FAQ: Employer Contribution Rates for FY 22-23

The fiscal year (FY) 2022-23 rates for the State of New Hampshire and for political subdivision employers were certified by the New Hampshire Retirement System (NHRS) Board of Trustees on September 8, 2020.

Here are answers to some common questions that participating employers may have concerning those rates.

How are employer contribution rates determined?

Employer contribution rates are developed as part of a biennial actuarial valuation, which is required by statute. The NH Constitution (Part, I, Article 36-a) requires that the rates be based on "sound actuarial valuation and practice" as required to maintain the retirement system trust fund at the level needed to meet its future obligations.

GRS, the retirement system's consulting actuary, determines the cost of future benefits, the unfunded actuarial accrued liability (UAAL), and employer contribution rates based on assumptions about many future events, such as the age when members will retire, their rate of salary growth, how long they will live after retirement, and how much the plan's investments will earn. These assumptions are based on detailed statistical models and adhere to national Actuarial Standards of Practice. However, they are not facts; no one can predict future events. When the actual experience doesn't match the assumptions, there can be an actuarial gain or loss. Put simply, gains reduce employer contribution rates, losses increase employer contribution rates.

When are employer contribution rates set?

Employer contribution rates are set every two years pursuant to RSA 100-A:16, III.

The contribution rates for FY 2022 and 2023 are based on the actuarial valuation as of June 30, 2019.

FY 22-23 EMPLOYER CONTRIBUTION RATES

	Pension	Medical Subsidy	Total
Employee-State	13.75%	0.78%	14.53%
Employee-Political Sub	13.75%	0.31%	14.06%
Teacher	19.48%	1.54%	21.02%
Police	30.67%	3.21%	33.88%
Fire	29.78%	3.21%	32.99%

Employer contributions are increasing for all four member groups from the FY 20-21 rates.

Why are employer contribution rates increasing in FY 22-23?

The rate increase is largely the result of recommended changes to the actuarial assumptions used to value the pension plan that were adopted by the Board of Trustees in June. The most significant drivers of the rate increase, in order of impact, were: 1) the reduction of the assumed rate of investment return from 7.25% to 6.75%; 2) the adoption of updated post-retirement mortality assumptions; and 3) a reduction in the payroll growth factor.

For additional details on the experience study, see: "FAQ: 2019 Actuarial Experience Study"

Of all the assumptions used to estimate the cost of a public pension plan, none has a larger effect on employer contribution rates than the investment return assumption. This is because, over time, earnings from investments account for a majority of the retirement system's funding.

In reviewing the assumed rate of return over a period of months, NHRS Trustees heard capital market presentations from several independent, expert sources, including NEPC, the retirement system's investment consultant. GRS, in its role as consulting actuary, advised the Board that an assumed rate of return within the range of 6.25% to 7.0% would be actuarially reasonable, but recommended adopting a rate of no more than 6.75%.

The 6.75% rate represents what NHRS Trustees believe the plan can realistically earn from its investments on an annual basis, when averaged over the long-term. In any given year, investment returns are likely to be higher or lower than the long-term assumed rate, depending on current economic and market conditions. The employer contribution rate for Group I Teachers was additionally impacted by the adoption of a payroll growth assumption lower than other member groups.

Why is the payroll growth assumption different for the Teacher group?

This was a decision driven by the demographic experience of teachers. Since 2016, the teacher payroll growth assumption has been set lower than the other three member groups (Employee, Police, and Fire) to compensate for an anticipated annual decrease in the number of active teachers due to an ongoing decline in New Hampshire's school-age population. From 2009 to 2019, the number of active teachers has declined from 18,709 to 17,730. The most recent state population projections from the New Hampshire Office of Strategic Initiatives show a declining school age population through at least 2025.

How does the NHRS 6.75% assumed rate of return compare to other state pension plans?

The National Association of State Retirement Administrators (NASRA) regularly analyzes data from more than 100 of the largest public pension plans in the country. Out of 127 public pension plans surveyed in February 2016, 114 have reduced their assumed rate of return.

