April 2010

Pension Division Newsletter

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New Online Training Session

The Office of the State Auditor (OSA) has recorded another online training session to assist with the completion of Pension reporting forms. The new online training provides step-by-step instructions on completing the Reporting Form. It can be viewed by visiting the "Training Opportunities" page of the Office of the State Auditor's website, or by using the links provided below. When you click on one of the links below, you will be brought to a webpage that requests your e-mail address. Once you've entered your address and name, a Windows Media Player screen will open with the webinar ready to play.

NEW Completing the Reporting Form (approximately 25 minutes)
https://www2.gotomeeting.com/register/147310578

Deferred Interest: Options and Calculations (approximately 18 minutes)
https://www2.gotomeeting.com/register/131127083

Completing the Maximum Benefit Worksheet (approximately 6 minutes)
https://www2.gotomeeting.com/register/278483842

Completing the Schedule Form (approximately 20 minutes)
https://www2.gotomeeting.com/register/824978186

Reporting Form Electronic Signatures

The OSA is pleased to announce an enhancement to the Pension reporting-year forms. New features have been added that allow the forms to be signed electronically through the State Auditor's Form Entry System (SAFES) webpage. This enhancement allows your relief association to submit the reporting forms online and eliminates the need for your relief association to manually submit form signature pages.

Detailed instructions for signing forms with electronic signatures were e-mailed to each relief association on April 19, 2010. The instructions, which include illustrations and answers to frequently asked questions, are also available on our website at:
http://www.auditor.state.mn.us/forms/pen/ReportingForms/pensionrf_elecsiginstr.pdf.

Reminder to Report Evidence of Misconduct

Public accountants performing an audit of a political subdivision or a local public pension plan must report to the OSA the discovery of evidence during the audit that points to nonfeasance, misfeasance, or malfeasance on the part of an officer or employee of the entity being audited. The reporting obligation includes an audit of a local public pension plan, including a volunteer fire relief association.

The report must be made “promptly” to both our office and the appropriate county attorney. "Prompt" reporting should be done prior to the routine filing of the relief association’s audit with the OSA. Especially in cases where evidence of fraud is discovered, the OSA may be able to assist with auditing or investigative services. The accountant is also required to provide the OSA and the county attorney with a copy of the completed audit report.

This mandatory reporting requirement is found in Minn. Stat. § 6.67, as amended during the 2009 legislative session in Chap. 86, art. 1 § 3, found at:
https://www.revisor.leg.state.mn.us/laws/?id=86&doctype=Chapter&year=2009&type=0.
More information on the mandatory reporting requirement can be viewed at:
http://www.auditor.state.mn.us/default.aspx?page=reportingfinancialconcerns.

Information Regarding Marriage Dissolutions

Relief associations are frequently contacted for information by the parties of their attorneys if a member of the association is getting a divorce. The court may need information regarding the value of the member’s accrued benefit to appropriately evaluate the marital assets. Courts may either award a percentage of the member’s benefit to the ex-spouse or a flat dollar amount. The division method may depend upon whether the member was active or retired at the time of the marriage dissolution.

Relief associations are usually given a draft copy of the divorce judgment or decree before it is filed with the court. If your relief association has questions regarding the draft, it should discuss the draft with the attorneys for both parties, with the court, or with the association’s own legal counsel. The OSA cannot provide guidance regarding marriage dissolutions. In addition, the relief association should remind both parties that the court order must comply with Minnesota Statutes, including sections 356.49, 518.58, 518.581, and 518.582. Relief associations in general are defined as governmental plans, and as such, are not subject to QDRO or ERISA rules.

Working Group Update

The Omnibus Retirement Bill, which includes the Working Group legislation, continues to make its way through the legislative process. No substantive changes have been made to the Working Group proposals. We will continue to keep you updated on the bill’s progress. Working Group information is available on our website at:
http://www.auditor.state.mn.us/default.aspx?page=reliefworkinggroup.

Investment Basics – Bonds

A document is attached entitled “Investment Basics – Bonds.” This is another installment in our ongoing series to provide education on investment topics. This document offers basic descriptions of different types of bonds, information about bond ratings, and explanations of bond risks.

If you have questions please contact us:

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Investment Basics
Bonds

Bonds are IOUs that are issued by companies and governments to finance day-to-day operations or to finance certain projects. Investors can buy bonds directly or purchase shares of pools of bonds through mutual funds or exchange traded funds. The original amount invested when a bond is purchased is called the principal. Usually, the principal is returned to the investor when the bond matures. In addition, investors usually receive interest payments at specific times each year until the bond matures. Bond maturity periods vary depending on the particular bond.

