale likely explain why larger pension plans spent less on administration than did volunteer firefighter relief associations. Given the need to keep accurate records to determine eligibility, calculate pension benefits, and comply with state auditing and reporting requirements, we think that volunteer firefighter relief association spending on administration has been reasonable.

Reporting

One aspect of administration that has been a concern for volunteer firefighter relief associations has been the large number of reports they are required to submit. At different points in time, volunteer firefighter relief associations must file reports with five state agencies as well as local governments. Major reporting requirements are listed in Table 2.13.

Table 2.13: Volunteer Firefighter Relief Association Reports Required by Statute, 2006

Statutory Reference	Description
317A. 823	Annual registration as a nonprofit corporation with the Secretary of State.
424A.04, subd. 4	A copy of the association's bylaws and copies of subsequent amendments filed with the State Auditor's Office.
69.051, subd. 1, 1a	Annual financial audits or statements submitted to the State Auditor's Office.
424A.10, subd. 3	Annual requests to the Department of Revenue for reimbursement of supplemental benefits paid during the preceding year.
424A.01, subd. 3; 69.772, subd. 4; and 69.773, subd. 5	Annual report to the local government agency showing available financing, accrued liabilities, and, when applicable, the required municipal contribution.
356A.06, subd. 5	Annual list filed with the Legislative Commission on Pensions and Retirement containing all the recipients of investment business.
356A.06, subd. 4(f)	A list submitted to the Campaign Finance and Public Disclosure Board of all the relief association board members who have filed required economic interest statements.
356A.07, subd. 2.	Year-end financial reports to each plan member.
356A.07, subd. 1	A summary of benefits to each new member, and to existing members and benefit recipients upon request.

SOURCE: *Minnesota Statutes* 2006.

[38] Administrative expenses were 0.62 percent of assets for volunteer firefighter relief associations with 2004 end-of-year assets under $150,000; 0.51 percent for associations with assets between $150,000 and $330,000; and 0.42 percent for associations with assets over $330,000.

Almost two-thirds of relief associations said that it was difficult to complete their required reports in a timely and accurate manner.

According to our survey, 64 percent of relief association respondents said they found it difficult to report in an accurate and timely manner, including 15 percent that said it was "extremely difficult." Associations with fewer assets were more likely to say they had difficulty completing the mandated reports than did associations with greater assets.

Many relief association representatives commented about the complexity of the State Auditor's financial reporting system and the frequency with which reporting requirements changed. In addition, relief associations, especially those with few assets, questioned the need for financial audits. Some respondents pointed out that the $200,000 asset minimum that triggers the need for an audited financial report (as opposed to a financial statement) has not been adjusted for inflation since its adoption in 1986.[39]

While we empathize with relief associations' concerns, we think that:

- **Most reporting requirements that volunteer firefighter relief associations must comply with are necessary to ensure public accountability.**

Because public funds are involved, relief associations must be accountable to the government agencies that protect the public welfare. In addition, volunteer firefighters are entitled to some assurance that their pensions are safe. When we reviewed volunteer firefighter pension laws in other states, we found that they all require annual reports or audited financial statements.[40]

At the same time, filing some reports at the state level may be unnecessary. For example, *Minnesota Statutes* require that relief associations annually file *Investment Business Recipient Disclosure* reports with the Legislative Commission on Pensions and Retirement.[41] Relief associations must also make these reports available at the local level. The reports identify the specific banks, brokerage firms, and investment managers used by each association, and the type and amount of investments held in each. The reports can be used to help identify conflicts of interest or questionable investment practices. However, commission staff told us that they do not systematically examine or use the information contained in the reports. According to commission records, about 20 percent of relief associations filed 2004 or 2005 reports at the state level.

Likewise, state law requires that relief associations annually submit a certified list of all individuals who filed *Economic Interest Statements* to the Campaign Finance and Public Disclosure Board.[42] As with the previous disclosure form, relief associations must keep each board member's *Economic Interest Statement* on file at the local level. According to the board, only 32 percent of associations complied with this reporting requirement in 2005; 29 percent complied in 2006. Staff told us that no one has asked to see any of the lists in the last few years, and disclosure board staff do not use the lists.

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[39] *Minnesota Statutes* 2006, 69.051, subd.1 and 1a.

[40] We compare volunteer firefighter pension plans across a number of states in Chapter 3.

[41] *Minnesota Statutes* 2006, 356A.06, subd. 5.

[42] *Minnesota Statutes* 2006, 356A.06, subd. 4(f).

In addition, relief associations must register annually as nonprofit corporations with the Secretary of State. According to statutes, this is unnecessary if an association has satisfactorily complied with certain financial reporting requirements, and the State Auditor has notified the Secretary of State of that compliance.[43] According to the State Auditor's Office, though, it discontinued sending this information to the Secretary of State a few years ago at the Secretary of State's request.

Training and Technical Support

Setting benefits, investing pension fund assets, maintaining accurate records, and fulfilling reporting requirements require a degree of technical knowledge and suggest a need for specialized training for relief association board members. However, we found that:

- **Despite widespread training opportunities, only a fraction of volunteer firefighter relief association board members have taken part in training activities related to their fiduciary responsibilities.**

The State Auditor's Office held 19 free training sessions at 12 sites throughout the state in 2006. Although designed mainly to acquaint relief associations with the state's newly computerized reporting system (Fire Relief Pension Accounting System or FRPAS), the sessions also covered bylaws, investments, and other financial and administrative issues. In total, 256 people attended these sessions. In addition, the State Auditor's Office held a workshop at the Minnesota State Fire Department Association's annual conference.[44]

There are several training opportunities available to relief associations.

The Minnesota State Fire Chiefs Association, the Minnesota State Fire Department Association, and the Minnesota Area Relief Association Coalition jointly sponsor ongoing training for relief associations (upon request) that covers a wide variety of pension-related topics. Over the last few years, this consortium has put on over two dozen training sessions involving approximately 125 relief associations. It also conducts an advanced training session in the Twin Cities metropolitan area annually that draws about 115 relief association members. Also, pension-related training is offered at the Minnesota State Fire Department Association's annual conference, which attracts about 100 association trustees.[45] In addition, there are a number of private businesses that offer training and other services to relief associations.

