

STATE OF TENNESSEE



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TO: All Political Subdivisions that Do Not Participate in the Tennessee Consolidated Retirement System

FROM: David H. Lillard, Jr., State Treasurer

DATE: January 30, 2015

SUBJECT: The Public Employee Defined Benefit Financial Security Act of 2014

The 108th General Assembly enacted the Public Employee Defined Benefit Financial Security Act of 2014 which was signed into law by Governor Bill Haslam on May 22, 2014. The new law requires any political subdivision that does not participate in the Tennessee Consolidated Retirement System (“TCRS”), but provides defined benefit pension plans to its employees, to ensure that its defined benefit pension plans are paying annually one hundred percent (100%) of their actuarially determined contributions (“ADC”), subject to a five (5)- year phase- in period. The purpose of the law is to ensure financial stability and financial soundness in a political subdivision’s pension plan or plans to provide pension benefits for future generations of employees. In an effort to assist political subdivisions in achieving compliance with the law, guidance has been developed providing an outline of a political subdivision’s obligations under the law.

One of the obligations is for a political subdivision to adopt a funding policy. A political subdivision may use the policy template developed by the Department of Treasury, or a political subdivision may use the funding policy adopted by the TCRS Board of Trustees on September 26, 2014 as a template for the development of its own policy. Should a political subdivision use the TCRS funding policy as a template, it should be noted that the TCRS funding policy was developed using a holistic approach in determining the most appropriate methodology used to establish the policy, given the size and complexity of the TCRS. The TCRS funding policy includes the four (4) steps that occur in the actuarial process that determine the funding requirements of the defined benefit plans under the TCRS, which are as follows: (1) procurement of actuarial services; (2) actuarial experience study; (3) actuarial valuation; and (4) actuarial audit. As a result of this approach, the TCRS funding policy includes more than is required in the new law. As a political subdivision begins to develop its own funding policies, it needs to determine which approach would be most appropriate. While the new law does not require that a political subdivision’s actuarial methodology and valuation be included in its funding policy, at a minimum, the following subsections of an actuarial valuation should, as a best practice, be addressed in the political subdivision’s funding policy: (1) valuation methodology and frequency; (2) funding the ADC; (3) asset smoothing method; (4) amortization methodology for actuarial gains and losses; (5) demographic data;

(6) benefit provisions; and (7) assumptions utilized. The detailed provisions that a political subdivision adopts in the above categories should comply with the methodology requirements contained in the law.

Political subdivisions shall develop their respective funding policies for fiscal years beginning after June 15, 2015, and shall submit their funding policies and any amendments thereto to the Tennessee Comptroller of the Treasury within thirty (30) days after adoption.

Attached to this memo please find: a copy of Chapter No. 990 of the Public Acts of 2014; Guidance for Political Subdivisions that Do Not Participate in the Tennessee Consolidated Retirement System - The Public Employee Defined Benefit Financial Security Act of 2014; the policy template developed by the Department of Treasury; and the TCRS Funding Policy. The TCRS Funding Policy may also be found online at: <http://treasury.tn.gov/tcrs/PDFs/FundingPolicy.pdf>

If a political subdivision has questions about the statutory requirements for a funding policy or related issues, please contact Jill Bachus, Director of the Tennessee Consolidated Retirement System, at (615) 741-7063 or jill.bachus@tn.gov. Thank you for your assistance in this matter.



State of Tennessee

PUBLIC CHAPTER NO. 990

SENATE BILL NO. 2079

By Norris, Kelsey, Bowling, Campfield, Crowe, Gardenhire, Henry, Tate

Substituted for: House Bill No. 2037

By McManus, Weaver, Lamberth, Evans, Rogers

AN ACT to amend Tennessee Code Annotated, Title 8, Chapter 37, Part 3 and Title 9, Chapter 3, relative to financial security for public defined benefit pension plans.

BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF TENNESSEE:

SECTION 1. Tennessee Code Annotated, Title 8, Chapter 37, Part 3, is amended by adding a new, appropriately designated section as follows:

8-37-310.

(a) The state treasurer shall develop and recommend to the board of trustees a funding policy with respect to the obligations of the Tennessee consolidated retirement system. The board of trustees shall adopt a funding policy which complies with the provisions of this section. Such adopted funding policy shall be in effect until amended.

(b) For the purposes of this section, "Actuarially determined contribution (ADC), formerly known as the actuarially required contribution" means the actuarially determined annual required contribution that incorporates both the normal cost of benefits and the amortization of the pension plan's unfunded accrued liability.

