5.6 – Funding Policy
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FUNDING OBJECTIVES

The main financial objective of the New Hampshire Retirement System (NHRS) is to receive employer and member contributions to fund the long-term costs of benefits provided by statute to plan members and beneficiaries. From the perspective of the members and beneficiaries, a funding policy based on actuarially determined contributions is one which will pay all benefits provided by statute when due. From the perspective of the contributing plan sponsors and taxpayers, the actuarially determined contributions have the additional objectives of keeping contribution rates relatively stable as a percentage of active member payroll and equitably allocating the costs over the active members' period of active service. For pension funding, the payment of benefits is supported in part by income earned on investment assets. This funding policy meets those criteria. It is stipulated by state law and implemented through the application of Board adopted governance policies.

Statutory Pension Funding Policy for NHRS

The statute that establishes the pension funding policy for NHRS is RSA 100-A:16.

RSA 100-A:16 Excerpts:

> **100-A:16 Method of Financing —** All of the assets of the retirement system shall be credited, according to the purpose for which they are held, between 2 funds, namely, the member annuity savings fund and the state annuity accumulation fund. Each of the funds shall be subdivided on account of the various member classifications. In making the determinations required under this section for financing the retirement system, the Board of Trustees shall use the entry age normal funding methodology. The Board of Trustees shall direct the system's actuary to prepare biennial valuations of the system's assets and liabilities commencing with the valuation prepared as of June 30, 2007. Such biennial valuation shall be the basis for determining the annual contribution requirements of the system until the next following biennial valuation.
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> II(b) The contributions of each employer for benefits under the retirement system on account of group II members shall consist of a percentage of the earnable compensation of its members to be known as the "normal contribution,'' and an additional amount to be known as the "accrued liability contribution;'' provided that beginning with state fiscal year 2013 and for each state fiscal year thereafter, any employer shall pay the full amount of such total contributions. The rate percent of such normal contribution, including contributions on behalf of group II members whose group II creditable service is in excess of 40 years, in each instance shall be fixed on the basis of the liabilities of the system with respect to the particular members of the various member classifications as shown by actuarial valuations.

II(c) The contributions of each employer for benefits under the retirement system on account of group I members shall consist of a percentage of the earnable compensation of its members to be known as the "normal contribution,'' and an additional amount to be known as the "accrued liability contribution;'' provided that beginning with state fiscal year 2013 and for each state fiscal year thereafter, any employer shall pay both normal and accrued liability contributions. The rate percent of such normal contribution in each instance shall be fixed on the basis of the liabilities of the system with respect to the particular members of the various member classifications as shown by actuarial valuation.

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II(e)(1) Immediately following the actuarial valuation prepared as of June 30 of each fiscal year, the Board shall have the system's actuary determine the amount of the unfunded accrued liability for each member classification as the amount of the total liabilities of the state annuity accumulation fund on account of such classification which is not dischargeable by the total of the funds in hand to the credit of the state annuity accumulation fund on account of such classification, and the aforesaid normal contributions to be made on account of the members in such classification during the remainder of their active service. The amount so determined with respect to each member classification shall be known as the "unfunded accrued liability" with respect to such classification.

(2) On the basis of each such unfunded accrued liability, the board shall have the system's actuary determine the level annual contribution required to discharge such amount as provided in subparagraph (3).

(3) The unfunded liability as of June 30, 2017, shall be amortized through 2039. Each subsequent change in liability as calculated in odd-numbered years shall be separately amortized over a fixed period of no longer than 20 years.

Board Established Policy Associated with Funding:

Actuarial Cost Method

The law stipulates under RSA 100-A:16 the use of the entry age normal actuarial cost method for each of the four member classifications. The purpose of this method is to determine the annual normal cost for each individual active member, payable from the date of employment to the date of retirement, that is:

- Sufficient to accumulate to the value of the member's benefit at the time of retirement, and
- A constant percentage of the member's year-by-year projected covered pay.

The actuarial accrued liability under this cost method is the accumulation of normal costs accrued prior to the actuarial valuation date. The actuarial accrued liability represents the theoretical amount of assets required to fund benefits earned on members' past service. The normal cost represents the cost required to fund benefits accruing during the current year. Under RSA 100-A:16, II(I), if the actuarially determined normal contribution rate as set forth in subparagraphs (b) and (c) on account of any of the various member classifications shall be negative in any fiscal year, then the excess amount resulting from the difference between zero and the negative actuarially determined normal contribution rate shall be used to reduce the member contribution rate for that member classification in that fiscal year.