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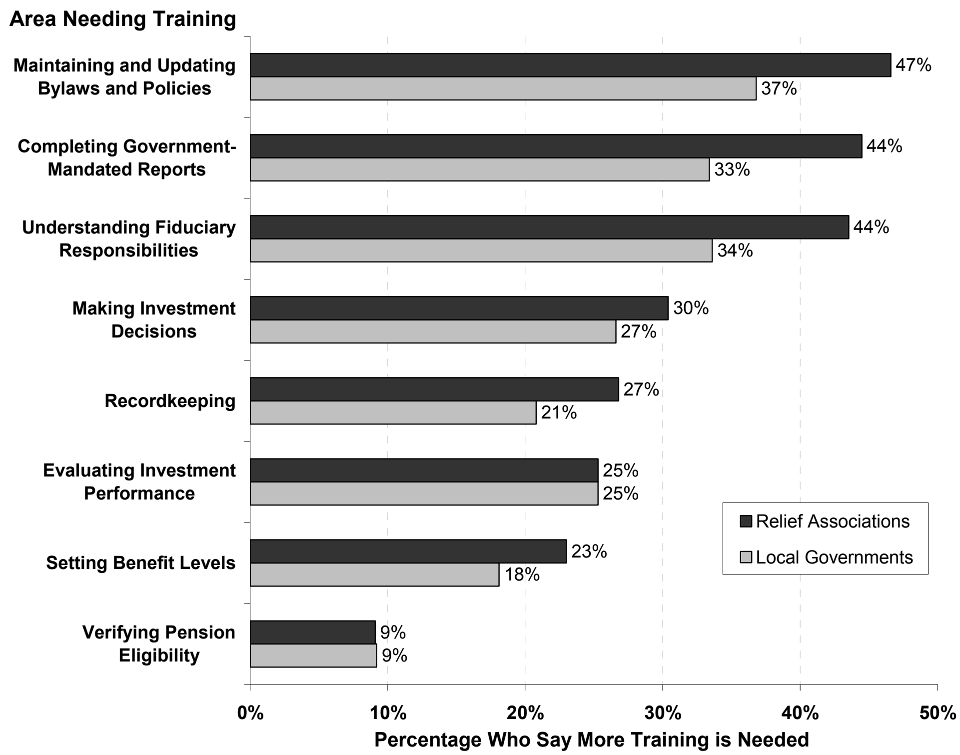
[43] *Minnesota Statutes* 2006, 317A.823, subd. 1(d). Other statutes require that the State Auditor's Office annually submit to the Secretary of State a list of volunteer firefighter relief associations that have complied with financial reporting requirements. *Minnesota Statutes* 2006, 69.051, subd. 1c.

[44] In 2005, the State Auditor's Office sponsored three free training sessions in addition to the workshop at the fire departments' annual conference. These sessions focused on bylaws, investments, reporting requirements, and financial and administrative issues. About 110 people attended the department's three sessions in 2005. Rose Hennessy Allen, Management Analyst, Office of the State Auditor, e-mail to Jo Vos, Office of the Legislative Auditor, October 23, 2006.

[45] Nyle Zikmund, Minnesota State Fire Department Association, e-mail to Jo Vos, Office of the Legislative Auditor, October 26, 2006.

While these training opportunities are important, they have only served a portion of the approximately 2,100 relief association presidents, secretaries, and treasurers and an even smaller portion of the approximately 6,400 relief association board members. In our survey, volunteer firefighter relief association representatives, especially those from associations earning lower rates of return or with fewer assets, said they needed more assistance and training. Figure 2.2 shows the areas where survey respondents think that more training is needed.

Figure 2.2: Survey Respondents' Opinions on Relief Associations' Need for More Training



NOTE: Percentages are based on 526 relief association responses to the question, "In your opinion, in what areas does your board need more training?" and 530 local government responses to the question, "In your opinion, in what areas do you think the relief association needs more training?" Respondents were instructed to check all items that applied.

SOURCE: Office of the Legislative Auditor analysis of surveys of volunteer firefighter relief associations and local governments, 2006.

Despite the desire for more training, relief associations spend very little on pension-related training. Although more than one-third of survey respondents want more training, relief associations overall spent approximately $10,000 on training and $52,000 on meetings in 2004—less than $10 per board member.

RELATIONSHIP WITH LOCAL GOVERNMENT

Relief associations have an ongoing relationship with local government and are often dependent on them for contributions to firefighter pension funds. Overall, we found that:

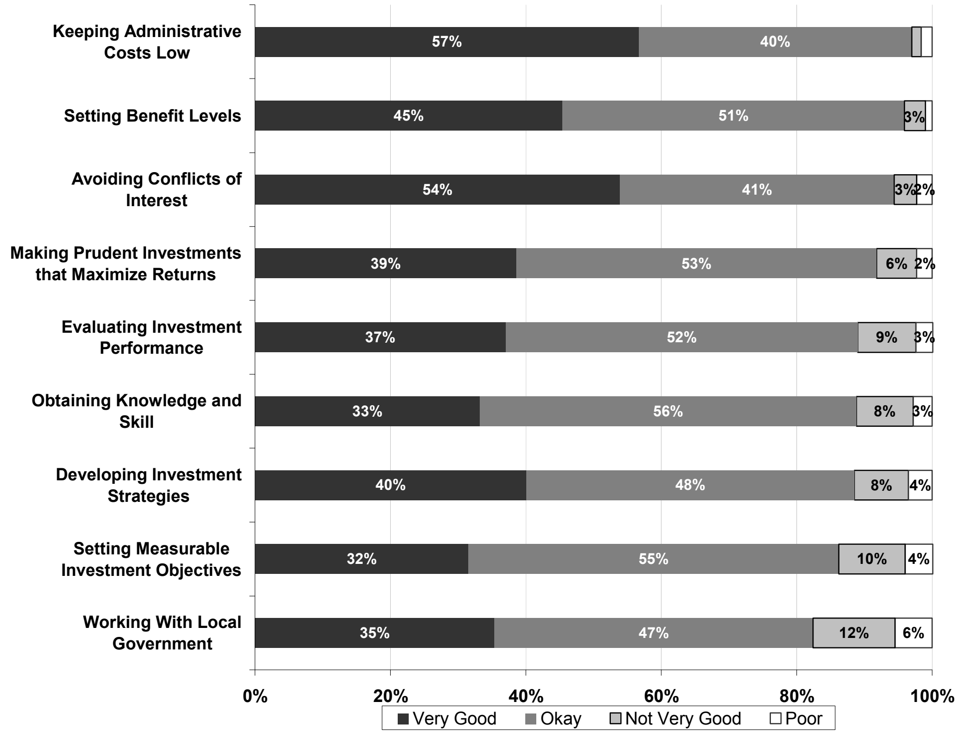
- **Most volunteer firefighter relief associations are satisfied with their working relationship with local government, and most local government representatives think that relief associations are doing a good job.**

Fifty-one percent of relief association survey respondents said that working with local government on pension-related issues was "relatively easy" and 36 percent said that it was "difficult but doable." In addition, most respondents were satisfied with the level of financial and administrative support provided by local government. One-half of the respondents to our local government survey said that their government voluntarily contributed toward volunteer firefighter pensions, while 40 percent said they were statutorily required to do so. In addition, 27 percent said they provided administrative support and 18 percent helped pay for financial audits or actuarial studies.