(c) The funding policy established by the board of trustees shall include, but not be limited to the following:

(1) The ADC for the retirement system shall include the normal costs and the amortization of the unfunded accrued liability, to the extent that the retirement system has any unfunded accrued liability for a particular fiscal year;

(2) The maximum amortization period for which any unfunded accrued liabilities will be paid; and

(3) A statement that the retirement system's budget shall include funding of at least one hundred percent (100%) of the ADC.

(d) The actuarial methodology is expected to provide that projected revenues (employer contributions, employee contributions, and investment earnings), and current assets will finance all of the projected benefits (death, disability, and retirement) provided by the retirement system. In the event the retirement system has an unfunded accrued liability, then the level dollar amortization method shall be utilized for financing the unfunded accrued liability.

(e) The ADC calculated by the retirement system's actuary shall be calculated utilizing the following methodology, and in accordance with the Actuarial Standards of Practice established by the Actuarial Standards Board:

(1) 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 costs of promised benefits, consistent with the objective of keeping contributions relatively stable and equitably allocating the costs over the employees' period of active service. Entry age normal cost method shall be used to achieve this purpose;

(2) 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. For the purposes of this subsection, the term "market corridor" means a range beyond which deviations are not smoothed;

(3) Level dollar amortization method of unfunded accrued liabilities;

(4) Mortality assumptions, which should consider the effect of expected mortality improvements, and shall be used no later than 2024;

(5) Investment earnings assumption based on the rate adopted by the board of trustees; and

(6) A closed amortization period not to exceed thirty (30) years for all unfunded accrued liabilities.

(f) In the event that an entity participating in the retirement system is funded below sixty percent (60%), such entity shall not establish benefit enhancements.

SECTION 2. Tennessee Code Annotated, Title 8, Chapter 37, Part 3, is amended by deleting sections 8-37-302, 8-37-303, 8-37-304, and 8-37-305 in their entirety.

SECTION 3. Tennessee Code Annotated, Title 9, Chapter 3, is amended by adding a new part thereto as follows:

9-3-501. This part shall be known and may be cited as "The Public Employee Defined Benefit Financial Security Act of 2014."

9-3-502. This act shall apply to political subdivisions that provide defined benefit plans not administered by the Tennessee consolidated retirement system.

9-3-503.

(a) As used in this part, unless the context otherwise requires:

(1) "Actuarially determined contribution (ADC), formerly known as the actuarially required contribution" means the actuarially determined annual required contribution that incorporates both the normal cost of benefits and the amortization of the pension plan's unfunded accrued liability.

(2) "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;

(3) "Political subdivision employee" means any person in the employ of a political subdivision who participates in the political subdivision's pension plan.

(4) "Pension plan" means the defined benefit pension plan established and maintained by a political subdivision for its employees, excluding a political subdivision's participation in the Tennessee consolidated retirement system pursuant to title 8, chapters 34 through 37. The term "pension plan" shall include all pension plans that are open or closed to membership, and shall also include the plural, referring to any and all pension plans provided by a political subdivision.

(5) "Unfunded accrued liability" means the actuarially determined accrued liabilities of the pension plan that are greater than the actuarially determined value of the pension plan assets.

9-3-504.

(a) Notwithstanding any provision of law, rule, ordinance, resolution, charter, pension plan, agreement or pension plan contract to the contrary, the applicable provisions of this part shall apply to any political subdivision in the state that has

established and maintains, directly or indirectly, a defined benefit pension plan for the benefits of its employees, irrespective of the manner in which the pension plan is administered.

(b) Each political subdivision shall develop a funding policy for financing the obligations under the pension plan. Such funding policy shall be legally adopted and approved through a resolution by the political subdivision's chief legislative body or governing body. The funding policy shall be in effect until amended. Each political subdivision shall develop a funding policy for fiscal years beginning after June 15, 2015. The funding policy and any amendment thereto shall be submitted to the comptroller of the treasury within thirty (30) days after adoption.

(c) The political subdivision's funding policy shall include, but not be limited to the following:

(1) The ADC for each pension plan shall include the normal costs and the amortization of the unfunded accrued liability, to the extent that any of the plans have any unfunded accrued liability for a particular fiscal year;

(2) The maximum amortization period for which any unfunded accrued liabilities will be paid; and

(3) A statement that the political subdivision's budget shall include funding of at least one hundred percent (100%) of the ADC, except as provided in § 9-3-505(b).

(d) The actuarial methodology is expected to provide that projected revenues (employer contributions, employee contributions, and investment earnings), and current assets will finance all of the projected benefits (death, disability, and retirement) provided by the plan. In the event that pension plan has an unfunded accrued liability, the level dollar amortization method shall be utilized beginning on or before June 15, 2020, for financing the unfunded accrued liability, and will continue to be utilized thereafter.

