



City of Grand Island

Tuesday, May 12, 2009

Council Session

Item F4

#9217 - Consideration of Firefighters and Police Pension Assets

Staff Contact: Jeff Pederson

Council Agenda Memo

From: Jeff Pederson, City Administrator
Meeting: May 12, 2009
Subject: Firefighters and Police Pension Assets
Item #'s: F-4
Presenter(s): Jeff Pederson, City Administrator

Background

For some time it has been known by the City and the Retirement Committee that there exists surplus money in the unallocated account for Public Service Pension assets. This determination is supported by an actuarial analysis that was conducted and was dated January 1, 2008 for Pre-1984 employees. Today, there exists approximately \$5.5m in the Fire unallocated account. There also exists a surplus of approximately \$180,000 in the unallocated account for Police.

I met with representatives of the Retirement Committee last fall to discuss concerns that the Committee had with the fact that the City was including in the 2008/2009 Budget a transfer from the unallocated account to the General Fund. We jointly agreed to formulate a set of questions relative to Federal Pension law to be answered by an Attorney who specialized in that field. A set of questions was posed to Attorney Michael Mueller of the Firm Cline, Williams, Wright, Johnson & Ordfather, L.L.P., and his response was received on March 23 of this year.

Discussion

The opinions rendered by Mr. Mueller on the several questions include a determination that the City can in fact use surplus assets in the unallocated employer account to meet City retirement match obligations for current and retired employees. Mueller recommended that, to do so, the City must amend its retirement plans to allow surplus assets to be used to fund current retirement matching contributions.

The City Attorney has prepared the attached Ordinance that amends the Plans for both Police and Firefighters to allow assets to be used for that purpose, provided that actuarial analysis show that surplus assets exist in the unallocated accounts. With passage of the

Ordinance, it would be the intention of the Finance Office to begin to expense required City retirement contributions immediately, and for the remainder of the Fiscal Year. This practice would be continued in subsequent budget years contingent upon a determination from the actuarial analysis that surplus funds exist.

Alternatives

It appears that the Council has the following alternatives concerning the issue at hand. The Council may:

1. Move to approve
2. Refer the issue to a Committee
3. Postpone the issue to future date
4. Take no action on the issue

Recommendation

City Administration recommends Council suspend the rules requiring three separate readings and approve Ordinance No. 9217.

Sample Motion

Move to approve Ordinance No. 9217.

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KEVIN COLLERAN, 1941-2006

March 23, 2009

Dale M. Shotkoski
City Attorney
City of Grand Island
Box 1968
Grand Island, NE 68802

Attorney-Client Privileged and Confidential

Re: Firefighter Pension Fund

Dear Dale:

This letter responds to your letter of September 23, 2008. You asked that we provide the City of Grand Island opinions concerning specified issues that you raised in the enclosure to your letter titled, "Request for Legal Opinion." We have reviewed the Adoption Agreement, City of Grand Island, Nebraska, Firefighters' Retirement System Plan and Trust adopted on October 28, 2008 (the "Adoption Agreement"), the Basic Municipal Employees Plan and Trust Agreement for the City of Grand Island, Nebraska, Firefighters' Retirement System Plan and Trust dated April 1, 2005 (the "Basic Plan Document") and the City of Grand Island Retirement System for Firefighters' January 1, 2008 Actuarial Valuation Report accompanying the Actuarial Certification dated May 21, 2008, prepared by Milliman, Inc. (the "Milliman Report"). Additionally, we reviewed Neb. Rev. Stat. Sections 16-1020 to 16-1042 (2007), the statutes dealing with the Firefighters' Retirement for a city of the first class. Based on our review of the foregoing and the provisions of the Internal Revenue Code of 1986 as amended dealing with governmental plans qualified under Section 401(a) et seq., we are rendering the opinions set forth in this letter. The numbered questions below correspond to those in your Request for Legal Opinion.

1. a). The following questions assume that any withdrawal or transfer from the unallocated employer account is from money that is in excess of benefits and expenses payable from that account. What requirements must be met before the unallocated employer account can be said to contain money in excess of benefits and expenses payable from that account (i.e., fully funded)?

