



**Funding, Investments, and Legislative Seminar**

# **Understanding Your TMRS Plan's Cost and Contribution Rate**

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# What Does the City's Plan Cost?

$$\textit{Contributions} + \textit{Income} = \textit{Benefits} + \textit{Expenses}$$

- ◆ Only after the last benefit payment has been made is the actual cost of a participant's benefit known. Until then, we have to use the best tools we have to estimate this cost and use the actuarial tools at our disposal to fund these benefits

# **What Contribution Rate is Required to Fund the Cost?**

- ◆ Each plan is actuarially valued each year
- ◆ Actuarial valuation looks at changes in both assets and liabilities compared to the actuarial assumptions made
- ◆ The old actuarial funding method, Unit Credit, did not project future potential liability associated with increasing salaries or benefit enhancements such as Updated Service Credit (USC) and Annuity Increases (COLAs)
- ◆ Unit Credit only valued the liability that had accrued as of the study date

# **The Question That Constantly Lingered Was: What Will My Rate Be Next Year?**

- ◆ The Board of Trustees elected to change the actuarial funding method to Projected Unit Credit (PUC)
  - ◇ Change made in conjunction with actuarial assumption changes based on actuarial experience investigation
  - ◇ Recommended by the System's actuary
  - ◇ Reviewed by second independent actuarial firm
- ◆ PUC takes the next step by estimating the total benefit at retirement, including expected future salary increases and benefit enhancements (USC and COLAs, if any), and discounts that cost back on a present value basis so that the city can begin pre-funding these future potential liabilities
- ◆ Contribution rate should be more stable from year-to-year, and funded percentage should improve over time

# **What Impacts My Contribution Rate?**

# Actuarial Funding Method

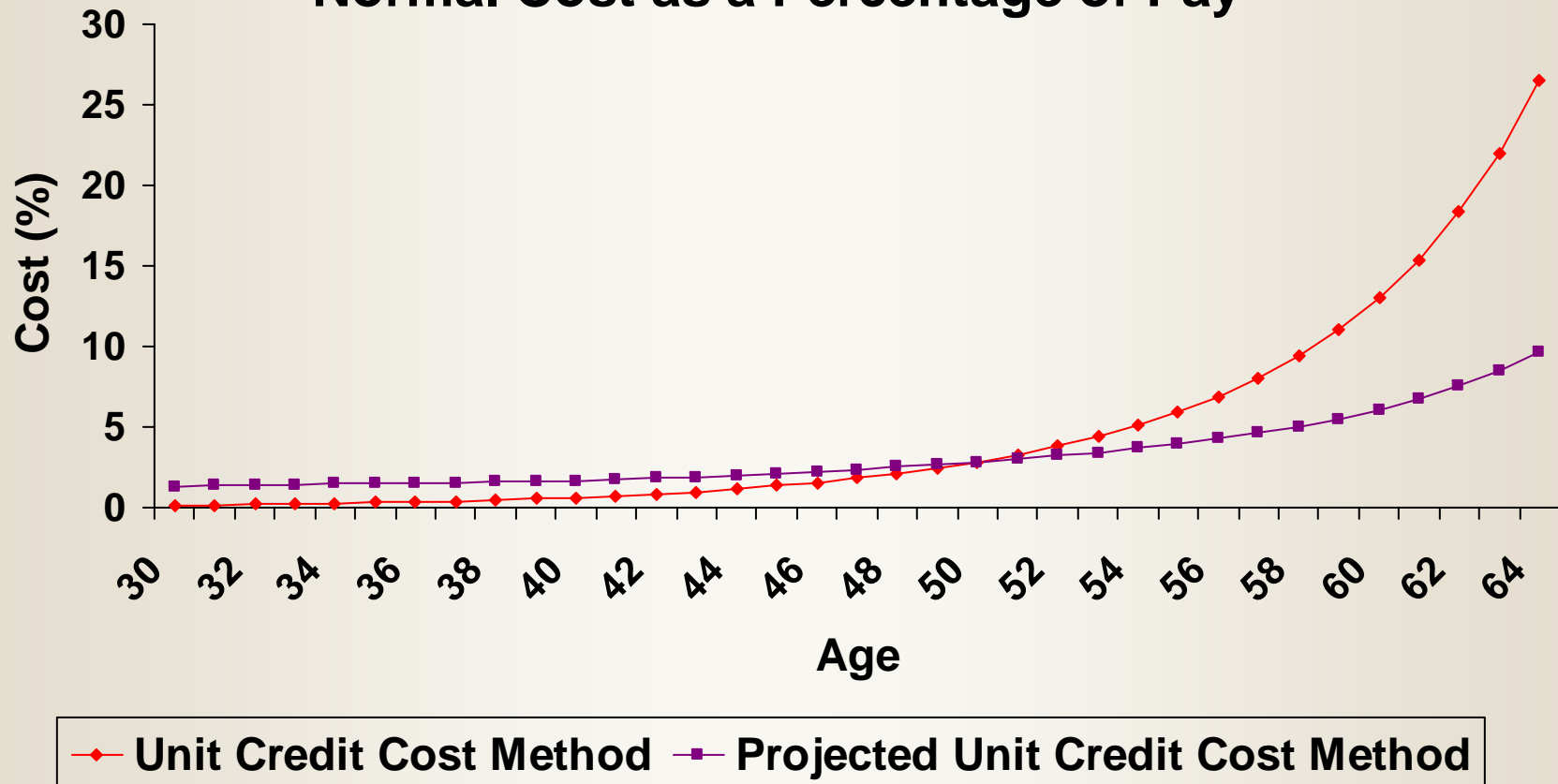
- ◆ Please remember that the actual cost of your plan is the same under any of the actuarial funding methods
  - ◇ The cost is still based on the reserves that an employee accumulates during their career, the City's promised matching amount, and any other monetary credits granted by the City during the employee's career
- ◆ It is the **allocation** of this cost between the current, past and future valuation years of service that distinguishes one funding method from another
- ◆ The difference in the actuarial funding method is how this cost will be divided up and funded into the future
  - ◇ The funding method does not change the cost of the plan, per se; it simply changes the funding schedule for the plan