(e) The ADC calculated by the political subdivision's actuary shall be calculated utilizing the following methodology, and in accordance with the Actuarial Standards of Practice established by the Actuarial Standards Board:

(1) 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 costs of promised benefits, consistent with the objective of keeping contributions relatively stable and equitably allocating the costs over the employees' period of active service. Commencing with the plan fiscal year beginning after June 15, 2019, a generally accepted actuarial method that achieves the above objectives shall be used, except the projected unit credit method is not permitted;

(2) 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. For the purposes of this subsection, the term "market corridor" means a range beyond which deviations are not smoothed;

(3) No later than the plan fiscal year beginning after June 15, 2020, the level dollar amortization method of unfunded accrued liabilities;

(4) 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 will continue to be utilized thereafter;

(5) Investment earnings assumption that shall not be greater than fifty (50) basis points above the rate adopted by the Tennessee consolidated retirement system; and

(6) A closed amortization period not to exceed thirty (30) years for all unfunded accrued liabilities.

(f) The ADC for the political subdivision's pension plan shall be determined by an independent, qualified actuary.

(g) The actuary used by the political subdivision shall be a member of the American Academy of Actuaries.

(h) The actuary used by a political subdivision for the calculation of the ADC for its pension plan 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.

9-3-505.

(a) A political subdivision shall annually pay a payment to the pension plan of no less than one hundred percent (100%) of the ADC; however, it may make a payment of more than one hundred percent (100%) of the ADC.

(b) A political subdivision that is not paying at least one hundred percent (100%) of the ADC to its pension plan for the fiscal year that includes June 30, 2015, shall maintain effort in the percentage of the ADC paid and, in addition thereto, in each subsequent year, pay the cumulative annual funding progress percentage to increase the funding percentage of the ADC to the pension plan until payment of one hundred percent (100%) of the ADC occurs within a maximum of five (5) consecutive years after June 30, 2015. The annual funding progress percentage is, as a minimum, the percentage determined by dividing by five (5) the difference between the percentage of the ADC paid in the plan fiscal year preceding July 1, 2015, subtracted from one hundred percent (100%). When payment of one hundred percent (100%) of the ADC occurs, the political subdivision shall continue to pay one hundred percent (100%) of the ADC annually. The ADC shall be recalculated each year and the percentage of funding shall be based on the most recent recalculation of the ADC.

(c) If a political subdivision is unable to meet the annual funding progress percentage set out in subsection (b) above, the political subdivision may submit a plan of correction to the state treasurer for consideration. If the state treasurer determines the plan of correction is sufficient to comply with the requirements of subsection (b) above as soon as possible and to pay one hundred percent (100%) of the ADC to the pension plan by June 30, 2020, the state treasurer shall submit the plan of correction to the state funding board for approval. The plan of correction shall contain, at a minimum, the following: the reason for the political subdivision's inability to meet the annual funding progress percentage of subsection (b) above; the political subdivision's detailed plan to comply with the requirements of subsection (b) above as soon as possible and to pay one hundred percent (100%) of the ADC to the pension plan no later than June 30, 2020, including, but not limited to the amount(s) to be paid by a date certain or over a period of time; 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 information provided in the political subdivision's plan of corrective action, the political subdivision shall promptly furnish any additional documentation the state treasurer may request, including, but not limited to, financial data and actuarial reports.

9-3-506.

(a) The following provisions shall apply to all political subdivisions subject to this act:

(1) For political subdivision employees hired on or after the effective date of this act, the political subdivision may freeze, suspend or modify benefits, employee contributions, plan terms and design on a prospective basis. The provision in the foregoing sentence does not affect any judicial precedents or statutory law as they apply to employees who were employed prior to the effective date of this act; and

(2) For any pension plan that is funded below sixty percent (60%), the political subdivision shall not establish benefits enhancements unless approved by the state treasurer.

(b) The accrued benefits earned prior to any adjustment pursuant to subsection (a)(1) above shall remain an enforceable right and may not be reduced without the written consent of the political subdivision employee, unless the employee is subject to the forfeiture of the employee's retirement benefits in accordance with § 8-35-124.

(c) Notwithstanding any other provision of law, for political subdivision employees hired on or after the effective date of this act, nothing under state law confers to participants in the pension plan an implied right to future retirement benefit arrangements, and such participants may not assert the indefinite continuation of the retirement formulas, contribution rates, eligibility ages, or any other provision of the pension plan. The provision in the foregoing sentence does not affect any judicial precedents or statutory law as they apply to employees who were employed prior to the effective date of this act.

9-3-507.

(a) In the event the political subdivision shall fail to fund the ADC according to the percentages established in § 9-3-505, the commissioner of finance and administration, at the direction 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 such political subdivision. The money withheld from state-shared taxes shall be paid to the political subdivision's pension plan.

(b) The deduction shall be made as a first charge against any moneys payable to such political subdivision regardless of the source of such payment and regardless of the purpose or contemplated use of such funds.

