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