Under RSA 100-A:16, II-a(a), if within a member classification the employer rates have lowered to require them to be equal to the member rates, then for all subsequent years the employer rates and the members' rates for such member classification shall continue to be equal whether the system liabilities increase or decrease.

Asset Valuation Method

The actuarial value of assets is based on the market value with investment gains and losses smoothed over 5 years. The actuarial value of assets will not consistently be above or below the market value and is expected to converge to the market value in a relatively short period of time. At any time, it may be either greater or less than market value. During periods when investment performance exceeds the assumed rate, actuarial value of assets will tend to be less than market value. During periods when investment performance is less than the assumed rate, actuarial value of assets will tend to be greater than market value. If assumed rates are exactly realized for four consecutive years, the actuarial value will become equal to market value.

Actuarial value is limited to a 20% corridor around the market value. This means that if the preliminary development of the actuarial value results in an amount that is greater than 120% of the market value (or less than 80% of the market value), the final actuarial value is limited to 120% (or 80%) of the market value. Any gains or losses on the market value outside of the 20% corridor are therefore recognized immediately.

Amortization Method

Pursuant to the Laws of 2018, Chapter 48, RSA 100-A:16, II(e), was revised in June 2018 and stipulates that the unfunded accrued actuarial liability as of June 30, 2017, shall be amortized through 2039. It further states that each subsequent change in liability as calculated in odd years will be amortized as a level percentage of pay for no longer than 20 years. For each actuarial valuation in the subsequent odd years, a new 20-year amortization, as a level percentage of payroll, of the actuarial gain or loss will be created in that actuarial valuation. This Actuarial Funding Policy implements the intent of the statute.

Beginning with the June 30, 2007, actuarial valuation which determined the employer contribution rates beginning with the fiscal year ending June 30, 2010, the 30-year period is a closed period ending June 30, 2039.

The amortization method is a level percentage of payroll, consistent with RSA 100-A:16, II(b) and (c).

Funding Target

The funding objective is to achieve 100% funding. For this purpose, 100% funding means that the Actuarial Value of Assets equals the Actuarial Accrued Liability. The amortization objective is to reach 100% funding by June 30, 2039 for the Unfunded Accrued Actuarial Liability as of June 30, 2017.

Risk Management

The main financial objective of this funding policy is to fund the long-term costs of benefits provided by statute to plan members and beneficiaries. There are numerous risks that NHRS faces in trying to achieve this objective including funding risk, demographic risk, investment risk, and benefit risk. The Board policies for managing these risks are outlined in this section.

Funding Risk

Frequency of Actuarial Valuations

Regular valuations manage funding risk by allowing employer contribution rates to reflect actual experience as it emerges. Funding valuations are required by RSA 100- A:16, III, as of June 30 every other year on the odd years to determine employer contribution rates for the biennium beginning two years after the valuation date.

Interim funding valuations on June 30 of the even years are required for financial reporting. Funding calculations from interim valuations may be used as additional information for budgeting contributions in anticipation of the next rate setting valuation.

Demographic and Investment Risk

Process for Reviewing and Updating Actuarial Assumption

The Board adopts actuarial assumptions based on recommendations of the system's actuary. Demographic and investment risks may be managed in part by having regular reviews of the actuarial assumptions. The law stipulates that the Board shall have the system's actuary make an actuarial investigation into the experience of the System at least every 5 years (RSA 100-A:14, IX) and shall adopt actuarial assumptions as necessary. The Board shall have the system's actuary make an actuarial investigation into the experience of the System every four years and shall adopt actuarial assumptions as necessary. If circumstances warrant, the Board may undertake an experience study or change assumptions more frequently based on the recommendation of the system's actuary.

The experience study report shall include, but not necessarily be limited to, analysis of and recommendations regarding the following assumptions.

- Pre-retirement withdrawal rates
- Retirement rates
- Disability rates
- Pay increase rates
- Mortality rates both before and after retirement
- Investment returns, which must be consistent with the investment policy, considering both real return and inflation

The experience study report will serve as the basis for determinations by the Board regarding whether demographic or economic assumptions should be modified for future valuations.

