Guidance for Political Subdivisions that Do Not Participate in the Tennessee Consolidated Retirement System

The Public Employee Defined Benefit Financial Security Act of 2014

Introduction

On May 22, 2014, Chapter 990 of the 2014 Public Acts was enacted into law creating the Public Employee Defined Benefit Financial Security Act of 2014. The new law establishes funding requirements for a political subdivision's defined benefit pension plan that does not participate in the Tennessee Consolidated Retirement System ("TCRS"). The TCRS currently includes over 500 political subdivisions. There are only approximately forty (40) political subdivisions which do not participate in the TCRS and independently administer defined benefit pension plans. A majority of these non-TCRS political subdivisions contribute at least one hundred percent (100%) of their actuarially determined contributions ("ADC"). Under current law, which has been in effect for many years, all defined benefit plans for political subdivisions that participate in the TCRS are required to pay one hundred percent (100%) of the ADC; this new law extends that same requirement to defined benefit pension plans for political subdivisions that do not participate in the TCRS.

This document applies to those political subdivisions with a defined benefit pension plan that is not established through the TCRS and does not apply to those political subdivisions participating in TCRS. In addition, this document does not apply to any defined contribution plan provided by a political subdivision.

Attached to this guidance is a template policy that the Department strongly suggests is used in the development of the political subdivision's funding policy.

Public Chapter 990 Provisions

In achieving compliance with the new law, the following serves as guidance to political subdivisions:

1. What entities are subject to this new law?

- The requirements contained in the law apply to any political subdivision in the State that has established and maintains a defined benefit pension plan that does not participate in the TCRS; this includes all defined benefit pension plans established and maintained by the political subdivision that are open or closed to membership.

- For the purposes of this new law, a "political subdivision" means any local governmental entity, including but not limited to any municipality, metropolitan government, county, utility district, school district, public building authority, housing authority, emergency communications district, and development district created and existing pursuant to the laws of this state, or any instrumentality of government created by any one (1) or more of the named local governmental entities.

2. How does a political subdivision determine its obligation for funding its defined benefit pension plan or plans?

- The first step for each political subdivision in meeting its obligation to fund its defined benefit pension plan or plans is to develop a funding policy.
- Each political subdivision subject to this new law shall develop a funding policy for its defined benefit plan or plans (which includes all defined benefit pension plans that are open or closed to membership) beginning after June 15, 2015. A political subdivision's funding policy will be in effect until it is amended.
- The funding policy, including any amendment thereto, shall be legally adopted and approved through a resolution by the political subdivision's chief legislative body or governing body.
- Once the funding policy is adopted, the policy and any amendment thereto, shall be submitted to the Comptroller of the Treasury within thirty (30) days after adoption; electronic submission is preferred. The address for submission of the funding policy is:

  Sandi Thompson
  Tennessee Comptroller of the Treasury
  Office of State and Local Finance
  505 Deaderick Street
  James K. Polk Building, Suite 1600
  Nashville, Tennessee 37243-0273
  Telephone: (615) 747-5380
  Fax: (615) 741-5986
  Email: sandi.thompson@cot.tn.gov

  Should you wish to submit your funding policy electronically, please submit it through the Comptroller of the Treasury's public portal, which may be accessed through the following link: http://www.comptroller.tn.gov/PublicPortal/index.asp
  To submit the funding policy, click on "File a Submission", which is located on the left-hand side of the webpage.

- The funding policy shall include the following information, at a minimum, but may include additional information as determined by the political subdivision:

- The actuarially determined contribution ("ADC") methodology which shall include the normal costs and the amortization of the unfunded accrued liability ;
- The maximum amortization period for which any unfunded accrued liabilities will be paid; and
- A statement that the political subdivision's budget shall include funding of at least one hundred percent (100%) of the ADC. The only exception is if the political subdivision, through a maintenance of effort, will make percentage payments of the ADC to the defined benefit pension plan until payment of one hundred percent (100%) of the ADC occurs no later than the fiscal year ended June 30, 2020.