As shown in Figure 2.3, over 90 percent of local government representatives reported that their relief association was doing a "very good" or "okay" job setting appropriate benefit levels, keeping administrative costs low, making prudent investments, and avoiding conflicts of interest. Eighty-two percent said that their association did an "okay" or a "very good job" working with local government on pension-related issues.

In addition, 86 percent of local government respondents were "satisfied" or "very satisfied" with their input on benefit levels and 84 percent responded similarly when we asked about the amount of information they received from the relief association regarding proposed changes in benefit levels.

Figure 2.3: Local Government Ratings of Volunteer Firefighter Relief Associations' Performance



NOTE: Percentages are based on 559 local government responses to the question, "In your opinion, how good a job does the board of trustees of your local volunteer firefighter relief association do in...?" Percentages exclude respondents answering "Board Not Involved" and "Don't Know."

SOURCE: Office of the Legislative Auditor analysis of surveys of local governments, 2006.

3 Options and Recommendations

SUMMARY

Minnesota's decentralized system for administering volunteer firefighter pensions creates problems and challenges. A decentralized system requires that relief association board members devote considerable time to meeting complex reporting requirements and acquiring expertise in investing—a level of commitment that may be beyond the capabilities of many associations, especially those with few assets. The most significant problem is that relief associations have earned low rates of return on their investments. On the other hand, they have generally been conservative in setting pension benefits and most have sufficient resources to cover anticipated future liabilities. To address investment problems, we recommend that the Legislature require all volunteer firefighter relief associations to invest through the State Board of Investment (SBI). We estimated that relief associations would have earned about $56 million more from 1997-2004 had they invested through SBI—income that could be used to increase pension benefits or reduce mandatory local government contributions. If the Legislature does not adopt this recommendation, we think that, at a minimum: (1) SBI should provide more outreach and assistance to relief associations, including participating in investment-related training, and (2) the Legislature should require that relief associations provide annual "report cards" to their membership that summarize association investments relative to certain benchmarks.

As previously discussed, Minnesota's decentralized system for administering volunteer firefighter pensions has resulted in over 700 individual pension plans. This chapter looks at how other states administer pensions for volunteer firefighters and whether procedural or organizational changes are needed to address inefficiencies in Minnesota's current framework. More specifically, it focuses on the following questions:

- **How many other states offer pension benefits to their volunteer firefighters? Do those states offering pensions use a decentralized or statewide system?**
- **Would a statewide system be more efficient and be able to provide higher pension benefits?**
- **What are the advantages and disadvantages of decentralized versus statewide pension systems for volunteer firefighters?**

In addition to the research methods discussed in Chapters 1 and 2, we examined the statutes of other states to learn how many offered or permitted volunteer firefighters to receive pensions. We collected pension-related information on 21 states and contacted pension officials in 12 of those states to learn more about their programs.

OTHER STATES

According to the National Volunteer Fire Council and other sources, 34 states either permit or require local fire departments to provide pensions to volunteer firefighters.[1] Our analysis of how other states administer pension plans found that:

- **There is no single "right" way to administer pension plans for volunteer firefighters—states vary greatly in how they administer and fund their plans.**

We reviewed statutes from 21 of the 34 states that either allow or require volunteer firefighters to receive pension benefits.[2] Table 3.1 compares the pension plans in reviewed states on several characteristics: whether plan administration is centralized or decentralized, funding source, plan type, and payment schedule.

Most of the states that we reviewed have centralized pension plans for volunteer firefighters.

Unlike Minnesota, most of the states that we reviewed (13) have centralized pension plans for volunteer firefighters. In contrast, eight states, including Minnesota, allow local pension boards or relief associations to determine pension features within state parameters. Also, benefits are portable in all state-administered pension systems that we reviewed, as long as the firefighter volunteers in fire departments that belong to the state system. States with locally administered systems, like Minnesota, do not require portability of benefits.

As shown in Table 3.1, all but 4 of the 21 states reviewed provide state aid to finance volunteer firefighter pension plans—usually from taxes on property insurance. While 14 states require local government contributions, a few states, including Minnesota, only require contributions if actuarial studies (or similar types of studies) indicate that a contribution is needed to pay future benefits. Finally, nine states require firefighters to contribute toward their pensions.

As shown, 16 of the 21 states give retired volunteer firefighters a monthly pension. In Minnesota, most pension plans give volunteer firefighters one "lump sum" payment upon retirement.[3]

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[1] National Volunteer Fire Council, *State by State Comparison: Retirement* (National Volunteer Fire Council, Washington, D.C., November 2, 2006); http://www.nvfc.org/benefits/state-by-state.php?Type=Retirement; accessed November 2, 2006. Some states refer to their retirement plans for volunteer firefighters as length of service awards programs (LOSAPs).

[2] We selected the states to review primarily based on the explicitness of their statutes and their proximity to Minnesota.

[3] Because states vary on the type of benefits paid and the schedule for those payments, it is difficult to compare benefit levels across states. Monthly benefits in the reviewed states with such plans ranged from $100 to $836 in 2006, and averaged about $280. About 4 percent of relief associations in Minnesota paid monthly benefits to retired firefighters. The average monthly payment in these associations for firefighters retiring after 20 years of service was about $460 in 2004.