# Actuarial Funding Method (cont.)

- ◆ Projected Unit Credit (PUC)
  - ◇ Does forecast the future salary increases and the potential liability associated with annually repeating benefits
  - ◇ Where you used to be able to point to the Prior Service portion of the contribution rate and say that is the portion of the rate that is amortizing the cost of your USC and Annuity Increase adoptions, you can no longer do that since part of the cost of these benefits is now in both the Normal Cost and the Prior Service rates.

# Actuarial Funding Method (cont.)

## Normal Cost as a Percentage of Pay



# Actuarial Assumptions (Just to Touch on a Few...)

## ◆ Salary Increase Assumption

- ◇ On an individual level, greater than expected assumption increases the rate (actuarial loss), and less than expected assumption reduces the rate (actuarial gain)

## ◆ Turnover

- ◇ This is a new actuarial assumption that had to be added with the change to Projected Unit Credit.
- ◇ Since we are projecting benefits that will become payable in the future, the actuary must estimate how many employees are likely to become vested, terminate their employment but leave their funds in TMRS, and ultimately draw a retirement benefit.

# Actuarial Assumptions (cont.)

## ◆ Withdrawal

- ◇ This is the estimate of how many members will ultimately take a refund and no longer be a liability on the City's plan
- ◇ Withdrawal greater than expected is an actuarial gain resulting in a decrease in the contribution rate; conversely, less than expected is an actuarial loss resulting in an increase in the contribution rate

## ◆ Investment Return

- ◇ Interest credited to the city's account that is less than expected causes a rate increase (actuarial loss), while interest credited to the city's account that is greater than expected reduces the city's rate (actuarial gain)

- ◆ The remainder of the laundry list: rate of retirement, rate of active death, average age, average length of service, etc.

