TCDRS Funding Policy

Effective as of the Dec. 31, 2023 Valuation

**Approved by the TCDRS Board of Trustees
on December 7, 2023**

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Texas County & District Retirement System Funding Policy

Effective as of the Dec. 31, 2023 valuation

Introduction

The funding policy governs how the Texas County & District Retirement System (TCDRS) determines the employer contributions required to ensure that benefits provided to TCDRS members are funded in a reasonable and equitable manner. The goals of TCDRS' funding policy are to fully fund benefits over the course of employees' careers to achieve intergenerational equity, and to balance contribution rate and benefit stability with the need for the plan funding to reflect current plan conditions.

This policy documents the current funding policies in effect as of the Dec. 31, 2023, actuarial valuation as established by state law, administrative rule and action by the TCDRS Board of Trustees (the board). The policy serves as a funding overview and complies with the GASB reporting requirements for an agent multiple-employer plan.

TCDRS funding overview

TCDRS is a model for responsible, disciplined funding. TCDRS does not receive any state funding. As an agent, multiple-employer plan, each participating employer in the system funds its plan independently. A combination of three elements funds each employer's plan: employee deposits, employer contributions and investment income.

- Employees deposit 4%, 5%, 6% or 7% of compensation, as adopted by the employer's governing body.
- Participating employers are required to contribute at actuarially determined rates to ensure adequate funding for each employer's plan. Employer contribution rates are determined annually and approved by the TCDRS Board of Trustees.
- Employee deposits and employer contributions are pooled and invested. Investment earnings fund a large majority of the benefits.

Pursuant to state law, TCDRS-participating employers must pay 100% of their actuarially determined required contributions each year.

An employer can make additional contributions exceeding its annual required contribution rate either by adopting an elected rate that is higher than the required rate or by making additional contributions on an ad hoc basis. Employers may choose to make additional contributions to pay down their liabilities faster, pre-fund benefit enhancements and/or buffer against future adverse experience.

In addition, employers annually review their plans and may adjust benefits and costs based on their local needs and budgets. Although accrued benefits may not be reduced, employers may reduce future benefit accruals and immediately reduce costs.

Methodology for determining employer contribution rates

The board hires independent outside consulting actuaries to conduct an annual valuation to measure the funding status and to determine the required employer contribution rate for each employer plan. To calculate the employer contribution rate, the actuary does the following:

- Studies each employer's adopted plan of benefits and the profile of its plan participants and uses assumptions established by the board to estimate future benefit payments.
- Discounts the estimate of future benefit payments to the present based on the assumed long-term rate of investment return to determine the present value of future benefits.
- Compares the present value of future benefits with the plan's assets to determine the difference that needs to be funded based on the funding policy.

The valuation of each employer plan is based on the system's funding policy, assets, benefits and participant profile of each participating employer plan. The four key components in the determination of employer contribution rates are the actuarial cost method, amortization policy, asset valuation method and actuarial assumptions.

Actuarial cost method

TCDRS has adopted the replacement life entry age cost method, a conservative cost method and an industry standard. The goal of this cost method is to fund benefits in an orderly manner for each participant over their career so that sufficient funds are accumulated by the time benefit payments begin. Under this approach, benefits are funded in advance as a level percentage of pay. This portion of the contribution rate is called the normal cost rate and generally remains stable from year to year.

Amortization policy

Any remaining unfunded amounts for benefits that are not covered by the normal cost rate will be funded by the unfunded actuarial accrued liability (UAAL) rate. UAAL amounts occur when benefit enhancements are adopted that have not been funded in advance, when there are actuarial gains or losses that occur due to actual investment or demographic experience that varies from what is actuarially assumed, or when actuarial assumptions or methods are changed. For amortization bases established on or after Dec. 31, 2023, UAAL amounts are amortized on a level-dollar basis over a closed period with a layered approach. The closed periods ensure all unfunded liabilities are financed over no more than 20 years from the time they occur. Each year, a new layer is established to amortize changes in the UAAL due to actuarial gains or losses, as well as a new layer for any plan benefit changes elected by an employer.