Table 3.1: Characteristics of Volunteer Firefighter Pension Plans in Selected States, 2006

State	Required Funding Sources			Type of Benefit Plan
	State Aid	Local Contribution	Firefighter Contribution	
Locally Administered				
Arizona	Yes	Yes	Yes	Defined Benefit Monthly
Colorado	Yes	Yes	No	Defined Benefit Monthly
Florida	Yes	Yes	Yes	Defined Benefit Monthly
Kansas	Yes	No	No	Defined Benefit Monthly
Minnesota	Yes	Yes	No	Varies
New York	No	Yes	No	Varies
North Dakota	Yes	No	No	Varies
Wisconsin	Yes	Yes	No	Defined Contribution
Centrally Administered				
Arkansas	Yes	Yes	No	Defined Benefit Monthly
California	No	Yes	No	Defined Benefit Monthly
Delaware	No	Yes	Yes	Defined Benefit Monthly
Georgia	Yes	No	Yes	Defined Benefit Monthly
Montana	Yes	No	No	Defined Benefit Monthly
Nevada	No	Yes	Yes	Defined Benefit Monthly
New Mexico	Yes	No	No	Defined Benefit Monthly
North Carolina	Yes	No	Yes	Defined Benefit Monthly
Oklahoma	Yes	Yes	No	Defined Benefit Monthly
Texas	Yes	Yes	No	Defined Benefit Monthly
Virginia	Yes	No	Yes	Defined Benefit Lump Sum
Washington	Yes	Yes	Yes	Defined Benefit Monthly
Wyoming	Yes	Yes	Yes	Defined Benefit Monthly

SOURCES: Office of the Legislative Auditor review and analysis of state statutes and telephone interviews with selected state pension officials, 2006.

All reviewed states require that firefighters serve a minimum number of years before being eligible for full benefits, with 20 years being most common. Most states, including Minnesota, pay partial benefits to firefighters serving fewer years. There is also a minimum age that must be reached to receive benefits, most often 55 or 60.

Finally, in reviewed states with a centralized retirement plan, money from individual fire departments or relief associations is either pooled and invested by a central board or pension commission or combined with a larger public employee pension fund. In contrast, most states with local control, including Minnesota, allow local boards to invest pension assets. However, New York and Wisconsin, which have locally-administered pension plans, require local pension boards to contract with state-approved vendors for investment and other management services.[4]

In comparing practices in Minnesota with those in our neighboring states, we found that:

- **Volunteer firefighter pension plans are more prevalent in Minnesota than in our neighboring states.**

Among neighboring states, Wisconsin's pension program is most similar to Minnesota's. Wisconsin's "Length of Service Awards Program for Volunteer Firefighters and Emergency Medical Technicians," which is a defined contribution plan that became effective in 2001, is financed by local government contributions and state aid. While there is no limit to local contributions, there is a cap on state matching grants. As of September 2005, about 23 percent of Wisconsin's 805 volunteer fire departments were enrolled in the program.[5]

Pension plans for volunteer firefighters are not common in the other neighboring states. Although South Dakota permits municipalities with volunteer firefighters to provide deferred compensation plans, the officials we interviewed were not aware of any municipalities or fire districts that offered one.[6] North Dakota allows local relief associations to administer volunteer firefighter pension plans and, like Minnesota, gives them considerable discretion in setting contribution and benefit levels and investing pension assets. Despite the availability of state aid to help pay for pensions, North Dakota officials told us that "only a handful" of communities actually pay pension benefits to volunteer firefighters.[7] Finally, Iowa does not provide for a retirement program for volunteer firefighters, although, in January 2003, a legislative task force recommended that a length of service awards program be established.[8] To date, however, the Iowa Legislature has not adopted the task force's recommendation.

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[4] In New York, the State Controller General maintains a website that lists approved vendors along with other relevant information, including their administrative expenses and investment performance. In Wisconsin, an eight-member board attached to the state's administration department contracts with private vendors to provide investment services to local pension boards. See: *New York Laws*, General Municipal Laws, art. 11A, sec. 217-a, and Wisconsin Legislative Audit Bureau, *Volunteer Fire Fighter and Emergency Medical Technician Service Award Program* (Madison, December 2005), 3.

[5] *Ibid.,* 4.

[6] Mr. Wade Hubbard, Legal Council, South Dakota Public Retirement System, telephone interview by author, October 10, 2006 and Ms. Christine Hibbeler, Director of Research and Planning, South Dakota Municipal League, telephone interview by author, October 10, 2006.

[7] Ms. Ilene Helwegener, Accountant, North Dakota Office of Management and Budget, telephone interview by author, October 11, 2006; Ms. Lois Hartman, Executive Director, North Dakota Firefighters Association, telephone interview by author, October 11, 2006; and Mr. Marvin Eckman, Audit Manager, North Dakota State Auditor's Office, telephone interview by author, October 11, 2006.

[8] Iowa Legislative Services Bureau, *Volunteer Fire Fighter Pension Task Force Final Report* (Des Moines, January 2003); http://www.legis.state.ia.us/GA/79GA/Interim/2002/comminfo/firefight/final.htm; accessed October 12, 2006.

OPTIONS FOR MINNESOTA

Administering a volunteer firefighter pension fund is a complex task. Not only does it require knowledge of state and federal laws and regulations that are always subject to change, it also requires relief associations to make prudent investments on behalf of members—investments that consider both asset safety and investment return. Investing pension funds is perhaps the most important responsibility that board members have.

As our findings in Chapter 2 indicate:

- **Minnesota's decentralized pension system for volunteer firefighters creates problems and challenges.**

First, volunteer firefighter relief associations have earned low rates of return on their investments over time while incurring higher than necessary investment costs. In addition, administrative costs are high when compared with centralized systems. Second, board members, especially those from associations with the fewest assets, have difficulty meeting complex reporting requirements. Despite the availability of training opportunities, board members, especially those from associations with the fewest assets, want—and we think need—additional training, especially as it relates to investments. Third, legislators and other policy makers have expressed concern about the wide variation in benefit levels throughout the state, although we found this variation related to state aid, which, in turn, is related to fire departments' activity levels.

The Legislature could consider a range of options to address pension-related problems.

The Legislature could make several changes to current procedures or to the organizational framework itself to help make volunteer firefighter pension administration more cost-efficient or less onerous for association officials. As part of our assessment of alternatives, we asked representatives from relief associations and the local governments they were affiliated with about various changes that could be made. Their responses are shown in Table 3.2.

Table 3.2: Survey Respondents' Opinions on Various Proposed Changes in Administering Volunteer Firefighter Pensions

	Relief Associations				Local Governments			
	Strongly Agree	Agree	Disagree	Strongly Disagree	Strongly Agree	Agree	Disagree	Strongly Disagree
No major changes are needed.	19%	59%	18%	4%	13%	59%	25%	4%
Requiring all firefighters to become partially vested after five years would help alleviate portability concerns.	12	40	40	9	12	55	28	5
Pension benefits should be more uniform statewide.	13	36	39	13	12	42	39	7
The state should simplify reporting requirements.	48	44	7	1	31	55	12	1
The state should provide more administrative/technical support, including document templates.	27	55	18	1	24	64	11	1
The state should take on more administrative responsibilities.	11	26	51	11	11	29	51	9
Relief associations should have the option of having firefighters receive benefits from a statewide system.	13	38	38	11	12	33	46	9
The state should take over investing all volunteer firefighter pension funds.	4	13	40	43	5	19	53	23
The state should take over all aspects of volunteer firefighter pension funds.	5	6	30	60	4	9	47	40

NOTE: The questions asked whether respondents agreed or disagreed with the various statements. The number of useable responses to each question for relief associations ranged from 506 to 521; the numbers for local governments ranged from 522 to 540. Percentages may not total 100 due to rounding.

