<u>Guidance for Political Subdivisions that Do Not Participate in the Tennessee Consolidated Retirement System</u>

<u>The Public Employee Defined Benefit Financial Security Act of 2014</u>

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. This public chapter is codified in Tennessee Code Annotated, Title 9, Chapter 3, Part 5. The law establishes funding requirements for a political subdivision that is not a participating employer in TCRS and has established and maintained its own defined benefit pension plan. The TCRS currently includes over 600 political subdivisions as participating employers. There are approximately ninety (90) political subdivisions that do not participate in the TCRS and independently administer defined benefit pension plans. The 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. Several years ago, the law was changed to extend 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 law, the following serves as guidance to political subdivisions:

<u>1. What entities are subject to this law?</u>

- 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 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 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 mailing and email address for submission of the funding policy is:

  Sandi Thompson
  Tennessee Comptroller of theTreasury
  Division of State Government Finance
  Cordell Hull Building
  425 Rep. John Lewis Way N
  Nashville, Tennessee 37243
  Telephone: (615) 747-5380
  Fax: (615) 741-5986
  Email: sandi.thompson@cot.tn.gov

- 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.

3. <u>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.
- The actuary's determinations, including the ADC, shall be contained in a report submitted to the political subdivision and shall include a certification indicating the actuary's report has been prepared in accordance with all of the Actuarial Standards of Practice established by the Actuarial Standards Board as well as an explanation for any deviations. The actuary shall also certify in the report the overall appropriateness of the analysis in addition to the assumptions and results.
- The Office of the Comptroller of the Treasury and the State Treasurer's Office may review a political subdivision's funding policy, actuarial valuation report, and actual funding to ensure that its ADC is being calculated and funded in accordance with Public Chapter 990.

4. <u>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 September 24, 2021, the investment earnings assumption rate was lowered to 6.75%. Therefore, the current maximum earnings assumption is 7.25%. 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) 714-7063; TCRS.DirectorsOffice@tn.gov.

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

- 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 be effective for a fiscal year as early as practical.

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

- 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.

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

- In the event that a political subdivision does not pay at least one hundred percent

(100%) of the ADC to its pension plan or plans, the political subdivision shall pay the difference between funding equal to one hundred percent (100%) of its ADC and what was actually paid by the political subdivision by adding the difference to the one hundred percent (100%) payment of the political subdivision's ADC, which must be paid in the fiscal year subsequent to the underpaid ADC (Tennessee Code Annotated § 9-3-505(d)).

- In the event that a political subdivision fails to pay at least one hundred percent (100%) of its ADC in a given year and does not pay 100% of its underpaid ADC in the subsequent fiscal year then 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 from 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)).

8. <u>Can a political subdivision make any changes to its plan or plans in order to meet its funding obligations?</u>

- 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 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 political subdivisions with an existing pension plan as of May 22, 2014, the political subdivision shall not establish a new pension plan that changes the funding policy, increases the employer cost, or adds to the unfunded accrued liability of an existing pension plan until it has received written approval from the state treasurer.
    - For the purposes of this law, a political subdivision establishes a new pension plan by taking any or a combination of the following actions: a) Establishing a tier that has not been previously provided as part of a pension plan, b) Reopening a previously closed pension plan or previously closed tier of a pension plan; or c) establishing a plan that is different form the political subdivision's existing pension plan.
- 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.
    - For the purposes of this law, a "benefit enhancement" means any change in member benefits, benefit structure, or benefit formula provided by a political subdivision relative to its pension plan that, according to the political subdivision's

actuary, will or is estimated to permanently, temporarily, or intermittently increase either the employer or employee contributions or the liabilities of the pension plan.

9. 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 thirteen basis points (.13%) of assets. TCRS charges a one-time technology fee of $40,081.05 amortized over three years and a per covered member fee of $17.78 to political subdivisions requesting operational management of its defined benefit plan.

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; TCRS.DirectorsOffice@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.