The concept of a "fully funded" unallocated account does not exist under the Nebraska statutes. In general retirement plan parlance, a fully funded plan is one where the value of the assets in the plan equals or exceeds the present value of the liabilities owed by the plan. Reviewing the Milliman Report, the Report Summary provides in part:

ONE PACIFIC PLACE
1125 SOUTH 103RD, SUITE 320
OMAHA, NE 68124-1090
(402) 397-1700

1207 M STREET
P.O. BOX 510
AURORA, NE 68818
(402) 694-6314

RAILWAY OFFICE PLAZA
115 RAILWAY STREET, SUITE A-115
SCOTTSSBLUFF, NE 69361
(308) 635-1020

OPERA GALLERIA
123 N. COLLEGE AVENUE, SUITE 330
FORT COLLINS, CO 80524
(970) 221-2637

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"Based on the actuarial valuation, it is anticipated that the unallocated account is sufficient to provide the minimum defined benefits for the remaining pre-84 hires. **Therefore, it is anticipated that no additional contribution will be required to be contributed to the unallocated account.**" (Emphasis in original)

However, the following appears under "*Post-84 Hires*":

Firefighters hired after January 1, 1984 are eligible for special duty-related death and disability benefits. However, the expected number of occurrences is considerably less than 1.0. Therefore, any prefunding of the benefit will generate way too little funds (if an actual death or disability occurs), or will create unneeded funds (if none occur).

Therefore, we have not included a specific liability for the post-84 benefit. Some cities are considering the purchase of insurance to provide a benefit if an a [sic] duty-related death or disability occurs.

The Milliman Report shows the actuarial present value of future minimum benefits for active participants to be \$525. (I recommend that the City verify this. This seems unrealistically low to me.) The Report shows that the value of the unallocated asset account is approximately \$293,000. Based on this, the unallocated asset account value substantially exceeds the present value of the future benefits. However, the quoted part of the Report dealing with the "*Post-84 Hires*" says that if an actual death or disability occurs, "any prefunding of the benefit will generate way too little funds." Thus, Milliman has not unequivocally stated that the unallocated account has sufficient funds to provide for all of the benefits. I recommend that the City not conclude that the Plan is "overfunded" without Milliman's concurrence. I expect that the City must purchase life insurance and perhaps disability insurance for Milliman to so indicate.

1. b). What can be done with excess funds if they exist?

Neither Nebraska statutes nor the Plan documents describe what can be done with "excess funds" in the unallocated account. Neb. Rev. Stat. Section 16-1025(2) requires the City to contribute amounts necessary to fund the retirement or other retirement benefits not provided by the employee. Employee contributions and employer contributions are described in Subsection (1). Neb. Rev. Stat. Section 16-1033 provides that forfeitures of the nonvested portion of the employer contribution account are to be deposited in the unallocated employer account. It further provides:

"If the actuarial analysis required by Section 16-1037 shows that the assets of the unallocated employer account are sufficient to provide for the projected plan liabilities, such forfeitures shall instead be used to meet the expenses incurred by the city in connection with administering the retirement system, and the remainder shall then be used to reduce the city contribution which would otherwise be required to fund pension benefits."

Thus, forfeitures can offset the City's 13% contribution required by Neb. Rev. Stat. Section 16-1025(1) if the actuarial analysis shows that the unallocated employer account will provide for the Plan liabilities and if the expenses incurred by the City in administering the Plan are satisfied.

In my opinion, the City can amend the Plan to allow excess assets in the unallocated employer account to be used to offset the employer contribution required by Neb. Rev. Stat. Section 16-1025(1). If the City had not contributed excess funds to the unallocated account, it would have those funds in its treasury to make the 13% employer contribution. The Legislature called the unallocated account the "unallocated employer account." If the City cannot so use those funds, I see no other use for them. The statutes specify the level of employee and employer contribution for the Firefighters' benefits. Neither the statutes nor the Plan documents contemplate providing benefits to the Firefighters greater than those specified in Neb. Rev. Stat. Section 16-1025. In providing that forfeitures can offset the City's liability for expenses and its contributions, the Legislature is providing that the Plan should use assets not allocated to the Firefighters' accounts to reduce the City's costs.