SOURCE: Office of the Legislative Auditor analysis of surveys of volunteer firefighter relief associations and local governments, 2006.

Below we discuss the advantages and disadvantages of possible alternatives. As shown in Table 3.3, options range from maintaining the status quo to completely centralizing all pension-related responsibilities within a state agency.

Table 3.3: Options to Improve Volunteer Firefighter Pension Administration

Option	Amount of Change Required
Maintain the status quo	Little or no change
Adopt procedural changes	
Eliminate unnecessary reporting requirements	
Focus training and technical support efforts	
Increase awareness of SBI	
Adopt uniform vesting requirements	
Update investment policies	
Develop investment performance report cards	
Require investing through SBI	
Create a voluntary statewide system	
Centralize pension administration	Major change

SOURCE: Office of the Legislative Auditor, 2006.

Maintain the Status Quo

The strongest rationale for no change is that relief association and local government officials are generally satisfied with the status quo. Also, except for their investment returns, relief associations have performed reasonably well. Nevertheless, we think that the Legislature should consider a range of options to address a variety of problems—from procedural and reporting requirements to investment performance. We present those options and our recommendations in the following sections of this chapter.

Adopt Procedural Changes

At a minimum:

- **The Legislature could adopt procedural changes—some mandating new responsibilities—to help address problems in volunteer firefighter pension administration.**

Procedural changes have advantages in that they are more widely supported among relief associations and local governments than are major structural changes. At the same time, their success in addressing system problems depends largely on the voluntary efforts of relief associations and their willingness to change their practices.

We have identified six procedural changes that the Legislature may wish to consider. None involve major changes in responsibilities for determining benefits or investing pension funds, although the last three options would mandate some increased levels of activity on the part of relief associations:

1. Eliminate unnecessary reporting requirements.

2. Provide more technical support and training on investment-related issues.

3. Increase relief associations' familiarity with the State Board of Investment.

4. Adopt uniform statewide vesting requirements.

5. Require that relief associations develop investment policies that adhere to best practices.

6. Require relief associations to develop and provide an annual "investment performance report card" to their membership.

We briefly discuss each of these procedural changes below.

Eliminate unnecessary reporting requirements

Completing state mandated reports in a timely and accurate manner is difficult for most volunteer firefighter relief associations. As we showed in Table 3.2, 92 percent of relief association respondents "agreed" or "strongly agreed" that the state should simplify reporting requirements. However, we think that the requirements relief associations find most burdensome—having annual financial audits done and completing the State Auditor's annual *Volunteer Fire Relief Association Financial and Investment Report*—are generally reasonable.

In the last year, the State Auditor's Office has tried to address relief associations' reporting concerns by significantly increasing the availability of automated reporting. For example, to make it easier for associations to submit financial and investment data, the State Auditor's Office implemented a new, automated system called FRPAS (Fire Relief Pension Accounting System) in 2006. Based on best accounting and budgeting practices, it automatically completes reporting forms and tracks relief association data if associations use it to enter transactions throughout the year. Although the auditor's office had some start-up problems and many smaller relief associations have found the new system difficult to learn and use, FRPAS may ultimately make it easier for associations to report data once they become familiar with it.

Requiring that some reports be filed with the state is unnecessary.

At the same time, requiring that some smaller, mandated reports be filed with various state agencies may be unnecessary. For example, as pointed out in Chapter 2, investment disclosure reports submitted to the Legislative Commission on Pensions and Retirement and lists of association board members filing economic disclosure reports submitted to the Campaign Finances and Public Disclosure Board are not used by the staff who receive them. Relief association compliance with both reporting requirements is low. Also, statutes permit the Secretary of State to accept, as proof of nonprofit incorporation, certain information sent by the State Auditor's Office in lieu of having relief associations register each year. The Legislature could consider eliminating the first two requirements altogether and amending the third to make it mandatory rather than permissive on the part of the Secretary of State. Doing so, however, will not lead to cost savings or improved investment practices, nor is it likely to address relief associations' major concerns about reporting.

Focus training and technical support efforts

As we showed earlier in Table 3.2, 82 percent of relief associations responding to our survey "agreed" or "strongly agreed" that the state should provide more administrative/technical support or training, including more document templates.[9] The Legislature could require that the State Auditor's Office periodically assess relief associations' training or support needs and ensure that ample opportunities to obtain that assistance exist statewide.

Recognizing that association trustees need—and want—more training and assistance, the State Auditor's Office recently questioned associations about their training needs for the upcoming year.[10] It specifically asked about the need for more training in three areas: FRPAS (Fire Relief Association Reporting System), reporting requirements, and bylaws. We applaud the State Auditor's efforts in continuing to deliver training to association trustees. We also think that, as relief associations become more comfortable with its financial reporting system, the auditor's office should focus its training efforts on other topics, such as investments and fiduciary responsibilities.

In general, relief associations need to take better advantage of training opportunities that currently exist.

At the same time, we think that between the Office of the State Auditor, various interest groups, and private businesses, ample training opportunities exist. In addition, the State Auditor's Office and interest groups, such as the League of Minnesota Cities, annually publish summaries of legislative changes that relief associations could use to keep their bylaws and other policies current. While more training and support are generally viewed as "good things," we think that association board members, including local government representatives, need to take more advantage of the training opportunities and technical assistance that currently exist. Statutes already require that relief associations develop and periodically revise a continuing education program for board members who are not "reasonably considered to be experts with respect to their activities as fiduciaries."[11] Board members are required to make a reasonable effort to obtain the knowledge and skills necessary to perform their fiduciary responsibilities.

Increasing training opportunities will likely result in increased administrative costs for relief associations. As we noted in Chapter 2, relief associations have spent very little for training. The extent to which administrative costs for the State Auditor's Office would increase depends on whether it expands its current training agenda or simply refocuses its current training on different topics.[12] The

[9] A document template is a preset format that lays out the information that should be in certain documents; associations can adapt them to reflect their unique needs.

[10] Brian Martenson, Management Analyst, Office of the State Auditor, e-mail to volunteer firefighter relief associations, November 17, 2006.

[11] *Minnesota Statutes* 2006, 356A.13, subd. 1.

