State Legal Provisions Addressing Pension Funding

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NASRA Resolution 2011-01, Funding Discipline in Public Employee Retirement Systems, states in part:

> [NASRA] supports disciplined funding of established benefits and efforts to ensure the financial integrity of public employee retirement systems, and encourages all state and local retirement systems to adopt a clear funding policy that specifies funding goals, target funding levels, commitment to meet actuarially determined contributions, and strategies to maintain predictable and level costs that are aligned with affordable and sustainable plan designs that provide secure lifetime retirement income.

NASRA Resolution 2012-01, Public Employee Retirement System Accounting Standards and Actuarial Methodologies, states in part:

> [NASRA] supports efforts by national public sector organizations to:
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> … Develop guidelines identifying acceptable and recommended practices for the systematic funding of state and local government retirement systems that contain the following policy objectives:
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> i. Actuarially Determined Contributions. A pension funding plan should be based upon an actuarially determined annual contribution that incorporates both the cost of benefits in the current year and the amortization of the plan's unfunded actuarial accrued liability.
> ii. Funding Discipline. A commitment to make timely, actuarially determined contributions to the retirement system is needed to ensure that sufficient assets are available for all current and future retirees.
> iii. Intergenerational Equity. The cost of benefits and required funding should be reasonably allocated to years of service, which means that annual contributions should be reasonably related to the expected and actual cost of each year of service.
> iv. Contributions as a Stable Percentage of Payroll. Contributions should be managed and controlled to the maximum extent, consistent with other policy goals, so that costs remain consistent as a percentage of payroll over time.
> v. Accountability and Transparency. The funding policy should be sufficiently clear regarding intent and effect for stakeholders to assess whether, how, and when the plan sponsor will meet the funding requirements of the plan.

Each state operates under legal requirements that direct the calculation and payment of required pension contributions. Typically these requirements are established in statute, though some pension funding policies include requirements originating in state constitutions, retirement board policies, case laws, and/or other sources. In some cases, funding policies include elements from multiple of these sources.

The NASRA paper, The ARC Experience of Statewide Retirement Plans, FY 01 to FY 13, found that:

> [P]olicies (i.e., statutes, constitutional provisions, or retirement board requirements) that require payment of the [Annual Required Contribution, or ARC] generally produce better pension funding outcomes than polices that do not require payment of the ARC. … Policy constraints that prevent payment of the ARC can negatively affect the ability of employers to fund the pension plan. … While not representing a guarantee that the ARC will be received, the plans in this study that have ARC requirements set in statute have, over the balance of the term, received a higher percentage of their ARC than those plans whose ARC statute is subject to a cap and those states with a fixed-rate contribution policy.

State Statutes

A common pension funding standard is a statutory requirement that pension contributions be based on the component parts of the actuarially determined employer contribution (ADC) prescribed by the Governmental Accounting Standards Board (GASB), essentially: 1) the normal cost; and 2) the cost to amortize the unfunded liability. Few policies established in statute or state constitution actually reference the ADC, its predecessor, the annual required contribution (ARC), or GASB, whose effective public pension accounting standards are silent on matters of pension funding.

Some states have added other contribution requirements in statute or state constitutions. Examples of these include an amortization period, actuarial cost method, target amortization dates, and other qualifying terms for establishing contribution rates, such as compliance with “generally accepted,” or “actuarially sound” principles, or practices.

Previous GASB pension standards allowed a funding amortization period for as long as 30 years, but GASB no longer provides guidance on the actual funding of a pension plan, including the length of the period over which a plan’s unfunded liabilities should be amortized. The Conference of Consulting Actuaries Public Plans Community white paper, “Actuarial Funding Policies and Practices for Public Pension Plans,” discusses features and outcomes of pension amortization policies, including the need to balance contribution rate volatility while also avoiding negative amortization. The white paper recommends that an amortization period of 15 to 20 years can help accomplish these competing objectives.

State Constitutions

For the handful of states whose constitutions address how a pension plan should be funded, such requirements are typically restricted to language that directs funding policies to be based on sound actuarial methods or principles. In some cases, such as Louisiana and Maine, constitutional funding requirements address specific mechanisms of funding policy, such as identifying the components of the required pension contribution in a manner similar to the sample language above, and specifying a period or timeframe within which all unfunded liabilities must be fully amortized. Similar to funding policies established in statute, no state constitution is observed to make reference to specific funding terminology such as the ADC.

