



Sample Funding Policy

[Section 802.2011, Texas Government Code](#) requires the governing board of a Texas public retirement system and, if the system is not a statewide system, its sponsor to jointly develop and adopt the same written funding policy and timely revise the policy to reflect any significant changes, including those made because of a funding soundness restoration plan. The process of developing a funding policy presents an opportunity for system trustees and their sponsor's governing body to have an open, robust discussion of the system's funding needs to establish funding priorities.

The [Guidance for Developing a Funding Policy](#) includes a checklist of potential questions for trustees to consider during funding policy development and, recognizing the wide variety of governing structures throughout Texas, does not attempt to provide a one-size-fits-all approach. However, it should be noted that more than 50 percent of Texas plans currently contribute on a fixed-rate basis, and the governing boards have limited discretionary authority over either benefit or contribution changes. At the request of stakeholders, the PRB developed the following sample funding policy with this governance structure in mind.

This sample funding policy is provided as an example of what a funding policy may look like and is not intended to indicate the specific methods outlined below are the best methods for any given retirement system, nor to imply an endorsement of these specific methods over other actuarial best practices.

Introduction

This funding policy outlines a formal long-term strategy for financing the pension obligations accruing under the **(system name)** with the goal of achieving a funded ratio that is equal to or greater than 100 percent, as required by Section 802.2011, Texas Government Code.

This policy is limited by the authority granted to the board of trustees under **(governing statute)** and was created in collaboration with **(sponsoring entity name)**. Therefore, this document creates a framework for proactively managing risks by outlining how the board will approach future changes to benefit and contributions levels under different conditions. In the event this policy conflicts with any statutory language, the statute shall prevail.

Funding Priorities

The primary funding priorities are to:

1. Ensure the security of accrued benefits by making certain contributions and assets are sufficient to pay benefits when due.
2. Limit the volatility of contribution rates for both the members of **(system name)** and **(sponsoring governmental entity)**, consistent with other funding objectives.

3. Ensure that each generation of members and employers incurs the cost of benefits for the employees who provide services to them, rather than deferring those costs to future members and employers;
4. Provide a reasonable margin for adverse experience to help offset risks.
5. Continue progress of systematic reduction of the unfunded actuarial accrued liability.

Funding Objectives

The system's funding objectives are:

- A funded ratio of 100 percent or more by *(date)*.
- A fully funded system with no unfunded liabilities.

Actuarial Methods

The board has adopted the following actuarial methods for purposes of actuarial valuations and the determination of the benchmark ADC:

I. Cost Method

The individual entry age normal actuarial cost method.

II. Asset Smoothing

A five-year asset smoothing period where 20 percent of any gain or loss is recognized in each subsequent year.

III. Amortization Policy

The amortization payment will be calculated as a level percent of payroll, as follows:

The amortization payment will be calculated as a layered closed-period amortization method with a single 30-year closed-period amortization base established for the initial UAAL base and a single 20-year closed-period amortization base established for each year's realized gains or losses thereafter.

Given the current assumed rate of return of X percent and payroll growth of Y percent, the amortization payment is expected to result in negative amortization if the single equivalent funding period is above Z years. The board's goal is to eliminate negative amortization as quickly as possible and ultimately maintain a contribution rate above the threshold that results in negative amortization.

Actuarial Assumptions Guidelines

A comprehensive experience study will be completed at least once every five years with possible review of individual assumptions more frequently, based on advice from the system's actuary. All assumptions will be determined based on actuarial standards of practice taking into account both actual experience and reasonable future expectations.

Actuarially Determined Contribution Benchmark

This policy has outlined a benchmark ADC for establishing a path towards achieving the goal of 100 percent funding. The following will trigger the board to act to adjust or recommend adjustments to benefit and/or contribution levels.

The board will notify (*sponsoring governmental entity*) upon receipt of two actuarial valuations showing the actual contribution is more than 2 percent over or under the ADC. In such case, a change in contribution rates is recommended. If the actual rate is within 2 percent of the ADC, no change is required.

Consideration of Plan Modifications

Guidelines for Future Reductions in Contributions

The board believes it is best to consider supporting a reduction in the actual employer contribution rate only when the following conditions exist:

- A. The funded ratio is at least 105 percent.
- B. Benefit reductions for current active members implemented within the last 10 years have been reinstated.
- C. Regular cost of living adjustments are built into funding assumptions.
- D. The total contribution rate is not less than the normal cost.

Guidelines for Future Benefit Enhancements

For all other benefit enhancements not specifically mentioned above, the board believes it is best to support such enhancements only when the following conditions exist:

- A. Annual cost of living adjustments are built into funding assumptions.
- B. The funding period is less than or equal to 10 years after incorporating the benefit enhancement.
- C. The actuarially determined contribution rate is less than or equal to the actual contribution rate.

Surplus Management Policy

In the event that the system achieves a funding ratio equal to or greater than 120 percent for at least two actuarial valuations, the board may consider the following actions:

- A. Review system risk management policies for efficacy.
- B. Evaluate current assumptions for reasonableness.
- C. Consider changes to employer and employee contributions.
- D. Work with (*sponsoring entity*) to review guidelines for benefit enhancements and implement potential changes.

Risk-Sharing Mechanisms

The board has determined that the key risk facing the system is when actual experience diverges from actuarial assumptions, resulting in actuarial losses. The following methods for sharing risk between the members and the sponsoring government will be considered/recommended:

- The actual contribution will be compared to the ADC each year. If the actual rate is less than the ADC rate for 2 consecutive years, the sponsor and employee contributions will be increased by no more than 2 percent of pay in one year or 4 percent total. The increase will be split 60 percent sponsor and 40 percent employees. If the maximum contribution increase has been applied and the actual contribution is still insufficient, the board shall recommend corrective action, including benefit or contribution changes, to the members and the sponsoring governmental entity.
- COLAs are tied to investment returns. Crediting rate is the lesser of CPI or 100 percent of the 5-year smoothed return minus 5 percent, not less than 0 percent or greater than 4 percent.

Review of Funding Policy

This policy may be amended from time-to-time to reflect changes in other board policies, emerging best practices for public defined benefit pension plans, prevailing opinions of future board members, and suggested changes by system stakeholders. The board and sponsoring entity will review the policy at least every two years and make recommendations if necessary to maintain progress towards the system's goals and objectives. Suggested changes to the policy may be submitted to the board in writing for consideration at future meetings.

This policy was adopted on **(date)**.

(NAME), System Official

(NAME), City Official