[12] State Auditor costs related to volunteer firefighter relief associations are subtracted from the total amount of state fire aid available to relief associations.

extent to which increasing training opportunities improves investing practices is unknown because it depends on the willingness of association board members to access opportunities and subsequently use the information provided.

Increase knowledge about the State Board of Investment

Many relief associations are not familiar with the investment options offered through the State Board of Investment.

As noted in Chapter 2, a large percentage of relief associations are not familiar with the State Board of Investment (SBI). To address this, the Legislature could require that SBI provide more outreach and assistance to volunteer firefighter relief associations, including participating in training sponsored by the State Auditor's Office or interest groups. The State Board of Investment could also step up its current outreach program by periodically attending regional meetings that interest groups routinely hold around the state.

As with our other procedural options, adopting this option would not likely produce wholesale revenue increases statewide, although increases could be significant for those choosing to participate. All things being equal, relief associations that choose to invest through SBI would likely earn higher rates of return on their investments (assuming they did not simply invest in the board's cash options) while incurring lower investment costs. The additional revenue could decrease the need for local governments to make mandatory pension contributions or it could be used to increase pension benefits. Adopting this option would also simplify reporting requirements somewhat and reduce the need for board members to obtain considerable investing knowledge. Using SBI also expands the investment options open to associations that do not use the services of an investment advisor because it permits them to invest in corporate stocks.[13] On the other hand, SBI administrative costs would likely increase due to additional outreach.

At the same time, we think that relief associations must assume some responsibility for their lack of knowledge about SBI. As we noted earlier, board members have a fiduciary responsibility to ensure that they are knowledgeable about their investment options. Furthermore, statutes require that they obtain the skills necessary to fulfill their responsibilities in a reasonable manner. While we recognize that board members are generally unpaid and that their responsibilities are complex and time-consuming, trustees must take their responsibility to make wise investments seriously.

Adopt uniform vesting requirements

As noted in Chapter 1, states have been finding it increasingly difficult to attract and retain volunteer firefighters. One way to help alleviate this problem is to permit pension benefits to be portable when firefighters move from one community to another. Individual relief associations may grant service credit for prior firefighting services if their bylaws so permit. As we saw in Chapter 2, few associations have done so.

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[13] *Minnesota Statutes* 2006, 356A.06, subd. 6, prohibits associations with assets of $1.0 million or less from investing in corporate stocks unless they use the services of an investment advisor registered with the Securities and Exchange Commission or the State Board of Investment to invest at least 60 percent of their assets, or a combination of the two resources for at least 75 percent of their assets.

One way to partially address pension portability concerns—short of adopting a centralized pension system—would be for the Legislature to require that all firefighters meeting local eligibility requirements become partially vested in their retirement systems after five years.[14] This way, volunteer firefighters moving from one community to another could receive partial pensions from both communities, and relief associations would not have to negotiate portability agreements among themselves. As shown in Table 3.2, 52 percent of relief association and 67 percent of local government survey respondents "agreed" or "strongly agreed" that requiring all firefighters to become partially vested after five years would help alleviate some pension portability concerns.

Reducing vesting requirements could raise pension costs for the majority of relief associations. Currently, only 21 percent of associations pay partial pensions to firefighters retiring with five years of service; most do not do so until firefighters have served for ten years. The extent to which costs would increase depends on the extent to which relief associations experience firefighter turnover after five years of service.

Update investment policies

Investment policies that set forth reasonable objectives can help increase public accountability.

Legislation adopted in 2006 requires that relief associations submit their current investment policy to the State Auditor's Office as part of their annual investment report.[15] However, there are no state standards as to what that policy should address. As discussed in Chapter 2, most association investment policies in the sample that we reviewed fell far short of industry best practices. To improve accountability, the Legislature could require that volunteer firefighter relief associations develop investment policies that incorporate best practices.

Better documentation of investment goals and objectives is unlikely to result in widespread cost savings or increased revenue. At the same time, it is not likely to increase relief associations' administrative costs because they are already required to have an investment policy. At a minimum, requiring that associations make investments according to a plan that contains performance benchmarks increases local accountability. Having a well thought-out investment policy requires that board members become better fiduciaries, and adhering to such a policy may produce better results.

Develop "investment performance report cards"

Another way to indirectly try to improve investment performance while increasing local accountability would be for relief associations to provide more information about their investments to their members. For example, the Legislature could amend statutes to require that associations provide annual report cards to their members that summarize how their investments have performed relative to certain benchmarks.

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[14] *Minnesota Statutes* 2006, 424A.02, subd. 1 and 2, permit relief associations to pay reduced pensions to retiring firefighters who have served at least five years.

[15] *Laws of Minnesota* 2006, chapter 271, art. 8, sec. 4. Prior to this, relief associations had to submit their 1997 policy and any changes subsequently made. This change helps ensure that the State Auditor's Office has the most current version of each association's policy.

At a minimum, benchmarks could include SBI's Income Share Account as well as those spelled out in relief associations' investment policies. Legislation adopted in 2006 requires that the State Auditor's Office compare the investment performance of each relief association with benchmark rates of return based on industry best practices.[16] The Legislature could require that the State Auditor's Office provide appropriate benchmarks to relief associations and that associations use them in annual summaries to members.

Providing more performance-related information could increase relief associations' administrative costs. This could be offset by increased earnings if such disclosure results in relief associations changing their investing behavior and earning higher rates of return. Regardless, requiring that relief association develop investment performance report cards increases public accountability.

Require Investing Through the State Board of Investment

The options that we have outlined so far do not make major changes in relief association responsibilities. However, to have a greater impact on investment practices and related costs:

- **The Legislature could require that all volunteer firefighter relief associations invest their pension funds through the State Board of Investment.**

Requiring relief associations to invest through SBI would likely increase earnings and reduce costs.

Unlike the changes outlined thus far, this option would significantly alter responsibilities. As discussed in Chapter 2, *Minnesota Statutes* currently allow, but do not require, that volunteer firefighter relief associations invest through SBI.[17] Under this option, relief associations would continue setting benefit levels and paying pensions, but they would have to choose among the investment options offered through SBI.[18] Relief associations that fail to specify how their funds should be invested would have their funds automatically invested in the Income Share Account. Because SBI already has procedures in place for relief associations to follow, requiring associations to invest through SBI should not increase state costs.

Adopting this option has some major advantages. First and foremost, most relief associations could generally expect higher rates of return (assuming they did not simply invest in the investment board's cash options) and lower investment costs. The additional revenue could decrease the need for local governments to make mandatory pension contributions, or it could be used to increase pension benefits. Adopting this option would simplify reporting requirements somewhat and reduce board members' need for investment-related training.