<u>3. Who should calculate the political subdivision's ADC?</u>

- A political subdivision's ADC shall be calculated by an independent, qualified actuary who shall be a member of the American Academy of Actuaries.
- The actuary shall not be an employee of that political subdivision and shall not be otherwise eligible to participate in any of the political subdivision's pension plans.

<u>4. What actuarial methodology should be used and included in the funding policy?</u>

- The actuarial methodology utilized by the actuary is a decision of the local government, but such methodology is expected to provide that projected revenues (employer and employee contributions, and investment earnings) and current assets will finance all of the projected benefits (death, disability and retirement) provided by the defined benefit plan or plans.
- The actuary engaged by the political subdivision to calculate its ADC for its pension plan or plans shall utilize the following methodology in accordance with the Actuarial Standards of Practice established by the Actuarial Standards Board:
    - *Actuarial Cost Method*-Actuarial cost method allocating normal costs over a period beginning no earlier than the date of employment which should not exceed the last assumed retirement age. This method is designed to fully fund the long-term cost of promised benefits, consistent with the objective of keeping contributions relatively stable and equitably allocating the costs over the employees' period of active service. The projected unit credit method is not permitted to be used in fiscal years after June 15, 2019;
    - *Actuarial Value of Assets*-Actuarial value of assets calculated using a maximum ten (10) year asset smoothing period. Any smoothing period greater than five (5) years will have a maximum twenty percent (20%) market corridor. The term "market corridor" means a range beyond which deviations are not smoothed;
    - *Treatment of Unfunded Liabilities*-

        - Level dollar amortization method for financing the unfunded accrued liabilities beginning on or before June 15, 2020, that will continue to be utilized in each subsequent year;
        - A closed amortization period not to exceed thirty (30) years for all unfunded accrued liabilities.
    - *Mortality Assumptions*-Mortality assumptions, which should consider the effect of expected mortality improvements, and shall be utilized beginning on or before the plan fiscal year after June 15, 2024, and that will continue to be utilized in each subsequent year;
    - *Investment Earnings*- Investment earnings assumption shall not be greater than fifty basis points (50 bps) above the rate adopted by the TCRS. As of July 1, 2014, the investment earnings assumption rate is 7.5%. Therefore, the current maximum earnings assumption is 8.0%. Please direct your inquiries for subsequent TCRS rates to the Director of the Tennessee Consolidated Retirement System; 502 Deaderick Street, 15th Floor, Nashville, Tennessee 37243; (615) 741-7063; jill.bachus@tn.gov.

<u>5. How often should the ADC be calculated and what would constitute the most recent calculation of the ADC?</u>

- The ADC shall be calculated at least once in a two year period and the required percentage of funding shall be based on the most recent calculation of the ADC.
- The effective date of the ADC, which is determined by the actuarial valuation, shall be included in political subdivision's funding policy. The ADC should effective for a fiscal year as early as practical. The Office of the Comptroller of the Treasury and the State Treasurer's Office may review a political subdivision's funding policy, actuarial valuation, and actual funding to ensure that its ADC is being calculated and funded in accordance with Public Chapter 990.

<u>6. What are a political subdivision's funding requirements in meeting its financial obligation to its defined benefit pension plan or plans?</u>

- Each fiscal year, a political subdivision shall make contributions to its defined benefit pension plan or plans of no less than one hundred percent (100%) of the ADC; however, for any fiscal year, a political subdivision is permitted to make contributions of more than one hundred percent (100%) of its ADC.
- In the event that a political subdivision is not paying at least one hundred percent (100%) of the ADC to its pension plan or plans for the fiscal year that includes June 30, 2015, the political subdivision has until June 30, 2020 to maintain an effort in paying a percentage of the ADC, and in addition to that, shall pay a percentage to increase

funding of the ADC annually, which is known as the "annual funding progress percentage".

- The minimum annual funding progress percentage is the percentage determined by subtracting the percentage of the ADC paid in the plan fiscal year preceding July 1, 2015 from one hundred percent (100%) of the ADC, and then dividing that by five (5). In order to determine the annual funding progress percentage, the percentage of funding shall be based on the annual recalculation of the ADC.
- The annual funding progress percentage paid to the defined benefit pension plan or plans may not be less than the amount set out in number 4 above within the five (5) year period of time, unless such lower percentages are submitted to the State Treasurer for approval as part of the political subdivision's plan of correction referenced in paragraph 6 below.
- Once the political subdivision pays one hundred percent (100%) of the ADC, then the political subdivision shall continue to pay one hundred percent of the ADC to its pension plan or plans annually.