Benefit enhancements are amortized over a 15-year closed period. All other changes in the UAAL are amortized over 20-year closed periods. These amortization periods are generally more conservative than those of most other public retirement plans and are stricter than the minimum amortization period required under state law.

Notwithstanding the layered approach, the total UAAL payment may not be less than the required payment obtained by amortizing the entire UAAL over a 20-year period.

If a plan is overfunded, the overfunded actuarial accrued liability (OAAL) is calculated annually using a 30-year open amortization period.

For newly participating districts that have five or fewer employees with at least one employee who is within five years of retirement eligibility, the consulting actuary may determine that any initial UAAL or any subsequent adoption of prior service credits is to be amortized over a five-year closed amortization period. This ensures that benefits are appropriately funded over the current generation of employees.

Asset valuation method

When determining the actuarial value of assets used for measuring a plan's funded status, TCDRS smooths each year's actuarial investment gains and losses, and recognizes them over a five-year period to better reflect the system's long-term investment horizon. Asset smoothing keeps employer contribution rates more stable while ensuring that rates reasonably reflect current market conditions. As actuarial asset investment gains and losses are recognized, they become part of the actuarial gains and losses for the year and are funded according to the amortization policy.

In addition, the board can set aside reserves from investment earnings that are used to help offset future negative economic cycles. These reserves are held separately and are not counted as part of a participating employer's plan assets until they are passed through to employers when determined appropriate by the board. Reserves help maintain rate and benefit stability.

Actuarial assumptions

Demographic and economic assumptions are used to estimate employer liabilities and to determine the amount of funding required from employer contributions. These assumptions reflect a long-term perspective of 20 years or more. Examples of key economic assumptions include long-term investment return, long-term inflation and annual payroll increase.

Demographic assumptions are the actuary's best estimate of what will happen to TCDRS members and retirees. Examples of demographic assumptions are employment termination rates, retirement rates and retiree mortality rates. A complete listing of all actuarial assumptions can be found in the annual system-wide valuation report.

Oversight

The board has established review policies to ensure that actuarial assumptions are appropriate and that the methodology for determining employer contribution rates is being correctly applied.

Review of actuarial assumptions

TCDRS' actuarial assumptions are periodically reviewed and revised as deemed necessary to reflect best estimates of future experience. Every four years, the TCDRS consulting actuary conducts an investigation of experience. TCDRS assumptions are compared to plan experience and future expectations, and changes to the assumptions are recommended as needed. The board adopts actuarial assumptions to be used in the valuation based on the results of this study.

An actuarial audit of every investigation of experience is required and must be performed by an independent auditing actuary to review the consulting actuary's analysis, conclusions and recommendations for accuracy, appropriateness and reasonableness. As part of this process, the auditing actuary independently analyzes economic and demographic assumptions to test the results and recommendations of the consulting actuary. The auditing actuary also examines the consulting actuary's methods and assumptions for reasonableness and internal consistency.

Review of actuarial valuation

To test accuracy and ensure that the actuarial methods and assumptions are being correctly applied, an audit of the valuation is required every four years. These audits are conducted by an independent auditing actuary and alternate between a peer review and a full replication audit of the valuation. In the peer review audit of the valuation, the actuary uses a sample of TCDRS plans to test the results of the valuation. The auditing actuary also examines the consulting actuary's methods and assumptions for reasonableness and internal consistency. In a full replication audit of the valuation, the auditing actuary performs all the steps of a peer review audit, but instead of analyzing sample data and plans, the auditing actuary fully replicates the original actuarial valuation.

Review and modification of funding policy

The board will review this policy on a regular basis and may modify this policy at its discretion. Modifications to the policy may be submitted for consideration to the board by staff and/or outside consulting actuaries as circumstances warrant.