



TO: Members of the Legislative Commission on Pensions and Retirement
FROM: Susan Lenczewski, Executive Director
RE: H.F. 3805 (O'Driscoll); S.F. xxxx: Authorizing Additional Sources of Funding for All Minnesota Public Pension Plans
DATE: April 4, 2016

Summary of H.F. 3805 (O'Driscoll); S.F. xxxx

H.F. 3805 (O'Driscoll); S.F. xxxx would add a new section to Chapter 356, which applies to all public pension plans, generally. The new section 356.631 would authorize the plans to accept payments from sources in addition to employer and employee contributions and earning thereon. Authorized payments would include:

- (1) Gifts;
- (2) Donations;
- (3) Bequests;
- (4) Life insurance death benefits;
- (5) Life insurance death benefits pursuant to a life insurance premium financing or other arrangement covering the lives of retirees and survivors under a public pension plan; and
- (6) Other similar sources of funding.

Policy Considerations

1. Supplements Existing Laws Applicable to MSRS and PERA Regarding Other Sources of Funding and Adds Uniformity. Minnesota statutes already permit gifts, donations, and bequests to two of the largest public pension funds:

- For the General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General), Minn. Stat. § 352.04, subd. 11 states: “**Gifts and bequests.** The director may credit to the retirement fund any money received in the form of donations, gifts, appropriations, bequests, or otherwise, or derived from it.”
- For the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General), Minn. Stat. § 353.34, subd. 6 states: “**Additions to fund.** The board of trustees may credit to the general employees retirement fund any money received in the form of contributions, donations, gifts, appropriations, bequests, or otherwise.”

Minn. Stat. §§ 16A.013 to 16A.016 authorizes Minnesota Management and Budget (MMB) to accept gifts, bequests and devises on behalf of any public institution, agency or department and pay out such gift, bequest or devise to the designated public institution, agency or department.

The bill would permit the Teachers Retirement Association (TRA) and all other public pension plans, in addition to MSRS-General and PERA-General, to receive such payments directly rather than have

to rely on the general authority to MMB to accept such payments on their behalves. The bill adds uniformity on this issue by giving all pension plans the same authority MSRS-General and PERA-General have to accept donations, gifts and bequests.

None of these statutes specifically address life insurance proceeds. The bill adds life insurance death benefits to the list of payments the pension plans are authorized to accept. Just as an active member or retiree might make a donation to a public pension plan, an active member or retiree might purchase a life insurance policy on his or her life and designate the pension plan as beneficiary to receive the death benefit. We are unable to locate any prohibition or impediment to doing so under Minnesota law. The bill authorizes death benefits from life insurance, including from life insurance under a premium financing arrangement, such as the arrangement sponsored by EPOCH International. See the next section regarding EPOCH for explanation.

2. Necessary First Step toward Implementing a Life Insurance Premium Financing Arrangement Such as That Presented by EPOCH International. Members may recall the presentation given by EPOCH International at the October 14, 2015, meeting of the Pension Commission. Since then, Commission staff has considered the materials provided by EPOCH and requested additional documents, information and analysis, which have not yet been received. We continue to believe additional information is needed on at least the following topics:

- The name and contact information for any institution that has concluded an EPOCH transaction;
- Whether the proposed EPOCH transaction violates any of Chapter 60A of the Minnesota statutes, especially the insurable interest and anti-STOLI (“stranger-originated life insurance”) provisions;
- Whether residents of other states who are retirees of Minnesota’s public pension plans will be able to participate in the program, in view of the program’s dependence on certain Minnesota state laws regarding insurable interest, which may be different than the laws of the state of a retiree’s residency;
- Whether offering the life insurance lump sum benefit only to retirees who satisfy certain age and residency requirements raises any anti-discrimination concerns under state or federal law;
- As suggested by a legal opinion provided by EPOCH, whether there is a need for releases from any person who could potentially benefit as a beneficiary under the life insurance to protect against challenges on the grounds of lack of insurable interest or any other grounds; and
- Whether there are any federal or state securities law implications for the State in the proposed arrangement which would involve a related trust issuing securities to fund the premium payments for the life insurance policies.

It would be possible for the Pension Commission to move forward with legislation to implement an arrangement such as that sponsored by EPOCH. To address the foregoing concerns, the Pension Commission might engage a consultant or legal counsel or direct that the relevant state agencies provide responses and legal opinions, if appropriate. Legislation could:

- (i) designate an agency, such as Minnesota Management and Budget, the State Board of Investment or a new entity, to oversee the coordination of the program, and
- (ii) direct the pension plans to evaluate the actuarial cost and administrative burden and design a process for enlisting retirees for the program, with appropriate waivers and releases.

The bill is a step forward in the many steps that would likely need to be taken in order to implement an EPOCH-type arrangement. The inclusion of authority to accept death benefits “pursuant to a life insurance premium financing or other arrangement covering the lives of retirees and survivors under any such pension plan” is intended to allow the plans to accept the benefits of an EPOCH-type arrangement.

3. There is Basis for the Position that Public Pension Plans Can Accept Payments Other Than Employer and Employee Contributions and Earnings Thereon and Still Remain Tax-Qualified. In the private sector, pension and other retirement plans, such as 401(k) plans, do not accept payments other than employer and employee contributions and earnings thereon. This is considered a condition of remaining tax-qualified. Internal Revenue Code § 401(a)(1) states that a plan shall constitute a qualified trust:

“if contributions are made to the trust by such employer, or employees, or both, or by another employer who is entitled to deduct his contributions under section 404(a)(3)(B) (relating to deduction for contributions to profit-sharing and stock bonus plans), ... for the purpose of distributing to such employees or their beneficiaries the corpus and income of the fund accumulated by the trust in accordance with such plan;”

The deductibility requirements of Code § 404 do not apply to a governmental plan since governmental entities do not pay federal tax and have no need for deductions. Accordingly, the limitation that appears to permit only deductible contributions to a qualified retirement plan could not apply to a plan sponsored by a governmental entity since, otherwise, not even employer and employee contributions could be made to such plan.

Commission staff is aware of two old IRS Revenue Rulings, 1968-223 (1968-1 C.B. 154) and 1963-46 (1963-1 C.B. 85), and a more recent Private Letter Ruling 200005035 (Nov. 9, 1999), wherein the IRS permitted a retirement plan to accept payments that were not employer or employee contributions or earnings thereon and remain tax-qualified. While none of these rulings specifically address donations, gifts, bequests or life insurance proceeds, they do address transfers of funds that were not employer or employee contributions. Without much analysis, each concludes with the statement that Code § 401(a)(1) does not require that contributions be made only by the employer or the employees.