

RESOLUTION 2014-74

**A RESOLUTION OF THE BOARD OF MAYOR AND  
ALDERMEN TO ADOPT A FUNDING POLICY FOR THE  
EMPLOYEE'S PENSION PLAN**

**WHEREAS**, the City of Franklin, by action of the Board of Mayor and Aldermen, adopted an Employees Pension Plan, and

**WHEREAS**, on May 22, 2014, the General Assembly of the State of Tennessee adopted Chapter 990, requiring each municipality with a pension plan independent of the Tennessee Consolidated Retirement System to prepare and adopt a formal pension funding policy, and

**WHEREAS**, the Board of Mayor and Aldermen wish to conform to the laws of the State by adopting a formal policy that will guide and stabilize future annual contributions, and

**WHEREAS**, the Board of Mayor and Aldermen wishes to be an early adopter of such a policy, in advance of the July 1, 2015 deadline.

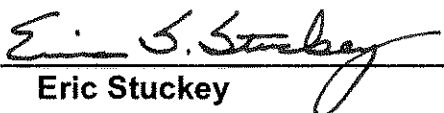
**NOW, THEREFORE, BE IT RESOLVED**, by the Board of Mayor and Aldermen for the City of Franklin as follows:

**Section 1.** That the Pension Funding Policy is hereby adopted.


**Section 2.** That the Resolution shall be effective upon adoption.

**IT IS SO RESOLVED AND DONE** on this 28<sup>th</sup> day of October, 2014.

ATTEST:

By:   
Eric Stuckey  
City Administrator

CITY OF FRANKLIN, TENNESSEE

by:   
Ken Moore, M.D.  
Mayor

**DATE:** October 1, 2014  
**TO:** Board of Mayor and Aldermen  
**FROM:** Eric Stuckey, City Administrator

**SUBJECT:**

Consideration of Resolution 2014-74 to adopt a Pension Funding Policy

**Purpose**

The purpose of this memorandum is to provide information to the Franklin Board of Mayor and Aldermen (BOMA) concerning the adoption of a Pension Fund Policy

**Background**

With the advent of Government Accounting Standards Board (GASB) statements 67 and 68, the historical precedent of pension funding has been altered. In the past, an actuarially determined contribution was considered a reliable amount for cities to pay for pension liabilities incurred in a given fiscal year. That amount was a "safe harbor" for cities in satisfying their obligations to the pension plan and for pension analysis by outside entities, such as the rating agencies and the IRS.

The new accounting standards separated the funding of pension plans from the accounting and financial reporting of the plans. Because the level of funding became uncertain, and because the Government Finance Officers Association and GASB made only recommendations and not requirements for annual funding, states like Tennessee have created legislation to define parameters and guidelines for what pension funding should be. In Tennessee, Chapter 990 of the recent legislative session articulates those requirements.

In response to the new law, staff has prepared a Pension Funding Policy statement that addresses the issues highlighted in Chapter 990. The proposed policy has been reviewed and recommended to BOMA by Employee Pension Committee.

**Financial Impact**

The City of Franklin has made regular contributions that match or exceed the amount calculated by an independent actuarial firm. For that reason, there will not be a significant financial impact resulting from the policy. Annual contributions will continue to vary, as before, depending on the investment results and the demographics of the City's workforce.

**Recommendation**

Staff recommends adoption of the Resolution.

## **Funding Policy of the City of Franklin Employees' Pension Plan**

The Board of Mayor & Aldermen, as Trustees of the City of Franklin Employees' Pension Plan, hereby adopts this document for its defined benefit plan funding policy.

### **Preamble**

The intent of this funding policy is to establish a formal methodology for financing the pension obligations accruing under the City of Franklin Employees' Pension Plan. 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 City of Franklin Employees' Pension Plan. 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 that this funding policy comply with all applicable laws, rules, and regulations of the State of Tennessee and the Federal Government.

### **Components of this Funding Policy**

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

### **Procurement of Actuarial Services**

City of Franklin Employees' Pension Plan 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 a fiduciary on behalf of City of Franklin Employees' Pension Plan.

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 City of Franklin Employees' Pension Plan

## **Actuarial Experience Study**

An actuarial experience study shall be conducted at least every four years. As determined necessary by the chair of the Investment Committee, 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. Post-retirement mortality with expected improvement in mortality to be phased in with future studies

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

1. Investment earnings (net of investment expenses)
2. Salary
3. Retiree Market Price Adjustment (Adjustment for change in purchasing power)
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) full retirement age actuarial equivalent factors, and (5) annuity factors. These factors shall be determined on a cost neutral basis.

## **Actuarial Valuation**

*Valuation method, frequency, and ADC.* An actuarial valuation to determine the Actuarially Determined Contribution (ADC) rate to finance pension obligations shall be performed annually beginning as of January 1, 2015. The valuation shall utilize the entry-age normal actuarial method. The valuation shall provide funding of at least 100% of the ADC. The ADC shall include (1) the normal cost, (2) the unfunded liability cost, and (3) the cost of administration for the operation of City of Franklin Employees' Pension Plan. The ADC shall be calculated and become applicable on first day of July that is six months following the valuation date.

*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 five years, for fiscal years beginning after June 30, 2014. For fiscal years prior to July 1, 2014, no smoothing period shall be used. 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 tiered 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 2015 actuarial valuation shall be funded no later than 2035. In subsequent actuarial valuations, new tiers of actuarial gains and losses shall be amortized over a closed period not to exceed 20 years.

Actuarial gains and losses may result from (1) actual experience versus assumed experience, (2) changes in demographic and economic assumptions, and (3) changes in benefit provisions.

*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).