Other state constitutions are silent with regard to funding policy specifics, but rather direct another party, such as the legislature, or retirement board, to establish a funding policy that is consistent with industry standards and practices. This is exemplified by the Georgia constitution, which states:

> It shall be the duty of the General Assembly to enact legislation to define funding standards which will assure the actuarial soundness of any retirement or pension system supported wholly or partially from public funds and to control legislative procedures so that no bill or resolution creating or amending any such retirement or pension system shall be passed by the General Assembly without concurrent provisions for funding in accordance with the defined funding standards

Sample Language for Pension Contributions

Based on a review of state constitutional and statutory language prescribing pension funding, standardized language creating a public pension funding requirement could read as follows:

> The contribution rate for retirement plans for public employees shall be not less than the normal cost plus the cost to fully amortize the unfunded actuarial accrued liability over a period that balances the objectives of intergenerational equity and minimizing cost volatility, in compliance with generally accepted accounting principles, including professional actuarial standards of practice.

In the spirit of using the state constitution to require the legislature or retirement board to develop and maintain specific funding standards otherwise reserved for state statute, the preceding language could have appended to it the statement,

> The Legislature shall enact legislation to define specific funding standards, including the cost method, maximum amortization period, and other components necessary to ensure that pension plans sponsored by the state and its political subdivisions are adequately funded.

The table below identifies nine states whose constitutions address pension funding, and all or selected relevant parts:

State	Constitutional Language
AZ	**Arizona Constitution, Article XXIX, § 1:** A. Public retirement systems shall be funded with contributions and investment earnings using actuarial methods and assumptions that are consistent with generally accepted actuarial standards.
GA	**Georgia Constitution, Art. 3 §10:** Paragraph V. Funding standards. It shall be the duty of the General Assembly to enact legislation to define funding standards which will assure the actuarial soundness of any retirement or pension system supported wholly or partially from public funds and to control legislative procedures so that no bill or resolution creating or amending any such retirement or pension system shall be passed by the General Assembly without concurrent provisions for funding in accordance with the defined funding standards.
LA	**Louisiana Constitution, Article X, § 29:** (E) Actuarial Soundness. (1) The actuarial soundness of state and statewide retirement systems shall be attained and maintained and the legislature shall establish, by law, for each state or statewide retirement system, the particular method of actuarial valuation to be employed for purposes of this Section. (b) The legislature shall, in each fiscal year, by law, provide an amount necessary to fund the employer portion of the normal cost, which shall be determined in accordance with the method of valuation established under (1) above. (c) The legislature shall, in each fiscal year, by law, provide for the amortization of the unfunded accrued liability existing as of June 30, 1988, which shall be determined in accordance with the method of valuation selected in (1) above, by the year 2029, commencing with Fiscal Year 1989-1990.
ME	**Maine Constitution, Article IX, § 18-A:** Beginning with the fiscal year starting July 1, 1997, the normal cost of all retirement and ancillary benefits provided to participants under the Maine State Retirement System must be funded annually on an actuarially sound basis. Unfunded liabilities may not be created except those resulting from experience losses. Unfunded liability resulting from experience losses must be retired over a period not exceeding 10 years.
MT	**Montana Constitution, Article VIII, § 15:** (1) Public retirement systems shall be funded on an actuarially sound basis…
NH	**New Hampshire Constitution, part 1, Article 36-a:** The employer contributions certified as payable to the New Hampshire retirement system or any successor system to fund the system's liabilities, as shall be determined by sound actuarial valuation and practice, independent of the executive office, shall be appropriated each fiscal year.
SC	**South Carolina Constitution, Article X, § 16:** The General Assembly shall annually appropriate funds and prescribe member contributions for any state-operated retirement system which will insure the availability of funds to meet all normal and accrued liability of the system on a sound actuarial basis as determined by the governing body of the system…
TX	**Texas Constitution Art. 16 § 67:** (a) (1) Financing of [pension] benefits must be based on sound actuarial principles. … (b)(3) The amount contributed by a person participating in the Employees Retirement System of Texas or the Teacher Retirement System of Texas shall be established by the legislature but may not be less than six percent of current compensation. The amount contributed by the state may not be less than six percent nor more than 10 percent of the aggregate compensation paid to individuals participating in the system. In an emergency, as determined by the governor, the legislature may appropriate such additional sums as are actuarially determined to be required to fund benefits authorized by law.
VA	**Virginia Constitution, Article X, § 11:** Retirement system benefits shall be funded using methods which are consistent with generally accepted actuarial principles. The retirement system shall be subject to restrictions, terms, and conditions as may be prescribed by the General Assembly.

See also

- Actuarial Funding Policies and Practices for Public Pension Plans, Conference of Consulting Actuaries Public Plans Committee, Conference of Consulting Actuaries Public Plans Community, October 2014
- The Annual Required Contribution Experience of State Retirement Plans, FY 01 to FY 13, NASRA, March 2015
- Funding Policies @NASRA
- NASRA Resolution 2011-01, Establishing Funding Discipline in Public Employee Retirement Systems
- NASRA Resolution 2012-01, Public Employee Retirement System Accounting Standards & Actuarial Methodologies
- Pension Funding Guidelines, Texas Pension Review Board, January 2017