The Plan is intended to meet the requirements of Section 401(a) of the Internal Revenue Code. The portion of the Plan providing the minimum benefits to the pre-1984 firefighters is a defined benefit plan. Internal Revenue Code Section 401(a)(2) requires that all assets of such a plan be used exclusively for the benefit of the employees or their beneficiaries. Once contributions are made to the Plan, the Plan sponsor may not reclaim the money unless there is a mistake of fact. Basic Plan Document Section 3.2 incorporates these requirements. Barring such a mistake, Plan assets cannot revert to the Plan sponsor until all benefit liabilities are paid. Additionally, if the Plan engages in a "prohibited transaction" described in Code Section 503(b), the trust holding the Plan assets loses its tax exemption. A prohibited transaction occurs if the trust engages in a transaction that results in a substantial diversion of its income or corpus to the creator of the trust (i.e., the City). Therefore, the City cannot remove assets from the Plan without a Plan termination after satisfaction of all liabilities.

I was able to obtain IRS approval of a "spinoff/termination" of a plan for another governmental client. Under that procedure, the Plan sponsor creates a new plan providing identical benefits to the current plan. The current plan transfers its liabilities and assets sufficient to satisfy those liabilities to the new plan. Assets in excess of those required to fund the liabilities in the new plan remain in the old plan. The Plan sponsor then terminates the old plan and receives back the excess assets from that plan.

I believe that a spinoff/termination would be difficult under this plan. First, the statutes do not authorize the assets to be returned to the City. Secondly, Neb. Rev. Stat. Section 16-1027(2) and the last paragraph of Basic Plan Document Section 7.3.1(b) provide that if the Participant wants a lump sum payment option, the Participant can request that the actuarial equivalent lump sum be the average of the cost of two annuity contracts purchased on the open market, if the difference between the cost of the two contracts does not exceed 5%. The Participant and the City each choose an annuity contract for determining the actuarial equivalent lump sum. If the difference between the costs of the two annuity contracts exceeds 5%, the Retirement Committee reviews the costs of the two contracts and makes a recommendation to the City Council on the amount of the lump-sum payment to be made to the Participant. The City Council then determines the amount of the single lump sum payment after a hearing.

In a spinoff/termination, the IRS requires that the participant's accrued benefit as of the date of the spinoff be funded through the purchase of an annuity contract. I doubt that the City could establish a procedure that would satisfy both the IRS requirement to purchase an annuity contract providing the Firefighter's accrued benefit and the statutory and Plan method of determining the Firefighter's lump sum benefit. Therefore, in my opinion, the City's preferred action is amending the Plan to allow the City to offset the excess assets in the unallocated employer account against the City's required employer contribution.

2. May the City withdraw money from the unallocated employer account and use it for purposes unrelated to the firefighters retirement system without violating state law, the Plan, and federal law?

As noted above, the City cannot simply withdraw the money from the unallocated employer account. Unless the City terminates the Plan, the funds must remain in Plan. The only exception is if the City made a contribution under a mistake of fact. In that case, the City can withdraw the funds contributed due to the mistake within one year of the date of the contribution.

3. May the City transfer money from the unallocated employer account for the purpose of paying its monthly contribution to each firefighter's employer account without violating state law, the Plan, and federal law?

As noted above, the City must amend the Plan to provide that the surplus funds will be used to defray the City's contribution under Neb. Rev. Stat. Section 16-1025(1). In my opinion, such an amendment would not violate federal law. Clearly with the amendment, it would not violate the terms of the Plan.

As noted above, the Nebraska State Statutes do not specifically authorize the unallocated account funds to be used to defray the City's contribution. However, I believe that one could reasonably infer from Neb. Rev. Stat. Section 16-1033 that the City could do so if the Plan so provided. As noted above, the last paragraph of that Section provides that forfeitures are to be allocated to the unallocated employer account. However, if the actuarial analysis shows that the assets of the unallocated account are sufficient to provide for projected plan liabilities, the forfeitures can be used first to reduce expenses incurred by the City. The remainder "shall then be used to reduce the City contribution which would otherwise be required to fund pension benefits." If forfeitures that would otherwise be deposited in the unallocated employer account can instead be used to reduce the City's contributions, the Legislature has clearly indicated an intent that those amounts are to be used by the City for its benefit in the Plan. The Firefighters' benefits are specifically described in the Statutes. They do not provide a mechanism for providing a benefit beyond the statutory benefits. Thus, the Plan must either apply the unallocated funds to the City's contribution liability or leave the funds in the trust totally unused. The later alternative is absurd.

The Legislature contemplated that the City might have to include provisions in its Plan or take action that the Legislature did not specifically describe in the statutes. Neb. Rev. Stat. Section 16-1034 provides in part:

The city and retirement committee shall have all powers which are necessary for or appropriate to establishing, maintaining, managing, and administering the retirement system. Whenever sections 16-1020 to 16-1042 fail to address the allocation of duties or powers in the administration of the retirement system, such powers or duties shall be vested in the city unless such powers or duties have been delegated by ordinance to the retirement committee.