In the interim years, the system's actuary shall issue a written opinion in regard to the reasonableness of the assumed rate of return that shall address any difference between the assumed rate of return and the expected rate of return as determined by the Independent Investment Committee (RSA 100-A:15, VII(c)(1)).

Because actuarial audits are valuable tools for monitoring the quality of actuarial services performed on behalf of NHRS, the Board shall also engage the services of an outside actuary to perform a review of the work of the system's actuary at least every four years. The process of staff procuring these actuarial audit services shall begin once the Board accepts each regular four-year experience study. The level and scope of the audit shall be determined by the Board. The Board may also pursue actuarial audit services outside of this four-year cycle, if it determines that circumstances warrant it. If there has been a change in actuarial firms since the most recent actuarial audit, the four-year requirement for actuarial audit services does not apply.

Responding to Favorable/Unfavorable Investment Experience

Investment risk is addressed in the system's Investment Manual. Annual investment experience other than assumed is reflected in the valuation asset method described above.

Asset Liability Studies

The Board adopts an asset allocation based on recommendations from the Independent Investment Committee (IIC), which relies on the advice from the

Chief Investment Officer and the investment consultant to formulate its recommendations to the Board. The asset allocation approved by the Board will reflect the results of an asset liability study performed at least once in every five-year period, or more often, as recommended by the IIC, retirement system staff, and investment consultant.

Risk Measures

In order to quantify the risks outlined in this Actuarial Funding Policy, the following metrics will be included in annual valuation reports. These metrics provide quantifiable measurements of risk and its movement over time:

- Funded ratio (actuarial value of assets divided by actuarial accrued liability).
    - Measures progress towards the funding objective of the 100% target funded ratio.
- Actual total payroll versus expected total payroll for each member classification.
    - Measures the funding risk associated with receiving contributions as a level percent of payroll.
- Dollar standard deviation of investment return divided by total payroll.
    - Measures the risk associated with relative impact of negative asset returns on the funded status of the plan. A decrease in this measure indicates a decrease in investment risk.
- Total unfunded actuarial accrued liability (UAAL) divided by total payroll.
    - Measures the risk associated with the relative impact of contribution decreases on the ability to fund the UAAL. A decrease in this measure indicates a decrease in contribution risk.
- Total actuarial accrued liability (AAL) divided by total payroll.
    - Measures the risk associated with the ability to respond to liability experience through adjustments in contributions. A decrease in this measure indicates a decrease in experience risk. This also provides a

long-term measure of the asset risk in situations where the system has a funded ratio below 100%.

- Total actuarial value of assets divided by total payroll.
    - Measures the risk associated with the ability to respond to asset experience through adjustments in contributions. A decrease in this measure indicates a decrease in asset risk.
- Dollar standard deviation of contribution rate divided by total payroll.
    - Measures the impact of a one standard deviation change in investment return on the annual contribution rate. This rate is expected to stabilize with the introduction of layered amortization.
- Net cash flow as a percent of market value of assets.
    - Measures money coming in less money going out. This ratio is expected to be negative and trend toward the negative of the real return assumption.
- Ratio of actives to retirees.
    - Fully mature plans may have ratios near 1.0.

Benefit Risk

Responding to Legislative Proposals and Changes

Benefit risk may be managed as follows:

- NHRS shall review legislative proposals and changes for the potential legal, administrative, IRC compliance, and funding impact on the system. If a legislative proposal has the potential for a meaningful impact on plan funding, the Board shall consult with the retirement system's actuary to estimate the actuarial impact to the system.
- Under RSA 100-A:15, VII(d), NHRS may request or recommend legislative proposals to comply with other state or federal regulations, improve administration, or secure funding for benefits provided by statute.

NHRS does not determine the eligibility requirements for benefits or the level of benefits.

Miscellaneous Matters Associated with Funding:

Overall Conformance with Professional Standards of Practice

By law, the actuary shall be a member of the American Academy of Actuaries and have at least seven years of actuarial experience (RSA 100-A:1, XXIX). The actuary shall meet the Qualification Standards of the American Academy of Actuaries, and the work of the actuary in connection with this policy shall conform to Actuarial Standards of Practice for public employee retirement plans promulgated by the Actuarial Standards Board. The actuary's work shall also satisfy the requirements of the Governmental Accounting Standards Board with respect to the development of information needed by the system and by employers for financial reporting purposes.