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[16] *Laws of Minnesota* 2006, chapter 277, art. 6, sec. 2.

[17] *Minnesota Statutes* 2006, 69.775(d) and (e).

[18] Relief associations should be allowed to retain a small portion of their funds locally to meet miscellaneous expenses. They also have to maintain a relationship with a local financial institution in order for SBI to wire funds to relief associations, when needed.

Despite the obvious advantages to investing through SBI, relief associations and local governments express little support for this option. In our surveys, we asked respondents about the proper role of SBI regarding volunteer firefighter pension funds. As Table 3.4 shows, no more than 5 percent of respondents said that all volunteer relief associations should be required to invest through SBI. Thirty-seven percent would instead prefer more incentives for associations to voluntarily do so. Most respondents do not see a need for any changes in SBI's role.

Over half of the relief associations responding to our survey said that no changes were needed in how they use SBI.

Table 3.4: Survey Respondents' Opinions on the Proper Role of the State Board of Investment

	Relief Associations		Local Governments	
	Number	Percentage of Total	Number	Percentage of Total
No changes needed	170	57%	133	50%
Provide more incentives to invest through SBI voluntarily	110	37	97	37
Require associations earning very low rates of return over time to invest through SBI	12	4	22	8
Require all associations to invest through SBI	8	3	13	5
Total	300	100%	265	100%

NOTE: The question was: "In your opinion, which statement best reflects your view about the proper role of the State Board of Investment (SBI) regarding volunteer firefighter pension funds?" Data exclude respondents who said that they were "not familiar at all" with the State Board of Investment on a previous question. Percentages may not total 100 due to rounding.

SOURCE: Office of the Legislative Auditor analysis of surveys of volunteer firefighter relief associations and local governments, 2006.

Create an Optional Statewide System

To help promote more uniformity across the state and ease relief associations' workload:

- **The Legislature could create an optional state-operated pension system for volunteer firefighters within the Public Employees Retirement Association that relief associations could choose to participate in.**

Under this alternative, the state would: (1) determine the type of retirement plan offered (defined benefit versus defined contribution) and the frequency with which payments would be made (lump sum versus monthly payments); (2) set benefit levels (statewide versus variable benefits based on local fire activities); (3) pay benefits; and (4) decide how funds would be invested. Depending on the number of relief associations choosing to participate, the statewide plan could create a new board of directors consisting largely of firefighters, or it could use Public Employee Retirement Association's (PERA) current board of directors. Choosing how to invest pension funds (through SBI) could be the responsibility of the board, or investment responsibility could be given to SBI, as it is for most of the plans that PERA administers.

There is some precedent for having an optional statewide pension program for volunteer workers at the state level. In 1987, the Legislature created a pension option within PERA for volunteer ambulance drivers and it could choose to establish a similar program for volunteer firefighters.[19] The program for volunteer ambulance drivers allows any publicly-funded ambulance service and its drivers to participate in a state-operated defined contribution program. Ambulance service providers fund the benefits for drivers who elect to participate in the plan and determine the contributions that will be made on behalf of participating volunteers. Individual participants each have their own accounts, with each participant designating how funds will be divided among one or more of the seven accounts of SBI's Minnesota Supplemental Investment Fund.[20]

Having a voluntary state-operated pension program for firefighters is not likely to have a significant impact on association practices. Although generally supported by 51 percent of relief association and 45 percent of local government representatives responding to our survey, as shown earlier in Table 3.2, it would likely be used very little due to its voluntary nature and Minnesota's strong tradition of local control. Some other states that operate voluntary statewide systems alongside their local systems have not experienced significant participation in their statewide option.

On the other hand, it would offer a viable option to relief associations (and local governments) that want to "get out of the business" of administering volunteer firefighter pensions. For this segment of the population, investment income would likely increase while investment costs would decrease. To the extent that relief associations participate in a voluntary state-operated system, pension portability could increase and variations in benefits and vesting requirements could decrease.

Under this option, state costs would likely increase in that PERA would have to be expanded to include an option for volunteer firefighters. In addition, to encourage participation, the state would likely have to offer benefits that are higher than what most associations currently pay while "grandfathering" in firefighters who earn above-average pensions. Furthermore, it is unlikely that local cities and towns would continue to make voluntary contributions toward pensions under a state-operated program.

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[19] *Laws of Minnesota* 1987, chapter 372, art. 5.

[20] According to staff at PERA, the retirement program for volunteer ambulance drivers has been used very little—largely because there is no state funding for ambulance drivers' pensions. As of July 2006, only 32 employers and 668 ambulance drivers were participating in the program. Public Employees Retirement Association, *Count of Ambulance Drivers with Accounts by Employer,* (St. Paul, July 6, 2006). Note that not all employers contributed to the program in 2005.

Centralize Pension Administration

Our final option—used most often by the states that we reviewed—would be the most disruptive to both relief associations and the state:

- **The Legislature could require that all relief associations participate in a state-operated retirement system for volunteer firefighters.**

As with the former option, the state would: determine the type of retirement plan offered and payment method; set benefit levels; pay benefits; and invest pension funds. Choosing how to invest pension funds could be the responsibility of a new state board overseeing volunteer firefighter pensions, or investment responsibility could be given to SBI, as it is for most of the plans that PERA administers.[21] Centralizing pension administration would still require that some entity at the local level keep records of eligible volunteers and certify their eligibility for retirement benefits (much the way local governments do now for public salaried employees).

Centralizing pension administration for volunteer firefighters has advantages and disadvantages.

Centralizing pension administration offers a number of advantages. First, it would likely lead to increased investment earnings and lower investment fees statewide as a result of pooling investments and using SBI. Second, it would decrease administrative costs due to economies of scale. Third, depending on how benefit levels were set, it could make pensions more portable and standardize vesting requirements. Fourth, it would eliminate training needs across the state.

There are some disadvantages to creating a new system for volunteer firefighters. Some people might find a uniform benefit system objectionable because the number of fire calls that volunteers respond to vary significantly across the state. Others could raise concerns about having pension plans that have been funded or managed well in the past subsidizing plans that have not. Also, it is unlikely that cities and towns would continue to make voluntary contributions toward pensions under a state-operated program. Finally, a centralized pension plan may not be able to address communities' unique firefighter recruitment and retention needs as well as pension plans that are administered locally.