(c) Regardless of a political subdivision's funding level of its ADC, a political subdivision may, with the recommendation of the state treasurer and the approval of the board of trustees of the Tennessee consolidated retirement system:

(1) Continue the administration of its pension plan, but have the pension plan funds co-invested with the pension plan assets for the Tennessee consolidated retirement system, but established in a separate fund from the Tennessee consolidated retirement system assets, and accounted for separately with accurate and detailed accounting records. The separate fund shall be operated in accordance with IRS Revenue Ruling 2011-1 or subsequent guidance regarding a group trust fund under Internal Revenue Code Section 401(a)(24). Before a political subdivision's pension plan assets are co-invested with Tennessee consolidated retirement system assets, the political subdivision shall provide the Department of Treasury with its plan document and a determination letter from the Internal Revenue Service that its plan assets are qualified assets or written advice from competent counsel of the Tennessee consolidated retirement system that the plan is a qualified plan. The political subdivision shall enter into an agreement with the retirement system for the co-investment of the political subdivision's pension plan assets, which shall include a charge assessed by the retirement system against the political subdivision for services related to the co-investment of assets; or

(2) Continue the pension plan, but have the plan administered by the Tennessee consolidated retirement system and have the assets co-invested with the Tennessee consolidated retirement system pension plan assets.

(A) The political subdivision shall enter into an agreement with the Tennessee consolidated retirement system to provide billing services, participant enrollment services, participant accounts, data processing, recordkeeping, investment and other related services that are necessary or appropriate to the administration of the political subdivision's pension plan. The agreement may provide that the services be provided directly by staff of the retirement system or through contracts with other providers.

(B) Any agreement entered into under this section shall require that the political subdivision remain the responsible administrator for the political subdivision's pension plan, and that neither the state of Tennessee nor the retirement system, or any of its officers, agents, employees, or boards shall act as a trustee or be considered the trustee for the political subdivision's pension plan.

(C) The chair of the retirement system shall assess a charge to the political subdivision for the administration of the political subdivision's pension plan and co-investment of its assets, in an amount to be determined by the chair, to meet the administrative

expenses of the retirement system in providing the administration and co-investment services under this section. It is the legislative intent that the state shall realize no increased cost as a result of the administration of the political subdivision's pension plan and co-investment of its assets, and that all costs associated with the administration of the pension plan, including administrative and co-investment costs, shall be the responsibility of the respective political subdivision. In the event that the political subdivision refuses or otherwise fails to satisfy this liability, such amounts shall become a lien on the property of the political subdivision and may be withheld from state-shared taxes which are otherwise apportioned to the political subdivision.

(D) As a condition of providing the services described in this section for the administration of a political subdivision's pension plan, and at any time thereafter, the chair of the retirement system may require that the political subdivision provide proof that the political subdivision's pension plan is a qualified plan and otherwise complies with the applicable provisions of the Internal Revenue Code, as amended. The chair of the retirement system may require an opinion of counsel or other assurance satisfactory to the chair that the provision of the services described in this section does not cause the retirement system, the state, or any of their agencies or employees to violate any federal or state laws or regulations.

(E) Political subdivisions shall take all actions that the retirement system, in its discretion, deems necessary for compliance by the retirement system with all applicable federal and state laws or for qualification of the retirement system for any exemptions from regulation available under those laws, including, but not limited to, the federal Securities Act of 1933, as amended, and the Investment Company Act of 1940, as amended.

(F) The political subdivision's plan shall be administered separately from the Tennessee consolidated retirement system, and shall be administered according to the political subdivision's pension plan documents.

(G) The political subdivision's plan assets shall be established in a separate fund from the Tennessee consolidated retirement system assets, and accounted for separately with accurate and detailed accounting records. The separate fund shall be operated in accordance with IRS Revenue Ruling 2011-1 or subsequent guidance regarding a group trust fund under Internal Revenue Code Section 401(a)(24). Before a political subdivision's pension plan assets are co-invested with Tennessee consolidated retirement system assets, the political subdivision shall provide the Department of Treasury with its plan document and a determination letter from the Internal Revenue Service that its plan assets are qualified assets.

(3) Notwithstanding any provision of the law to the contrary, through its administration of a political subdivision's pension plan, or the co-investment of the political subdivision's pension plan assets, as set forth in subdivisions (1) and (2) of this subsection, the Tennessee consolidated retirement system shall not be liable for the payment of any retirement allowances or other benefits on account for the political subdivision employees or their respective beneficiaries, for which reserves have not been previously created from funds contributed by the political subdivision or the political subdivision employees for such benefits.

