The assumed rate of return

There's a lot of information out there regarding the New Hampshire Retirement System, some of it fact, some of it fiction. This document, along with others in the "NHRS ... Now You Know" series, is designed to provide you with straight talk about the retirement system.

The New Hampshire Retirement System's employer contribution rates, unfunded liability, and funded ratio are calculated based on assumptions about many future events, such as the age when members will retire, their rate of salary growth, how long they'll live after retirement, and how much the plan's investments will earn.

Of all the assumptions used to estimate the cost of a public pension plan, none has a larger impact than the investment return assumption. This is because, over time, earnings from investments account for a majority of revenues required to fund benefits.

The current NHRS assumed rate of return is 7.25%. This rate represents what the NHRS Board of Trustees believes 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.

According to the most recent data compiled by the National Association of State Retirement Administrators (NASRA) in its survey of the nation's top 129 public pension funds, the median rate assumption is 7.36%.

The NHRS one-, three-, five-, 10-, 20-, and 25-year investment returns for the periods ended June 30, 2018, were 8.9%, 7.7%, 8.7%, 7.1%, 6.4%, and 8.0%, respectively.

The NHRS Independent Investment Committee invests in a mix of asset classes based on an investment policy set by the Board of Trustees. The goal is to meet or exceed the assumed rate of return over the long term, while at the same time prudently managing the risk and liquidity of the portfolio.

In recent years, an academic debate has emerged concerning the valuation of pension obligations, with some taking the position that liabilities should be calculated at the so-called "risk-free" rate, typically the rate of return on a portfolio consisting entirely of US Treasury bonds, rather than an assumed rate of return based on a plan's actual asset allocation. Calculating liabilities using this approach would exponentially increase liabilities, while at the same time undervaluing likely investment returns, thereby artificially increasing employer contributions.

The assumed rate of return – along with other demographic and economic assumptions – is regularly reviewed by Trustees and may be adjusted periodically to better reflect the retirement system's actual experience. Trustees lowered the

assumed rate of return from 7.75% to 7.25% in May 2016. The change was based on data and recommendations contained in a five-year experience study for the period ending June 30, 2015, conducted by the retirement system's consulting actuary, as well as input from the retirement system's investment consultant and other experts.

The determination of an investment return assumption, which is typically based on a 30- to 50-year time horizon, involves careful review of several financial, economic, and market factors. This long-term approach promotes predictability and stability of plan costs and contribution rates.

The most important point to remember about investment performance is that while short-term results matter, the financial well-being of the pension plan depends largely upon meeting or exceeding the assumed rate of return over the long term.

Sources: NHRS 2018 Comprehensive Annual Investment Report (CAIR); NHRS Experience Study, July 1, 2010 – June 30, 2015; National Association of State Retirement Administrators