State of Tennessee

David H. Lillard, Jr., State Treasurer

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Governor Haslam Signs Landmark Local Government Pension Reform Bill into Law

Governor Bill Haslam has signed into law a bill that is designed to assure Tennessee local government entities fully pay the annual payment to their public employee pension plans in order to protect the financial stability of local governments and to protect workers' pensions.

This groundbreaking legislation, the first of its kind in the nation, was sponsored by Senate Majority Leader Mark Norris (R-Collierville) and Representative Steve McManus (R-Memphis) and written by state Treasurer David Lillard, Jr. Nationally recognized experts have commented on the favorable effect of the legislation on government financial stability.

The new law, called the Public Employee Defined Benefit Financial Security Act of 2014, will require all local government entities that operate pension plans in Tennessee to pay the payments recommended by their actuaries each year. These payments, formerly known as the Annual Required Contribution or ARC, are the amount of money actuaries determine is needed to annually fund in a financially-sound manner the benefits provided by public pension plans.

Under the new law, local government entities that haven't been paying 100 percent of their ARC will have six years to gradually ramp up their yearly payments. If local government entities fail to pay 100 percent of the ARC after that phase-in period, the state will have the authority to withhold money it provides to those governments and use it to make the required payments.

Previously-existing law had long required that the approximately 500 local government entities in the Tennessee Consolidated Retirement System, or TCRS, pay 100 percent of the yearly ARC. Local government entities in TCRS have also long been subject to possible state intercept of funds if they failed to pay 100 percent on the ARC. As a result, TCRS is ranked by various organizations as having one of the best funded pension plans in the nation. This legislation simply applies these best practices to local government pension plans that are not already in TCRS.

"The overwhelming majority of local governments in Tennessee are members of the TCRS and are already paying 100 percent or more of their ARC each year, so this law will not affect them," said Senator Norris, the bill's prime sponsor in the Senate. "For those few that don't pay 100 percent, this law will move them toward a more sustainable financial future. When local governments hire employees and promise them pensions, those promises need to be kept. This law will reduce the likelihood that local government pension plans will run out of money at some point in the future and help protect taxpayers from the costly burdens of potential default."

“Each year that a local government doesn’t fully fund its ARC, it creates a liability that will eventually have to be paid,” said Representative McManus, the bill’s House sponsor. “Those liabilities add up over time. And when the costs of providing those pensions come due, it can create a tremendous burden for future generations of taxpayers if the pension plans have been underfunded for years.”

“A local government that fails to pay 100 percent of its ARC each year is like a runner with a shorter stride than the people he is racing against,” Treasurer Lillard said. “With each stride, the runner falls farther and farther behind the competition. For local governments not funding annual pension payments, it is the taxpayers who ultimately lose.”

“This legislation is something all states should consider,” said Charles E.F. Millard, managing director, head of pension relations for Citigroup and a former director of the United States Pension Guaranty Corporation. “The health of public pensions depends upon their investment returns and plan structures, of course. But the key determinant of the health of our public plans is whether the public employer makes its full annual contribution. If everyone did this, public pensions would be far healthier than they are today.”

“From a credit standpoint, we have always viewed full funding of the ARC as a positive and important element of a government’s liability management,” said John Sugden, a senior director at Standard & Poor’s Ratings Services.

Each local government entity will continue to choose the actuaries that will determine their ARC payments, provided those actuaries use generally-accepted accounting methods when making their calculations.

There is also a provision that will allow the Tennessee Treasury Department to work with any local governments that would experience severe financial hardships if they cannot pay the transition payments over six years.

The new law does not require payment of unfunded liabilities that local governments have already accumulated - it simply addresses the financial methodology that pension plans should follow going forward into a financially strong future.

“Tennessee has a well-deserved reputation as one of the best financially managed states in the nation,” Treasurer Lillard said. “This landmark legislation continues that proud tradition by applying a common sense approach to local government pension funding.”

The Public Employee Defined Benefit Financial Security Act of 2014 is Public Chapter 990, which may be viewed at http://www.tn.gov/sos/acts/108/pub/pc0990.pdf

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