SECTION 4. If any provision of this act or the application thereof to any person or circumstance is held invalid, such invalidity shall not affect other provisions or applications of the act which can be given effect without the invalid provision or application, and to that end the provisions of this act are declared to be severable.

SECTION 5. This act shall take effect immediately upon becoming a law, the public welfare requiring it.

SENATE BILL NO. 2079

PASSED: April 16, 2014

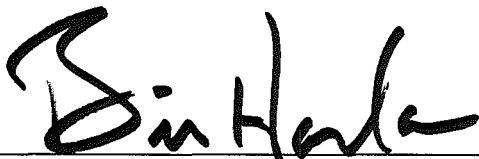


RON RAMSEY
SPEAKER OF THE SENATE



BETH HARWELL, SPEAKER
HOUSE OF REPRESENTATIVES

APPROVED this 22nd day of May 2014



BILL HASLAM, GOVERNOR

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.

3. Who should calculate the political subdivision’s ADC?

- 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.

4. What actuarial methodology should be used and included in the funding policy?

- 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.

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 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.

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.
- 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 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)).

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 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.

Funding Policy Template

Submit your policy and any amendments thereto to: 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; (615) 747-5380 (telephone); (615) 741-5986 (fax); sandi.thompson@cot.tn.gov. Electronic submission is preferred. We strongly suggest that your political subdivision utilize this policy template in order to develop the political subdivision's funding policy.

Should you have any questions about Chapter Number 990 of the Public Acts of 2014 (The Public Employee Defined Benefit Financial Security Act of 2014), please contact Jill Bachus, the Director of the Tennessee Consolidated Retirement System at 502 Deaderick Street, 15th Floor; Nashville, Tennessee 37243; (615) 741-7063 (telephone); jill.bachus@tn.gov. The (*name*) hereby adopts this document as the defined benefit plan funding policy for (*pension plan*). This document is prepared in accordance with Public Chapter 990, Acts of 2014.

Preamble (*recommended, but not required*)

The intent of this funding policy is to establish a formal methodology for financing the pension obligations accruing under the (*name*). The purpose of the methodology is to ensure that current assets plus future assets from employer contributions, employee contributions, and investment earnings will be sufficient to finance all defined benefit pension benefits provided by (*name*), including, but not limited to death, disability and retirement benefits. The funding policy is intended to reflect a reasonable and fiscally conservative approach with each generation of taxpayers financing, considering the cost of pension benefits being accrued. This funding policy recognizes that there will be investment market place volatility and that actual economic and demographic experience will differ from assumed experience. Accordingly, this funding policy is intended to provide flexibility to smooth such volatility and experience in a reasonable, systematic, and financially sound manner. Further, it is the intent that this funding policy comply with all applicable federal and state laws, rules, and regulations.

This funding policy is being adopted by the (chief legislative body/governing body) of (*name*) in accordance with Chapter Number 990 of the Public Acts of 2014, and also in fulfilling its fiduciary duty. Also, Chapter Number 990 of the Public Acts of 2014 requires the (*name*) to develop a funding policy. Moreover, adoption of a funding policy is recommended by the Government Finance Officers Association and the Governmental Accounting Standards Board.

Components of this Funding Policy (*required*)

1. The ADC for the pension plan, which shall include the normal costs and the amortization of any unfunded accrued liability;
2. The maximum amortization period; and
3. A statement indicating that the political subdivision shall include at least one hundred percent (100%) funding of the ARC within its budget.

Actuarial Services *(Not required for inclusion in the funding policy, but required by law)*

(Name) shall obtain the services of an independent, qualified actuary who shall determine *(Name's)* ADC for its defined benefit pension plan. The actuary shall be a member of the American Academy of Actuaries, shall not be a member of *(Name)* and shall not be otherwise eligible to participate in any of *(Name's)* pension plans.

(Recommended, but not required)

(Name) shall acquire the services of professional actuarial firms to perform an actuarial experience study, an actuarial valuation, an actuarial audit, and other necessary actuarial services. . The actuarial firm that performs the actuarial audit shall not be the same firm that performs the actuarial valuation and the actuarial experience study. The contractual agreement with an actuarial firm shall not exceed five (5) years. The actuarial firm shall be independent and shall act as an advisor on actuarial matters on behalf of *(Name)*.

In addition to being a member of the American Academy of Actuaries, the lead actuaries of actuarial firms shall have the requisite experience, capabilities, strengths, and qualifications including, but not limited to, the following: *(include, expand, or omit any of the following)*

1. Attainment of the Fellowship of the Society of Actuaries (FSA) designation,
2. Attainment of the Enrolled Actuary (EA) designation,
3. At least seven (7) years of actuarial experience in the defined benefit field,.

Actuarial Experience Study *(Recommended, except where noted as required)*

An actuarial experience study shall be conducted *(state time period and effective date)*. As determined necessary *(Name)*, assumptions may be evaluated on an interim basis.