There is also strong local resistance to centralizing pension administration for volunteer firefighters, as shown earlier in Table 3.2. In our surveys, 90 percent of relief association respondents and 87 percent of local government respondents "disagreed" or "strongly disagreed" that the state should take over all aspects of volunteer firefighter pension funds, including making investments and setting benefit levels. Opposition was strongest among relief associations with the most assets.

[21] If the state adopted a defined contribution plan, it could also allow individual firefighters to direct their own investments.

CONCLUSIONS AND RECOMMENDATIONS

Minnesota's decentralized system of administering volunteer firefighter pensions creates problems and challenges. Nevertheless, there are several reasons for maintaining some elements of the state's current organizational framework. First, for the most part, relief associations have been conservative in setting benefits. Although nearly all would likely earn higher rates of return if they invested through SBI, most relief associations have sufficient resources to cover liabilities. Second, the Legislature has implemented a system of checks and balances that appears to be working—important reports are filed, fire aid is distributed, and pensions are funded and paid according to law. Third, local control may have some benefits that are difficult to quantify, such as increased community involvement, personal service, and civic pride. Fourth, there is little support for widespread structural changes among the relief associations and local governments that we surveyed. Finally, it is important to remember that the primary purpose of offering pensions to volunteer firefighters is to reward them for community service, not to provide for retirement. It is generally assumed that firefighters will rely primarily on other sources of income to finance their retirement.

At the same time, "less drastic" changes should be implemented to help address concerns about the investment practices and performance of volunteer firefighter relief associations. Relief associations should be earning higher rates of return on their investments, and board members should do more to ensure that they are fulfilling their fiduciary responsibilities related to investing. There are two approaches the Legislature could take to accomplish this—one mandatory and the other voluntary. We recommend the mandatory approach.

RECOMMENDATION

The Legislature should require that all volunteer firefighter relief associations invest their pension funds through the State Board of Investment.

Investing through SBI could result in higher pension benefits or reduced mandatory local government contributions.

We think that this could increase investment income for relief associations, which, in turn, could result in higher pension benefits or reduced mandatory local government contributions.[22] According to our estimates discussed in Chapter 2, had relief associations invested almost all of their pension funds in SBI's Income Share Account from 1997-2004, they would have earned about $56 million more in investment income.

If the Legislature does not choose to adopt the "mandatory" approach, we think that two other procedural options should be adopted to encourage more relief associations to invest through SBI. First, we think that SBI should provide more outreach and assistance to volunteer firefighter relief associations, including participating in investment-related training sponsored by the Office of the State

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[22] As noted previously, relief associations should be allowed to retain a small portion of their funds locally to meet miscellaneous expenses.

Auditor or other interested parties. As noted earlier, making wise fiduciary decisions is perhaps the most important responsibility that trustees have. Too many trustees say that they are not familiar with the SBI, even though it is one of their investment options. Trustees need to access information about SBI to help them make prudent investment decisions.

Second, we think that the Legislature should require that relief associations provide annual "report cards" to their membership that summarize how association investments have performed relative to certain benchmarks. In this way, firefighters themselves would be able to judge how well their investments have performed and hold their local boards accountable for their decisions. This type of reporting though requires that relief associations adopt reasonable benchmarks so that performance can be evaluated. The State Auditor's Office is required to develop benchmarks based on industry best practices to use in comparing relief association performance, and these benchmarks should be incorporated into relief association report cards.

Regardless of whether the Legislature chooses to require or encourage relief associations to invest through SBI, relief associations should adhere to long-term investment strategies that reflect their individual needs.

RECOMMENDATION

The Legislature should require volunteer firefighter relief associations to develop investment policies that incorporate best practices.

As noted earlier, industry best practices recommend that investment policies: (a) contain enough detail to implement a specific investment strategy; (b) outline the duties and responsibilities of all parties involved; (c) set forth portfolio diversification, rebalancing, and risk guidelines; and (d) incorporate specific, measurable investment objectives or benchmarks.

The Legislature should eliminate some minor reporting requirements.

In terms of simplifying reporting requirements, we think that, while onerous for many relief associations, most are necessary for public accountability purposes. However, we think that two requirements should be eliminated:

RECOMMENDATION

The Legislature should repeal statutory language that requires volunteer firefighter relief associations to file investment disclosure reports with the Legislative Commission on Pensions and Retirement.

Staff at the Legislative Commission on Pensions and Retirement told us that they do not use the reports that are submitted. Furthermore, few relief associations file the required information with the commission. We recognize that such information is useful to help identify conflicts of interest or questionable business relationships. However, relief associations would still have to prepare the disclosure reports for public review at the local level, and the State Auditor's Office should ensure that these reports are available locally.

RECOMMENDATION

The Legislature should repeal statutory language that requires volunteer firefighter relief associations to annually file a list of trustees completing economic disclosure statements with the Campaign Finance and Public Disclosure Board.

Implementing this recommendation would simply eliminate a list of names from being submitted to the Campaign Finance and Public Disclosure Board. Individual relief association trustees would still have to complete economic disclosure reports each year. Statutes require that the reports themselves be filed at the local level. At the same time, the State Auditor's Office should ensure that relief association trustees are completing the statements and making them available at the local level.

Finally, we think that it is important to have a venue where representatives from volunteer firefighter relief associations, state and local governments, and interest groups can meet to address mutual concerns.

RECOMMENDATION

The Office of the State Auditor should continue using its Volunteer Fire Association Working Group to address pension-related issues for volunteer firefighters.

In fall 2004, the State Auditor's Office established a Volunteer Fire Association Working Group to help identify and address various issues, including unclear laws, complex reporting, and training needs. Group members include relief association officers, local government officials, interest group representatives, and staff from the State Auditor's Office and the Legislative Commission on Pensions and Retirement. Since its inception, the group has proposed several statutory changes that the Legislature has subsequently adopted. We encourage the State Auditor to continue to use this group as both a communication tool and instrument of change.

List of Recommendations

- The Legislature should require that all volunteer firefighter relief associations invest their pension funds through the State Board of Investment (p. 56).
- The Legislature should require volunteer firefighter relief associations to develop investment policies that incorporate best practices (p. 57).
- The Legislature should repeal statutory language that requires volunteer firefighter relief associations to file investment disclosure reports with the Legislative Commission on Pensions and Retirement (p. 57).
- The Legislature should repeal statutory language that requires volunteer firefighter relief associations to annually file a list of trustees completing economic disclosure statements with the Campaign Finance and Public Disclosure Board (p. 58).
- The Office of the State Auditor should continue using its Volunteer Fire Association Working Group to address pension-related issues for volunteer firefighters (p. 58).

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