*Benefit provisions.* The actuarial valuation shall include all benefits being accrued by members of City of Franklin Employees' Pension Plan including, but not limited to, retirement, disability, death benefits, and post-employment market-price adjustments. 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, recommended by the Investment Committee, and adopted by the Board shall be utilized in the actuarial valuation.

### **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 City website. Further, the actuarial experience study, the actuarial valuation, and the actuarial audit shall be maintained on the City website for a period of no less than five years after being published.

### **Effective Date**

This policy be effective upon its adoption by the Board of Mayor & Aldermen, and shall remain in effect until amended by the Board or preempted by state law.

Chapter 990

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-SOS(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.





## BEST PRACTICE

### Core Elements of a Pension Funding Policy (CORBA) (2013)

**Background.** The Government Finance Officers Association (GFOA) has recommended that every state and local government that offers defined benefit pensions formally adopt a funding policy that provides reasonable assurance that the cost of those benefits will be funded in an equitable and sustainable manner.<sup>1</sup> To provide the desired degree of assurance, a pension funding policy would need to incorporate the following principles and objectives:

1. Every government employer that offers defined benefit pensions should obtain no less than biennially an actuarially determined contribution (ADC) to serve as the basis for its contributions;
2. The ADC should be calculated in a manner that fully funds the long-term costs of promised benefits, while balancing the goals of 1) keeping contributions relatively stable and 2) equitably allocating the costs over the employees' period of active service;
3. Every government employer that offers defined benefit pensions should make a commitment to fund the full amount of the ADC each period. (For some government employers, a reasonable transition period will be necessary before this objective can be accomplished);
4. Every government employer that offers defined benefit pensions should demonstrate accountability and transparency by communicating all of the information necessary for assessing the government's progress toward meeting its pension funding objectives.

These principles and objectives necessarily will affect decisions related to the treatment of three core elements of a comprehensive pension funding policy:

- *Actuarial cost method* - the technique used to allocate the total present value of future benefits over an employee's working career (*normal cost/service cost*).
- *Asset smoothing method* - the technique used to recognize gains or losses in pension assets over some period of time so as to reduce the effects of market volatility and stabilize contributions.
- *Amortization policy* - The length of time and the structure selected for increasing or decreasing contributions to systematically eliminate any unfunded actuarial accrued liability or surplus.

**Recommendations.** To ensure consistency with the principles and objectives described above, the GFOA recommends that a pension funding policy treat each of its core elements as follows:

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<sup>1</sup> "Guidelines for Funding Defined Benefit Pensions" (2013) (CORBA).

**Actuarial cost method.** The actuarial cost method selected for funding purposes should conform to actuarial standards of practice and allocate normal costs over a period beginning no earlier than the date of employment and should not exceed the last assumed retirement age. Moreover, the selected actuarial cost method should be 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.<sup>2</sup> While not the only method that would satisfy this criterion, the entry age method—level percentage of pay normal cost—is especially well suited to achieving this purpose.

**Asset smoothing.** The method used for asset smoothing should:

- Be unbiased relative to market. Thus, for example:
  - The same smoothing period should be used for both gains and losses, and
  - Market corridors (a range beyond which deviations are *not* smoothed), if used, should be symmetrical<sup>3</sup>, and
- Provide for smoothing to occur over fixed periods (the use of rolling periods normally should be avoided), ideally of five years or less, but never longer than ten years.
  - Provide for a market corridor if smoothing is to occur over a period longer than five years.

**Amortization.** Amortization of the unfunded actuarial accrued liability<sup>4</sup> should:

- Use fixed (closed) periods that
  - Are selected so as to balance the twin goals of demographic matching (equitable allocation of cost among generations) and volatility management (funding at a level percentage of payroll) and
  - Never exceed 25 years, but ideally fall in the 15-20 year range;
- Use a layered approach for the various components to be amortized (that is, an approach that separately tracks the different components to be amortized); and emerge as a level percentage of member compensation or as a level dollar amount.

**Additional considerations for plans closed to new entrants.** When a plan is closed to new participants, the aggregate actuarial cost method – level percentage of pay normal cost – is especially well suited for funding.

For closed plans with no remaining active members:

- Special attention needs to be given to the mix of investments (given the shorter time horizon); and
- In comparison to open plans:

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<sup>2</sup> Employers using some other actuarial cost method should carefully monitor demographic changes and trends in the covered workforce inasmuch as such changes could result in increased employer contributions as a percentage of payroll.

<sup>3</sup> Generally, the appropriate corridor will depend upon the length of the smoothing period, with longer smoothing periods requiring narrower corridors.

<sup>4</sup> Special considerations may apply to the amortization of a surplus (e.g., use of a longer amortization period).

- Asset smoothing periods should be shorter (typically no longer than three years);
  - Corridors, if used, should be narrower; and
- Amortization periods should be shorter (typically no longer than 10 years for gains and losses).

For closed plans that still have active members:

- The continued use of level percent of member compensation amortization remains appropriate, but *not* for a long period (i.e., as the number of active members decreases); and
- In comparison to open plans:
  - Asset smoothing periods should be shorter;
    - For asset smoothing periods that exceed five years, a corridor (not to exceed 20 percent) should be used; and
  - Amortization periods should be shorter.

### **References.**

- California Actuarial Advisory Panel, *Actuarial Funding Policies and Practices for Public Pension and OPEB Plans*, February 2013 at:  
[http://www.sco.ca.gov/Files-ARD/BudLeg/CAAP\\_Funding\\_Policies\\_w\\_letter.pdf](http://www.sco.ca.gov/Files-ARD/BudLeg/CAAP_Funding_Policies_w_letter.pdf)