Assumptions adopted by the *(Name)* should be established based on past experience and future expectations as the result of an extensive actuarial experience study.

Demographic assumptions to be established include, but are not limited to, the following: *(adapt as necessary)*

1. Turnover pattern
2. Pre-retirement mortality based on expected improvement in mortality
3. Pattern of retirement
4. Pattern of disability
5. Post-retirement mortality *(It should be noted when expected improvement in mortality will be used)* *(Required beginning on or before the plan fiscal year after 6-15-24)*

Economic assumptions to be established include, but are not limited to, the following: *(adapt as necessary)*

1. Investment earnings (net of investment expenses) *(Required: the investment earnings assumption cannot exceed the rate adopted by TCRS by more than 50 basis points)*
2. Salary
3. Retiree COLA

Economic assumptions shall include an underlying assumption for inflation.

(adapt as necessary) The actuarial experience study shall also generate administrative factors including, but not limited to, the following: (1) survivorship benefit option factors, (2) social security leveling option factors, (3) early retirement reduction factors, (4) age 65 actuarial equivalent factors, and (5) annuity factors. These factors shall be determined on a cost neutral basis.

Actuarial Valuation *(Not required for inclusion in the funding policy, but required by law)*

Valuation method and frequency. An actuarial valuation to determine the “Actuarially Determined Contribution (ADC)” rate to finance pension obligations shall be performed (annually) beginning as of (date). The valuation shall utilize the *(Example: entry-age normal actuarial method or another permitted method)*. The ADC shall include (1) the normal cost, (2) the unfunded liability cost, and (3) the cost of administration. The ADC shall be calculated and become applicable on *(as an example: July 1 that is 12 months –adapted to specific situation)* following the valuation date.

Funding the ADC. The ADC, as determined by an actuarial valuation, shall provide funding at a level of no less than 100%. With respect to the obligations of *(name)*, the budget shall include funding of at least 100% of the ADC. *(Adapt as necessary in compliance with the provisions in Public Chapter 990)*

Asset smoothing method. (Insert specific method adopted) (Example: An asset smoothing method shall be utilized to determine the actuarial value of assets. The difference between the amount actually earned and the earnings assumption for a particular year shall be amortized in level amounts. The asset smoothing period shall be a maximum of ten (10) years; however, for any smoothing period greater than five (5) years, there shall be a corridor so that the actuarial value of assets cannot be 20% more than nor 20% less than the market value of assets existing as of the actuarial valuation date.

Amortization methodology for actuarial gains and losses. Insert specific methodology but remember that level dollar amortization is required for the plan fiscal year after 6-15-20 and that the maximum amortization period is 30 years.

(Example: Unfunded liabilities shall be amortized utilizing the level dollar amortization method over a closed period not to exceed 20 years. A tier approach will be utilized with new actuarial gains and losses from each actuarial valuation. Each tier shall be amortized over a closed, maximum 20 year period. The amortization period may be shortened or extended from valuation to valuation but the gains and losses for a specific tier must be completely amortized within 20 years. Any extension of the amortization period for a specific tier cannot exceed the 20 year maximum less whatever time has elapsed from the beginning of the amortization period.

The unfunded liability based on the 2013 actuarial valuation shall be funded no later than 2033. In subsequent actuarial valuations, new tiers of actuarial gains and losses where actual experience differed from assumed experience, changes in demographic and economic assumptions are made, and changes in benefit provisions are enacted shall be amortized over a closed period not to exceed 20 years.)

Demographic data. The demographic data in an actuarial valuation shall include: (1) all active members, (2) all inactive vested members, (3) all inactive non-vested members with an account balance, and (4) all annuitants (including beneficiary annuitants and disability annuitants).

Benefit provisions. The actuarial valuation shall include all benefits being accrued by members of (name) including, but not limited to, retirement, disability, death benefits, and post-employment cost-of-living adjustments (COLAs). The valuation shall be based on the benefit eligibility and benefit terms as set out in state law.

Assumptions utilized. Demographic and economic assumptions as determined by an actuarial experience study and adopted by the (name) shall be utilized in the actuarial valuation.

Actuarial Audit *(Recommended, but not required)*

An actuarial audit by an independent actuarial audit firm shall be conducted at least once in a ten (10) year period. The purpose of the actuarial audit shall include, but not be limited to the following: (1) the validation and verification of actuarial valuation results for both funding and accounting; (2) an evaluation of the reasonableness of actuarial assumptions and methods; (3) compliance with professional standards such as generally accepted actuarial standards; and (4) compliance with state law and Board policy.