# Plan Benefits Adopted

- ◆ **Updated Service Credit** — this provision can impact a city's rate based on many varied scenarios
  - ◇ **Basic USC impact:** If employees have large changes in their salary (promotions, big pay increases, etc.), or the city makes changes in the plan of benefits (deposit rate or matching ratio) they will potentially receive a new updated service credit that will add additional liability to the city's plan cost
  - ◇ **Single, large monthly deposits:** Examples of this type of deposit include drag-down pay at termination, severance pay, etc. In the past, these types of payments could increase the average salary disproportionate to an employee's actual average salary, resulting in a windfall to the employee, while adding additional liability to a city's plan that was not anticipated by the city. Since the formula used to calculate the Average Updated Service Credit Salary now removes the highest month and the lowest month and averages the remaining 34 months, single, large monthly deposits to TMRS should no longer have significant impact on a member's USC calculation.

# Plan Benefits Adopted

## ◆ Updated Service Credit (cont.)

- ◇ **Transfer Updated Service Credit:** If you are a 7%, 2:1 city and your city hires someone who previously worked for a 5%, 1:1 city, once that employee has been with your city for four calendar years, they are eligible for USC, and the new USC will be based on the combined years of service from both cities and the matching ratio, deposit rate and their three-year average salary (probably larger than with the former city) with your city;
- ◇ Because you grant Transfer USC, your USC cost will be greater because you will be bringing all that old credit up to current levels.

# Plan Benefits Adopted

## ◆ Buy-Back

- ◇ Allows an employee who has previously withdrawn their deposits and interest to reestablish that credit in TMRS
- ◇ The adopting city is agreeing to match those funds (offset somewhat by the withdrawal fee) as if the service was performed in that city
- ◇ The adopting city may also incur additional cost due to future USC, especially if the originally withdrawn credit was at a much smaller salary than the employee currently earns

## ◆ Restricted Prior Service Credit

- ◇ This credit has no monetary value and is not used in the calculation of Updated Service Credit
- ◇ Granting this credit does potentially shorten the period of time the adopting city has to fund the smaller benefit that becomes due sooner
- ◇ The net result here is typically a small increase (if any) in the contribution rate

# Amortization Method and Period

- ◆ The Board of Trustees did elect to change the amortization method from “Open” or “Rolling” to a “Closed” method
- ◆ But remember that we are using a layered amortization approach; therefore, differences in your city’s actual versus expected UAAL (actuarial gains or losses) have their own closed 30-year period
- ◆ At the end of the period one piece of the city’s liability will be fully amortized and will roll off
- ◆ In 25 or 30 years, when the initial (large) UAAL is fully amortized, the city will still have a UAAL, but the funded percentage should be much higher, the ratio of UAAL to payroll much lower, and the contribution rate closer to just the normal cost
- ◆ Cities that experienced an increase in their 2009 contribution rate of 0.5% or more due to the change in actuarial funding method and/or actuarial assumption changes were allowed a 30-year amortization period, compared to the previous 25-year period

# Using the “Phase-in” Period

- ◆ If your city elected to use the phase-in period, since you are not fully funding the “actuarial cost” of the plan during the first seven years, your city will experience an actuarial loss each year. This loss will be reported by the city in its financial statements as a net pension obligation
- ◆ The faster you can get to the “full rate,” the less impact these actuarial losses will have on future contribution rates
- ◆ The City’s contribution rate will still change from year-to-year based on the results of the actuarial valuation
- ◆ But the changes TMRS has made should ultimately result in a more level contribution rate from year-to-year, and a contribution rate that more accurately reflects the ultimate cost of the benefits adopted by the city

# **Intergenerational Equity and Rate Stabilization**

- ◆ These are the primary goals of advance funding the benefits adopted by the city.
- ◆ The city is currently paying the cost of the active employees and the COLAs for past employees.
- ◆ Once this 30-year period is over, we will be to a point where the cost is back to just funding the benefits for the current generation of employees.
- ◆ The goal of all projected actuarial funding methods is to accumulate, over each active participant's working lifetime, sufficient assets at retirement to pay for all future benefits, including COLAs.

# Questions & Answers