Types of Bonds

Bonds are generally issued by domestic and foreign governments and corporations. Most domestic bonds are issued by one of three groups: the U.S. government; a state or local government; or a corporation.

- **U.S. Government Bonds**

U.S. government bonds issued by the U.S. Treasury are considered very safe and the income earned is exempt from state and local taxes. U.S. government bonds are issued based on years to maturity as follows:

1. U.S. Treasury bills mature between 90 days and one year;
2. U.S. Treasury notes mature between two and 10 years; and
3. U.S. Treasury bonds mature between 10 and 30 years.

Bonds are also issued by U.S. government agencies and instrumentalities that have different ratings and risks.

- **Municipal Bonds**

Municipal bonds are issued by state and local governments. These bonds are exempt from federal taxes. Also, some states will exempt their own citizens from paying taxes on their bonds, making certain municipal bonds completely tax-free. Since public pension plans do not pay income tax this tax-free aspect of municipal bonds is of little value to a relief association.

- **Corporate Bonds**

Generally, corporate bonds carry more risk than U.S. government bonds or municipal bonds. They are usually categorized by years to maturity as follows:

1. Short-term: one to five years;
2. Intermediate-term: five to 15 years; and
3. Long-term: longer than 15 years.

Bond Risks

Many view bonds as an integral part of a well-diversified portfolio. Bonds are generally considered safe and reliable investments and can provide a continual stream of income. As with all investments, bonds do have some risks associated with them. Some considerations when deciding whether to purchase bonds are provided below.

- **Inflation Risk**

Inflation can erode a fixed-interest rate bond's value over time. As inflation rises, a bond's fixed interest rate is diminished, especially for long-term bonds. Some bonds have variable interest rates.

- **Interest Rate Risk**

Bond prices are inversely affected by interest rates. When interest rates rise, bond prices go down. During times of inflation interest rates often go up, reducing the value and interest income from bonds.

- **Credit Risk**

Credit risk is associated with a bond issuer's ability to make interest payments on time and repay the principal when the bond matures. The bonds ratings above are based on their credit risk. The lower the bond rating the higher the credit risk of a particular bond. A higher credit risk means there is a greater perceived chance that the bond issuer will be unable to make bond payments.

- **Liquidity Risk**

Liquidity risk is associated with the ability to convert an investment into cash. Bonds generally have higher liquidity risk because there are not exchanges to trade bonds on, as there are with stocks. Bond ratings and years to maturity are a large factor in the liquidity of a particular bond. Bonds with short maturity dates and with high credit ratings are generally much more liquid than bonds with long maturities and lower credit ratings.

- **Market Risk**

Market risk relates to supply and demand. When there is a large demand for bonds, market risk is lower because it is easier to find someone to buy your bonds at full value. When demand is lower for bonds and supplies of bonds increase, market risk is at its highest because bonds are more difficult to sell and often sell for less than face value. If you buy a bond and hold it to maturity, then market risk will not be a factor.

Bond Ratings

Bonds are rated according to risk. Bonds are usually rated by agencies such as Moody's Investors Service or the Standard and Poor's Corporation. The chart below shows the bond ratings along with the grade and risk of default for each rating.

Bond Rating	**Grade**	**Risk**
AAA	Investment Grade	Lowest Risk
AA	Investment Grade	Low Risk

A	Investment Grade	Low Risk
BBB	Investment Grade	Medium Risk
BB/B	Junk	High Risk
CCC/CC/C	Junk	Highest Risk
D	Junk	In Default

Investment Authority

Relief associations are authorized to invest up to 100 percent of their portfolio in government and corporate bonds, subject to certain limitations and quality ratings. (See Minn. Stat. § 356A.06, subds. 6 and 7.) Relief associations do not, however, have authority to directly invest in below-investment-grade (junk) bonds or in international bonds. Sometimes mutual funds have small positions in below-investment-grade bonds or international bonds. If so, these securities will be subject to the 20 percent portfolio limitation on "other investments."

Additional Resources

Additional information on relief association investment authority and investment policies is available on the Office of the State Auditor's website at the links provided below.

Statement of Position on Relief Association Investment Authority:
http://www.auditor.state.mn.us/other/Statements/firereliefinvestmentauthority_0907_statement.pdf

Statement of Position on Relief Association Investment Policies:
http://www.auditor.state.mn.us/other/Statements/firereliefinvestmentpolicy_0905_statement.pdf

Investment Basics Edition on Investment Fees:
http://www.auditor.state.mn.us/other/PensionDocs/pensionNewsletter_0904.pdf

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