NHRS ... NOW YOU KNOW

Demystifying ‘unfunded liability’

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, are designed to provide you with straight talk about the retirement system.

Unfunded pension liability – which is more formally referred to as unfunded actuarial accrued liability (UAAL) in financial statements – is the difference between a retirement system’s assets and the value of benefits already accrued.

Simply having an unfunded liability does not mean that a pension plan is unable to pay the benefits for which it is presently obligated or to meet current cash flow requirements.

The New Hampshire Retirement System (NHRS, retirement system) had an unfunded liability of $4.99 billion at the close of Fiscal Year 2018. This figure represents the actuarial value of NHRS benefits that have been earned in the past, but have not yet been funded. This unfunded liability – which is being paid off through 2039 – is borne solely by the participating employers. Overall, the unfunded liability accounts for more than 70 percent of current employer rates.

NHRS presently has a funded ratio of 63.6 percent. This means that the actuarial value of the retirement system’s assets is 63.6 percent of the projected amount needed to pay for current and accrued benefits for retirees and members.

It’s important to note that an unfunded pension liability is not an absolute dollar figure; it is an estimate based on a number of assumptions – demographic and economic – and is, therefore, subject to fluctuation. As a result, the funded ratio is a better measure of a plan’s financial status.

<u>Despite the unfunded liability, retirement benefits for NHRS members and retirees are secure. There is a plan in place to pay down the current unfunded liability by 2039 and funds are available to pay present benefits.</u>

The New Hampshire Constitution (Part I, Article 36-a) requires Trustees to set actuarially sound employer rates and requires employers to pay those rates in full. Current NHRS employer contribution rates are calculated to reflect the cost of benefits as they accrue, as well as pay down existing unfunded liabilities.

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-collection of employer contributions;

- The diversion of roughly $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 (2001-02 and the great financial crisis of 2008-09) negatively impacting investment performance.
- The NHRS Board of Trustees' adoption of more conservative actuarial assumptions in 2011 and 2016 based on the results of five-year actuarial experience studies required by statute and the Board's Actuarial Funding Policy. Changes to the assumptions for investment returns, payroll growth and mortality increased the UAAL and financially strengthened the retirement system by generating additional revenue through increases to employer contribution rates.

Since 2007, more than 90 changes have been made to RSA 100-A, the law governing the retirement system. In addition to changes to the plan design that reduced future benefit accruals, this legislation created several statutory safeguards to prevent a repeat of the policy factors that contributed to the current unfunded liability.