

## **Important Considerations Regarding Financing Retirement Obligations Tennessee Consolidated Retirement System**

The Tennessee Consolidated Retirement System (TCRS) finished the 2021 fiscal year with a historic 25.6% investment return, the fourth highest annual percentage return TCRS has experienced since its consolidation in 1972. The record-high annual earnings represent over \$13.6 billion in new investment income added to the portfolio in a single year. Each of the employers participating in TCRS received their share of the earnings based on their average asset balance for the year.

TCRS continues to be recognized as one of the strongest funded pensions plans in the nation; however, this achievement remains dependent on prudent financial management by all stakeholders. This includes periodically reviewing the economic and demographic assumptions used to determine the financial health of the plan and the actuarially determined contributions (ADC) required to fund it.

### **New Actuarial Assumptions**

As communicated in March 2021, an experience study was slated to be performed for the four-year period ending June 30, 2020. This experience study and recommended changes to the actuarial assumptions used by the plan were considered by the TCRS Board of Trustees at its September 24, 2021 meeting. The study resulted in the Board approving a reduction to the investment return assumption from 7.25% to 6.75% and various changes to demographic related assumptions. These new assumptions were implemented with the June 30, 2021 actuarial valuation which determined ADC rates effective July 1, 2022.

The investment return assumption has a major impact on a plan's finances and actuarial funding level. Our goal is to set a rate that is reasonable and results in each generation funding the cost of pension benefits being accrued. Most employers can expect increases to their ADC rates as a result of this 0.50% reduction to the investment return assumption; however, its impact will be offset by the portion of the FY21 record setting investment earnings recognized in the actuarial valuation. Pursuant to the TCRS Funding Policy, investment gains and losses are smoothed over a 10-year period.

While the investment return assumption is the most consequential, the experience study also analyzed demographic assumptions including mortality, payroll growth, salary, retirement, and termination behavior. Ultimately, the Board of Trustees voted to adopt generational mortality which has the second most significant impact on ADC rates, after the investment return

assumption. An overview of the experience study and assumption changes can be found at <https://treasury.tn.gov/Portals/0/Documents/Retirement/Actuarial/ExperienceStudy2020Presentation.pdf>.

### **Changes to Administrative Fee Methodology**

In addition to normal costs and the costs associated with any unfunded liability, the ADC includes a component for funding TCRS administrative and operational costs. TCRS has historically based the collection of these costs on the active members of each participating employer. Effective July 1, 2022, TCRS will collect the administrative and operational costs based on the total number of active and retired members for each participating employer. While the overall affect to ADC rates will be minimal, this change will lead to a more equitable distribution of administrative costs over time.

### **Funding Considerations**

We understand that even small changes to an employer’s budget can shift fiscal priorities. Any ability to pay above the recommended ADC should be considered as an action that can help mitigate the risk of increasing employer contributions in future years due to changes in actuarial assumptions and interest rate volatility. Moreover, you can reduce any net pension liability that will be reflected as debt in your financial statements.

Should you need further assistance in evaluating your employer contribution rate or wish to discuss alternative plan provisions, please reach out to your regional Treasury Outreach Representative.

### **Treasury Outreach**

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