7. Are there any options for a political subdivision if it cannot meet the its funding obligation within the time frame established in the new law?

- If a political subdivision is unable to meet the annual funding progress percentage, the political subdivision may submit a plan of correction to the State Treasurer for consideration. If the State Treasurer determines that the plan of correction is sufficient to meet the annual funding progress percentage as soon as possible, and to pay one hundred percent (100%) of the ADC to the pension plan or plans by June 30, 2020, then the State Treasurer shall submit the plan of correction to the State Funding Board for approval. In order to submit a plan of correction to the State Treasurer for consideration, you may submit the plan to the Director of the Tennessee Consolidated Retirement System; 502 Deaderick Street, 15th Floor, Nashville, Tennessee 37243; (615) 741-7063; jill.bachus@tn.gov.
- At a minimum, the plan of correction shall contain the following: the reason for the political subdivision's inability to meet the annual funding progress percentage; the political subdivision's detailed plan to comply with the requirements of meeting the annual funding progress percentage as soon as possible, and to pay one hundred percent (100%) of the ADC to the pension plan no later than June 30, 2020; the amount or amounts to be paid by the political subdivision by a date certain or over a period of time; the reports necessary to demonstrate how the political subdivision will comply with the plan of corrective action; and any amendment to the political subdivision's funding policy to comply with the plan of corrective action.

- In addition to the plan of corrective action, the political subdivision shall promptly furnish any additional documentation that the State Treasurer may request.

8. What happens if a political subdivision fails to meet its funding obligations pursuant to this new law?

- In the event that a political subdivision fails to pay at least one hundred percent (100%) of its ADC, or does not pay 100% the maintenance of effort requirement during the five (5) years after June 30, 2015, or does not pay the total amount or amounts approved under a plan of correction referenced in number 6 above, the Commissioner of Finance and Administration, at the discretion of the Comptroller of the Treasury, is authorized to withhold such amount or part of such amount form any state-shared taxes that are otherwise apportioned to the political subdivision. The money withheld from state-shared taxes shall be paid to the political subdivision's pension plan (Tennessee Code Annotated § 9-3-507(a)).

9. Can a political subdivision make any changes to its plan or plans in order to meet its funding obligations?

- At a minimum, for political subdivision employees hired on or after the effective date of this act (May 22, 2014), the political subdivision may freeze, suspend or modify benefits, employee contributions, plan terms and design on a prospective basis (Tennessee Code Annotated § 9-3-506(a)). There may be specific provisions within a political subdivision's 's plan document that will allow changes to amend the political subdivision's pension plan terms and conditions for employees hired before May 22, 2014.
- For any pension plan that is funded below sixty percent (60%), the political subdivision shall not establish benefit enhancements unless approved by the State Treasurer.

10. Can a political subdivision utilize the services of the TCRS to assist in the asset management and operational management of its defined benefit plan?

- The political subdivision may, at its discretion, with the recommendation of the State Treasurer and approval of the TCRS Board of Trustees:
    - continue with the administration of its pension plan or plans, but have the pension plan assets co-invested with TCRS pension plan assets; or
    - have its plan or plans administered by the TCRS, and have the assets co-invested with TCRS pension plan assets.

- The current investment expense of the Treasury Department for TCRS pension funds is approximately ten basis points (.10%) of assets, and the cost to political subdivisions for pension administration is less than $35 per active member annually.

If a political subdivision is interested in more information about utilizing the TCRS as an administrator, please feel free to inquire with the Director of the Tennessee Consolidated Retirement System; 502 Deaderick Street, 15th Floor, Nashville, Tennessee 37243; (615) 741-7063; jill.bachus@tn.gov.

The State reserves the right to request additional information from a political subdivision, relative to its compliance with the provisions contained in Public Chapter 990.