Transparency and Accountability *(Recommended, but not required)*

This funding policy, the actuarial experience study, the actuarial valuation, and the actuarial audit shall be readily available for review. Accordingly, the funding policy shall be posted on the agency's website. Further, the actuarial experience study, the actuarial valuation, and the actuarial audit shall be maintained on the departmental website for a period of no less than five years after being published.

Filing of Funding Policy *(Required)*

Pursuant to Public Chapter 990, Acts of 2014, this funding policy and any amendments thereafter shall be submitted to the comptroller of the treasury within thirty (30) days after adoption.

Effective Date *(Required)*

This policy shall remain in effect until amended by the (name) or preempted by federal or state law.

(Chair)

Date Adopted

Funding Policy of the Tennessee Consolidated Retirement System

The Board of Trustees of the Tennessee Consolidated Retirement System (TCRS) hereby adopts this document as the defined benefit plan funding policy that will be applicable to all participating employers.

Preamble

The intent of this funding policy is to establish a formal methodology for financing the pension obligations accruing under the TCRS. It is intended that current assets plus future assets from employer contributions, employee contributions, and investment earnings should be sufficient to finance all benefits provided by TCRS. The funding policy is intended to reflect a reasonable, conservative approach with each generation of taxpayers financing, to the greatest extent possible, the cost of pension benefits being accrued. This funding policy recognizes that there will be investment market place volatility and that actual economic and demographic experience will differ from assumed experience. Accordingly, this funding policy is intended to provide flexibility to smooth such volatility and experience in a reasonable, systematic, and financially sound manner. Further, it is the intent that this funding policy comply with all applicable laws, rules, and regulations of the State of Tennessee and the Federal Government.

This funding policy is being adopted by the Board both as a prudent action and as its fiduciary duty. Also, Chapter Number 990 of the Public Acts of 2014 requires the Treasurer to develop and recommend a funding policy for the Board. Moreover, adoption of a funding policy is recommended by the Government Finance Officers Association, the Governmental Accounting Standards Board, and the actuarial profession.

Components of this Funding Policy

1. Procurement of actuarial services
2. Actuarial experience study
3. Actuarial valuation
4. Actuarial audit

Procurement of Actuarial Services

TCRS shall acquire the services of professional actuarial firms to perform an actuarial experience study, an actuarial valuation, an actuarial audit, and other necessary actuarial services. Actuarial firms shall be selected by a competitive process. The actuarial firm that performs the actuarial audit shall not be the same firm that performs the actuarial valuation and the actuarial experience study. The contractual agreement with an actuarial firm shall not exceed five years. The actuarial firm shall be independent and shall act as an advisor on actuarial matters on behalf of TCRS.

The lead actuaries of actuarial firms shall have the requisite experience, capabilities, strengths, and qualifications including, but not limited to, the following:

1. Member of the American Academy of Actuaries,
2. Attainment of the Fellowship of the Society of Actuaries (FSA) designation,
3. Attainment of the Enrolled Actuary (EA) designation,
4. At least seven years of actuarial experience in the defined benefit field, and
5. Ineligible to participate in TCRS.

Actuarial Experience Study

An actuarial experience study shall be conducted at least every four years as of June 30. As determined necessary by the Board chair, assumptions may be evaluated on an interim basis.

Assumptions adopted by the Board should be established based on past experience and future expectations as the result of an extensive actuarial experience study.

Demographic assumptions to be established include, but are not limited to, the following:

1. Turnover pattern
2. Pre-retirement mortality based on expected improvement in mortality
3. Pattern of retirement
4. Pattern of disability
5. Post-retirement mortality with expected improvement in mortality to be phased in with the 2016 and 2020 studies, except that expected improvement shall apply immediately to the hybrid plan

Economic assumptions to be established include, but are not limited to, the following:

1. Investment earnings (net of investment expenses)
2. Salary
3. Retiree COLA
4. Social security wage base

Economic assumptions shall include an underlying assumption for inflation.

The actuarial experience study shall also generate administrative factors including, but not limited to, the following: (1) survivorship benefit option factors, (2) social security leveling option factors, (3) early retirement reduction factors, (4) age 65 actuarial equivalent factors, and (5) annuity factors. These factors shall be determined on a cost neutral basis.

Actuarial Valuation

Valuation method and frequency. An actuarial valuation to determine the “Actuarially Determined Contribution (ADC)” rate to finance pension obligations shall be performed annually beginning as of June 30, 2015. The valuation shall utilize the entry-age normal actuarial method. The ADC shall include (1) the normal cost, (2) the unfunded liability cost, and (3) the cost of administration for the operation of TCRS. The ADC shall be calculated and become applicable on July 1 that is 12 months following the valuation date.