When NHRS reduced its assumed rate of return from 7.75% to 7.25% in 2016, the average among all plans was 7.62%; the average rate, as of February 2020, was 7.22%, and more plans have reduced their assumed rate of return since then.

How does the change in rates from FY 20-21 to FY 22-23 compare to previous cycles?

For the five-year period ending July 1, 2020, the aggregate employer contribution rate for all member groups increased cumulatively by 6.3%; for the same five-year period, the U.S. consumer price index (CPI) increased cumulatively by 8.6%. The aggregate 19.6% increase from FY 20-21 to FY 22-23, while significant, is less than the 23.2% increase in FY 14-15 over the prior biennium.

How do NHRS employer contribution costs compare to other states?

In FY 19, the most recent year national data is available from the Public Plan Database, NHRS employer pension contributions were below the national average of more than 200 state pension plans as a percentage of payroll (15.4% to 18.2%).

In FY 17, the most recent year national data was compiled by NASRA, NHRS employer pension contributions were also below the national average as a percentage of state and local government direct general spending (3.98% to 4.70%).

Does the NHRS Board of Trustees have any leeway when certifying employer rates?

There is very limited discretion in setting the employer rates. The state Constitution and state law require that the NHRS Board of Trustees certify actuarially sound employer contribution rates necessary to keep the retirement system on track to meet its long-term obligations and that employers pay those rates in full.

The relevant section of Part I, Article 36-a of the Constitution reads, in part:

> *"The employer contributions certified as payable to the New Hampshire retirement system … as shall be determined by sound actuarial valuation and practice … shall be appropriated each fiscal year to the same extent as is certified."*

In addition to the constitutional mandate, Trustees are also bound by their fiduciary duty to the pension plan, which is the highest standard of conduct under the law. When NHRS fiduciaries make decisions about benefit administration, investments, or any other subject that falls within their statutory responsibilities, they are required to act solely in the best interest of the collective membership, not on behalf of individual members or member groups, employers, lawmakers, taxpayers, or anyone else who might have an interest in the outcome of the decision.

Even if permitted by law, reducing contribution rates without consideration of the impact on NHRS' long-term ability to fund benefits would run counter to the Board's fiduciary duty, and would result in creating additional unfunded liabilities to the detriment of the plan and its participants.

Why are there different rates for each of the member classifications?

Employer contribution rates for Employee, Teacher, Police, and Fire members are determined separately based on benefit structure, demographics, and other information unique to each member classification, so rates vary among the different groups. Group II rates are higher because the retirement age for Police and Fire members is lower and the Group II benefit formula produces a larger pension than the Group I benefit formula. (Note: Group II members are not eligible for Social Security benefits for their NHRS-covered employment; neither they nor their employers pay Social Security taxes.)

In addition to the pension costs, the employer rates also contain a Medical Subsidy rate that ranges from 0.31% to 3.21% of covered payroll, depending on the member classification. (See below for more information on the Medical Subsidy.)

How does the unfunded pension liability affect employer contribution rates?

There are three components to employer contribution rates: the normal cost, unfunded actuarial accrued liability (UAAL), and the medical subsidy.

The normal cost reflects the estimated actuarial cost of pension benefits as those benefits are earned each year by members. This cost is shared by the employer and the member, with members paying the majority of the normal cost. The normal cost will continue to decline over time due to 2011 legislative changes that reduced benefit provisions for new members hired on or after July 1, 2011, as well as any member hired prior to that date but not vested prior to January 1, 2012.

The UAAL is the estimated value of NHRS benefits that have been earned in the past, but have not yet been funded. The current unfunded liability is borne solely by the employers. Overall, the unfunded liability accounts for more than 70% of the total employer contribution rate.