Neb. Rev. Stat. Sections 16-1020 to 16-1042 do not address what should happen if the unallocated employer account contains a surplus that can never be used. Thus, unless the City has delegated by ordinance to the retirement committee the power to address this, the City can address it by ordinance amending the Plan. Section 12.3(i) of the Basic Plan Document provides:

Police and Fire Plans: Notwithstanding any provision of this Section 12.3 to the contrary, a Retirement Committee shall be established to supervise the general operation of the Plan. The number and members of the Retirement Committee shall be in accordance with the relevant statutes of Nebraska, as amended from time to time. **The City shall continue to be responsible for the general administration of the Plan unless specific functions or all functions with regard to the administration of the Plan are delegated, by ordinance, to the Retirement Committee. Whenever duties or powers are vested in the City or the Retirement Committee under the Plan or applicable state law, or whenever the Plan or such law fails to specifically allocate the duties or powers of administration of the Plan, such powers or duties shall be vested in the City unless such powers or duties have been delegated by ordinance to the Retirement Committee.**

Therefore, unless the City has by ordinance delegated the power to dictate how the unallocated employer account will be used to the Retirement Committee, the City can amend the Plan to direct how the surplus assets in the unallocated employer account will be used.

4. May the City withdraw money from the unallocated employer account to reimburse the City for past contributions that it made to each firefighter's employer account without violating state law, the Plan, and federal law?

As noted above, the City cannot withdraw funds from the unallocated employer account. Doing so risks the qualified status of the Plan under federal law.

5. With regard to all money transferred by the City into the firefighters retirement system since 1984; must such money be credited to either the employer account or to the unallocated employer account?

Neither the statutes nor the Plan deals with assets outside the employer and employee contribution accounts and the unallocated employer account. The Milliman Report does not reflect assets other than the unallocated employer contribution account and the employer and employee contribution accounts of the pre-84 Firefighters. I do not see a basis under the statutes or the Plan documents for the Plan trustee to hold assets other than those in the employer and employee contribution accounts described in Section 16-1025 or in the unallocated employer contribution account. Section 3 of the Basic Plan Document describes the contributions that the employees and the City make. Section 3.1(a) describes the mandatory employee contributions and the City's "pickup" of that contribution. Section 3.2 describes the employer contributions. Section 3.2(a)(i) provides that the City shall contribute to the trustee the amount stated in the adoption agreement. The City also must make the employer contribution for employees employed by the City on January 1, 1984, in the amount equal to the employee's contributions prior to 1984. Finally, Section 3.2(a)(iii) provides:

"The City shall make additional contributions to the Plan in amounts and at such times as are necessary to provide the benefits stated in this Agreement. For Fire Plans, such additional Employer contributions shall be paid to an Unallocated Employer Account and shall not exceed the applicable limitations of Code section 415."

Adoption Agreement item C describes the mandatory employee contributions. Adoption Agreement item E describes the allocation of City Contributions and Forfeitures. Neither the Adoption Agreement nor the Basic

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Plan Document describes accounts or contributions other than the Employee and Employer contributions described in Neb. Rev. Stat. § 16-1025 and those that are allocated to the unallocated Employer Account.

6. If your response to question #5 is that money transferred by the City into the firefighters retirement system since 1984 may be credited to an account separate from the employer account or the unallocated employer account; describe the purpose of such an account.

Not applicable.

7. Does authority exist with the Retirement Committee to prohibit or approve the City's use of the unallocated employer account or any account that you may have described in response to question 6.

Neb. Rev. Stat. § 16-1034 provides that the Retirement Committee is established to supervise the general operation of the retirement system. However, the governing body of the City is responsible for the general administration of the retirement system unless specific functions or all functions concerning the administration of the retirement system are delegated by ordinance to the Retirement Committee. As noted above, whenever Sections 16-1020 to 16-1042 fail to address the allocation of duties or powers in the administration of the retirement system, those powers or duties "shall be vested in the City unless such powers or duties have been delegated by ordinance to the retirement committee."