Funding the ADC. The ADC, as determined by an actuarial valuation, shall provide funding at a level of no less than 100%. With respect to the obligations of TCRS, the retirement system’s budget shall include funding of at least 100% of the ADC. Tenn. Code Ann. §8-37-310(c)(3).

Tenn. Code Ann. §8-37-402 requires the general assembly to make appropriations sufficient to provide the amounts of normal contribution and accrued liability contribution to be required on account of state employees; this section further requires the general assembly to make appropriations sufficient to provide the amounts of normal contribution and accrued liability contribution to be required on account of teachers, which is to be included by the commissioner of education in the commissioner's estimate submitted to the general assembly of the funds necessary for the operation of the school system. Similarly, Tenn. Code Ann. §8-35-206 requires a participating political subdivision employer to pay the rate of contribution determined by the retirement system's actuary.

Asset smoothing method. An asset smoothing method shall be utilized to determine the actuarial value of assets. The difference between the amount actually earned and the earnings assumption for a particular year shall be amortized in level amounts. The asset smoothing period shall be ten years. However, there shall be a corridor so that the actuarial value of assets cannot be 20% more than nor 20% less than the market value of assets existing as of the actuarial valuation date.

Amortization methodology for actuarial gains and losses. Unfunded liabilities shall be amortized utilizing the level dollar amortization method over a closed period not to exceed 20 years. A tier approach will be utilized with new actuarial gains and losses from each actuarial valuation. Each tier shall be amortized over a closed, maximum 20 year period. The amortization period may be shortened or extended from valuation to valuation but the gains and losses for a specific tier must be completely amortized within 20 years. Any extension of the amortization period for a specific tier cannot exceed the 20 year maximum less whatever time has elapsed from the beginning of the amortization period.

The unfunded liability based on the 2013 actuarial valuation shall be funded no later than 2033. In subsequent actuarial valuations, new tiers of actuarial gains and losses where actual experience differed from assumed experience, changes in demographic and economic assumptions are made, and changes in benefit provisions are enacted shall be amortized over a closed period not to exceed 20 years.

A participating employer may request an amortization period of more than 20 years but less than 30 years. The participating employer must provide the justification for extending the amortization period. Extending the amortization period to provide benefit enhancements is not an acceptable justification. The Board delegates to the Director of TCRS the authority to approve amortization periods of more than 20 years but less than 30 years. On an annual basis, the Director of TCRS shall report to the Board those entities with amortization periods of more than 20 years.

Demographic data. The demographic data in an actuarial valuation shall include: (1) all active members, (2) all inactive vested members, (3) all inactive non-vested members with an account balance, and (4) all annuitants (including beneficiary annuitants and disability annuitants).

Benefit provisions. The actuarial valuation shall include all benefits being accrued by members of TCRS including, but not limited to, retirement, disability, death benefits, and post-employment cost-of-living adjustments (COLAs). The valuation shall be based on the benefit eligibility and benefit terms as set out in state law.

Assumptions utilized. Demographic and economic assumptions as determined by an actuarial experience study and adopted by the Board shall be utilized in the actuarial valuation.

Employer groups. Separate actuarial valuations shall be prepared for the following groups and subgroups:

1. State and higher education employees hired before July 1, 2014
 - a. General employees
 - b. Public safety bridge benefits
 - c. State judges
2. State and higher education employees hired after June 30, 2014
 - a. General employees
 - b. Public safety bridge benefits
 - c. State judges and others
3. K-12 teachers hired before July 1, 2014
4. K-12 teachers hired after June 30, 2014
5. Each participating political subdivision by plan (legacy and hybrid)

Actuarial Audit

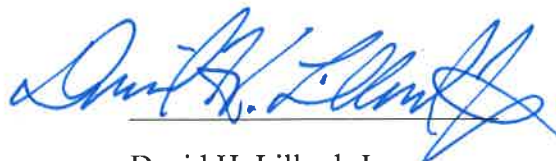
An actuarial audit by an independent actuarial audit firm shall be conducted at least once in a ten year period. The purpose of the actuarial audit shall be: (1) the validation and verification of actuarial valuation results for both funding and accounting; (2) an evaluation of the reasonableness of actuarial assumptions and methods; (3) compliance with professional standards such as generally accepted actuarial standards; and (4) compliance with state law and Board policy.

Transparency and Accountability

This funding policy, the actuarial experience study, the actuarial valuation, and the actuarial audit shall be readily available for review. Accordingly, the funding policy shall be posted on the departmental website. Further, the actuarial experience study, the actuarial valuation, and the actuarial audit shall be maintained on the departmental website for a period of no less than five years after being published.

Effective Date

This policy shall remain in effect until amended by the Board of Trustees or preempted by state law.



David H. Lillard, Jr.
Tennessee State Treasurer and
Chair of the TCRS Board

September 26, 2014

Date Adopted