There have been several contributing factors to the current NHRS unfunded liability:

- A flawed statutory funding methodology in effect from 1991-2007 that led to the long-term under-calculation of employer contributions;
- The diversion of approximately $900 million in investment earnings from the pension trust into a "Special Account" over roughly the same period. (The Special Account, which was created by legislation in the 1980s and repealed in 2012, funded other post-retirement benefits such as cost-of-living adjustments);
- Global economic dips (the 2001-02 dot-com bubble and the Great Financial Crisis of 2008-09) negatively impacting investment performance;
- Adoption of more conservative actuarial assumptions in 2011, 2016, and 2020 by the NHRS Board of Trustees, based on the results of actuarial experience studies required by statute and the Board's Actuarial Funding Policy. (Note: While the changes to the assumptions for investment returns, payroll growth and mortality increased the UAAL, they also financially strengthened the retirement system trust fund by generating additional revenue through increases to employer contributions.)

Despite the unfunded liability, retirement benefits for NHRS members are secure. Changes made in recent years have put NHRS on a solid path to financial health, however, the unfunded liability took many years to create, and it will take many years to eliminate.

In 2007, the Legislature created a closed, 30-year amortization period to pay off the UAAL, which commenced on July 1, 2009. In 2018, legislation was enacted to recognize actuarial gains and losses incurred after July 1, 2017, over closed periods of no more than 20 years. This is referred to as "layered amortization." The approximate $5 billion UAAL as of June 30, 2017 – referred to as the "initial UAAL" – will continue to be paid down through 2039.

Future actuarial gains and losses will be layered and spread more evenly over time, avoiding some of the potential employer contribution rate volatility as 2039 approaches, and also providing a basis for managing gains and losses incurred beyond 2039.

Because it was only enacted recently, layered amortization has only a minor impact on the FY 22-23 contribution rates, although it did, in fact, reduce the impact of the assumption changes slightly.

What impact did the recent retiree cost-of-living adjustment (COLA) have on the rates?

The COLA enacted by the Legislature in 2019 – which phases in a permanent increase to the monthly benefit for eligible retirees and beneficiaries – increased the employer contribution rates within a range of 0.11% to 0.34% as a percent of payroll, depending on the member classification, and decreased the funded ratio of the pension plan by 0.2%.

Why is the Medical Subsidy included in the employer rate?

The Medical Subsidy is a statutorily-required payment made by NHRS directly to an eligible retiree's former employer or the employer's health insurance administrator that goes toward the cost of health insurance for a qualified retired member, spouse, or dependent child(ren). The Medical Subsidy is not a health insurance plan.

Medical Subsidy benefits are funded from a 401(h) trust for political subdivision Employees, state Employees, Teachers, and Police and Fire members. Because these benefits are pay-as-you-go, employers are required by statute to pay the minimum rate necessary to maintain the benefits provided for each of the above groups.

Because this benefit is a closed plan, except with respect to certain Group II members, the Medical Subsidy rates are expected to decrease in future years. Medical Subsidy rates will decline in FY 22-23 for state Employees, Teachers, Police, and Fire.

Does the State of New Hampshire pay any portion of the political subdivision employer rates?

No. In 2012, the New Hampshire Supreme Court upheld statutory changes to RSA 100-A:16 enacted in 2009 that reduced the percentage the State of New Hampshire paid toward employer retirement contributions for Teacher, Police, and Fire members employed by political subdivisions. Those contributions were subsequently eliminated entirely with the enactment of House Bill 2 in 2011.

The Supreme Court decision did not change the total amount of employer contributions that must be paid to the retirement system – it only upheld the State's authority to reduce, and eventually eliminate, its contribution toward employer retirement contributions for Teacher, Police, and Fire members employed by political subdivisions. The net result of the decision was to shift pension costs from the State to political subdivisions.

When RSA 100-A:16 was enacted in 1967, the State was responsible for 40% of the employer contribution for Teacher members employed by political subdivisions. The statute was amended in 1977, requiring the State to pay 35% of the employer contributions for Teacher, Police, and Fire members employed by political subdivisions.

RSA 100-A:16 was amended in 2009 to reduce the State's share to 30% in FY 2010 and 25% in FY 2011. The 2009 amendment also restored the State contribution to 35% in FY 2012. However, the statute was amended again in 2011 to eliminate the State's percentage share of employer contributions altogether. The 2011 amendment also included a one-time transitional appropriation of $3.5 million in an effort to offset political subdivision employer contributions in FY 2012.