Reviewing the Plan document, Section 1.1.16, the definition of "Funding Agent" indicates that the City must approve the funding agent if the Retirement Committee selects it. Section 1.1.33 defines the Retirement Committee as "The Retirement Committee created under Section 12.3 for general supervision of the Plan and to perform the duties stated in this Agreement and those other duties as are properly delegated in this Agreement, by law or otherwise by the City to the Retirement Committee." As noted above, Section 12.3(i) provides that the Retirement Committee is established to supervise the general operation of the Plan. However, the City continues to be responsible for the general administration of the Plan unless specific functions or all functions concerning the administration of the Plan are delegated by ordinance, to the Retirement Committee. The last sentence of subsection 12.3(i) provides:

"Whenever duties or powers are vested in the City or the Retirement Committee under the Plan or applicable state law, or whenever the Plan or such law fails to specifically allocate the duties or powers of administration of the Plan, such powers or duties shall be vested in the City unless such powers or duties have been delegated by ordinance to the Retirement Committee."

Section 12.3(d) of the Basic Plan Document provides:

"Until authorization and creation of a Retirement Committee and thereafter, to the extent that rule making and other powers as aforesaid shall not be granted to such Committee, or in the event the Employer, after creating a Retirement Committee, shall discontinue the same or reduce its power and authority (the right so to do being hereby reserved to the Employer), such power shall be vested or become revested, as the case may be, in the Employer."

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I find nothing in the statutes or the Plan that would grant the authority to the Retirement Committee to prohibit or approve the City's use of the Unallocated Employer Account. The Retirement Committee may have certain powers that have been delegated to it by the City ordinance. However, I would be surprised if any such ordinance would restrict the City's authority with respect to the Unallocated Employer Account or any other assets of the Plan. Moreover, even if the City had delegated such authority, Section 12.3(d) would give the City the right to discontinue or reduce that power.

I trust that this letter responds to your questions. However, if you need additional clarification, please contact me.

The foregoing opinions are based upon Nebraska and United States law and the terms of the Plan in effect on the date of this letter. We do not undertake to advise you of any changes in applicable law. This letter is for the benefit of the City of Grand Island, Nebraska. No other party is authorized to rely upon the opinions set forth in this letter without first obtaining our written permission to do so. Our opinions are limited to those expressly set forth in this letter. No other opinion or conclusion should be inferred.

Very truly yours,

A handwritten signature in cursive script, appearing to read "Michael C. Mueller".

MICHAEL C. MUELLER

For the Firm

ORDINANCE NO. 9217

An ordinance to amend the Basic Municipal Employees Plan and Trust Agreement for the City of Grand Island, Nebraska, Firefighters' Retirement System Plan and Trust and the Basic Municipal Plan and Trust Agreement for the -City of Grand Island, Nebraska, Police Officers' Retirement System Plan and Trust to revise and amend said plans to provide for the City to continue to be responsible for the general administration of the plans and to specifically allow that if the actuarial analysis of the plans shows that the assets in the unallocated account are sufficient to provide for subjected plan liabilities, that the assets can be used to reduce expenses incurred by the City and shall then be used to assist in meeting the City's contribution which is required to fund pension benefits.

BE IT ORDAINED BY THE MAYOR AND COUNCIL OF THE CITY OF GRAND ISLAND, NEBRASKA:

SECTION 1. Pursuant to NEB. REV. STAT. §16-1034, the City has such powers and duties vested in it for the administration of the police and firefighter retirement systems.

SECTION 2. Retirement plans are in place for the police and firefighter retirement systems and said plans in the basic plan documents allows for the general administration of the plan to continue to be with the City. The plan documents shall be amended to specifically provide the City the authority to maintain and utilize the unallocated employer accounts pursuant to NEB. REV. STAT. §16-1033 so that if the actuarial analysis of the plans show that the assets in the unallocated accounts are sufficient to provide for projected plan liabilities, the assets can be used to assist in meeting expenses incurred by the City and also may be used to assist in meeting the City's contribution which is required to fund pension benefits.

ORDINANCE NO. 9217 (Cont.)

SECTION 3. If any section, subsection, or any other portion of this ordinance is held to be invalid or unconstitutional by any court of competent jurisdiction, such portion shall be deemed separate, distinct, and independent, and such holdings shall not affect the validity of the remaining portions thereof.

SECTION 4. This ordinance shall be in force and take effect from and after its passage and publication, within fifteen days in one issue of the Grand Island Independent as provided by law.

Enacted: May 12, 2009.

Margaret Hornady, Mayor

Attest:

RaNae Edwards, City Clerk