'The 80% pension funding myth'

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.

NHRS is sometimes asked, "I know that the long-term goal is to fully fund the pension trust, but isn't aiming for 80% funding good enough?"

The answer is that 80% is not "good enough" under sound actuarial practice, state law, fiduciary duty, and, most importantly, Article 36-a of the NH Constitution, which requires that pension contributions be "determined by sound actuarial valuation and practice."

This question isn't new, or unique to NHRS. In fact, the American Academy of Actuaries (AAA) released an issue brief in 2012 titled, "The 80% Pension Funding Myth." The brief was updated and re-issued in the fall of 2021. A link to the full document is below, but here are some of the key points:

"While it is unclear when widespread use began, an 80% benchmark has appeared in research reports, legislative initiatives, and in the media as a bright line between healthy or well-funded plans and unhealthy or underfunded plans. A 2007 Government Accountability Office (GAO) report on state and local government pension plans portrayed 80% as a de facto benchmark for a healthy pension system, attributing that criteria to unidentified public sector experts and stakeholders."

"Actuarial funding methods generally are designed with a target of 100% funding—not 80%. If the funded ratio is less than 100%, actuarially determined contributions are structured with the objective of attaining a funded ratio of 100% within a reasonable period of time."

"A funded ratio of 80% should not be used as the primary criterion for identifying a plan as being either in good financial health or poor financial health. No single level of funding should be identified as a defining line between a healthy and an unhealthy pension plan. All plans should have a reasonable funding or contribution strategy to accumulate assets equal to 100% of a relevant pension obligation, unless reasons for a different target have been clearly identified and the consequences of that target are well understood."

"While the funded ratio may be a useful measure, understanding the health or soundness of a pension plan cannot be reduced to a single measure or benchmark at a single point in time. Instead, actuaries

evaluate pension plans based on the strategy in place to address all of their unfunded liabilities over an appropriate time frame."

NHRS presently has a funded ratio of 64.2% percent, which means that the actuarial value of the retirement system's assets is a little bit less than two-thirds of the projected amount needed to pay for current and accrued benefits for retirees and members. As the AAA brief noted, it's possible to have two retirement systems with the same funded ratio and one of the plans may be significantly more sound than the other.

In NHRS' situation, the Legislature created a closed, 30-year amortization period to pay off its unfunded actuarial accrued liability (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, will continue to be paid down through 2039. However, actuarial gains and losses after that date are being spread more evenly over time, providing a manageable basis for addressing future gains and losses and serving as a safety valve for employer contributions as 2039 approaches.

As a result of this legislation and other adjustments to the pension plan, meaningful funding progress has been made over the past decade. The funded ratio has improved from 56.1% to 64.2%, an increase of approximately 14%, despite strengthening the actuarial assumptions twice during that same period. Had the funding goal been 80% over this time, fewer contributions would have been paid, less investment income would have been generated, and the pension trust would have been in a far weaker position.

So, back to that question about whether 80% is good enough: no, it's not.

Read the full American Academy of Actuaries brief:
https://www.actuary.org/sites/default/files/2021-10/80percent_Myth_Issue_Brief.pdf

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