

Summary of Retirement Issues

From August 2006 to March 2007, a “Working Group” of employer and employee representatives studied the New Hampshire Retirement Service. Our work was facilitated by the Federal Mediation Service. The recommendations were presented as a package to the House ED&A Committee, which adopted some of them and discarded others. They were right to discard some of the items. The original amendment was prepared in haste, and the House ED&A Committee was able to pare the bill down to a specific set of reforms that will enable the NHRS trust fund to regain an 85% funding level within 10-15 years.

HB 653 was passed overwhelmingly by the House. Although there are key elements in the Working Group’s proposal omitted from the bill, it is an important start and was largely adopted by the Senate ED&A committee. The Senate Committee, in an unconventional move, also took the authority of granting a COLA away from the Fiscal Committee for this year. Part of the Senate’s version of HB 653 would provide a 2 ½ % COLA this year (something the Fiscal Committee was apparently reluctant to do.)

The Senate Committee did not deal with the Working Group’s proposal for a permanent COLA, which was to be funded largely by increased employee contributions. The Senate proposed that a study commission, to be created by HB 876 should figure out how to provide future COLAs. Meanwhile, the provisions in HB 653, although less than optimal, are a critical first step. Both bills are awaiting action in the full Senate.

This report walks you through the interconnected policy pieces, and explains why certain provisions in HB 653 are critical. When considering policy options for the retirement system, it is important to remember that when one element is changed, it impacts something else. It is appropriate to take prompt and comprehensive action, and these bills are a significant beginning.

Essential aspects of HB 653

1. The funding calculation methodology

HB 653 changes the methodology for calculating the funding of NHRS to Entry Age Normal (EAN). It is a commonly accepted method and is likely to be required by the Government Accounting Standards Board (GASB.)

Current law requires NHRS to use the Open Group Aggregate (OGA) methodology. The OGA method, adopted in the early 1990's, artificially reduced employer contribution rates by shifting the burden forward. Low employer contributions resulted in an over-reliance on investment returns. When returns fell drastically in the market downturn of 2001-2003, the funding level dropped significantly. The change to EAN will provide reliable data concerning the funds liabilities and prevent a repetition of the circumstances of under funding.

2. Employer rate floor

The employer rate has been like an adjustable rate mortgage. The proposed "floor" will reduce volatility and assure a steady flow of funding.

3. Increase the trigger rate for the Special Account

Current law requires actuarial earnings in excess of ½% of the assumption rate to be put into the Special Account to fund Cost of Living Adjustments and other post-retirement benefits. Since the NHRS Board reduced the earnings assumption rate to 8.5%, investment gains in excess of 9% will be sent to the Special Account.

Due to the impact of the three consecutive bad investment years, 2001-2003, the trust fund cannot afford the previous gains-sharing methodology. HB 653 raises the trigger rate to 10.5%, so that funds will not enter the Special Account unless investment gains exceed 10.5%. And, no funds will be moved, until after the trust fund regains an 85% funding level.

HB 653 does an excellent job reforming the methodology and assuring adequate funding of future pensions. But, by cutting off funds to the Special Account, the source of funding for COLAs is gone, for a decade or more. The Working Group's recommendations include a proposal for funding retiree COLAs.

What's not in HB 653

The core of the Working Group's proposal: Changing the way COLAs are funded

1. Increase contributions from employees

- Effective 7/1/07: Reinstate the Additional Contributions program, with two revisions
 - Include the opportunity for Group I members to pre-fund an additional annuity to offset the age 65 reduction.
 - Do not allow retirees to withdraw the additional contributions in a lump sum.
- Effective date(s) to be determined, but not prior to 7/1/08: Increase member contribution rates
 - Increase Group I rate from 5% to 7%
 - Increase Group II rate from 9.3% to 13%

2. Build a 2% Cost of Living Adjustments into the plan

According to the report to the Fiscal Committee by Gabriel Roder Smith, the average NHRS pension is **\$17,640**. The table below shows how a 2% annual cost of living adjustment would help to maintain the value of the pension over a decade. When the CPI-U exceeds 2%, the COLAs may be augmented by the Retirement Stabilization Fund.

| | Average Pension | Year 1 | Year 5 | Year 10 | Year 15 | Year 20 | Year 25 | Year 30 |
|-----------------------|-----------------|--------|--------|---------|---------|---------|---------|----------|
| Employee, state | \$11,580 | 11,811 | 12,785 | 14,115 | 15,585 | 17,207 | 18,998 | \$20,975 |
| Employee, subdivision | \$8,886 | 9,063 | 9,810 | 10,831 | 11,959 | 13,204 | 14,578 | \$16,095 |
| Teacher | \$18,971 | 19,350 | 20,945 | 23,125 | 25,532 | 28,189 | 31,123 | \$34,363 |
| Police, state | \$35,248 | 35,952 | 38,916 | 42,967 | 47,439 | 52,376 | 57,828 | \$63,846 |
| Police, sub-division | \$37,839 | 38,595 | 41,777 | 46,125 | 50,926 | 56,226 | 62,078 | \$68,540 |
| Fire, state | \$34,985 | 35,684 | 38,626 | 42,646 | 47,085 | 51,985 | 57,396 | \$63,370 |
| Fire, sub-division | \$38,651 | 39,424 | 42,673 | 47,115 | 52,019 | 57,433 | 63,411 | \$70,010 |
| NHRS average pension | \$17,640 | 17,992 | 19,475 | 21,503 | 23,741 | 26,212 | 28,940 | \$31,952 |

Note: These figures are the minimum you will get. Additional amounts above the 2% may be added from the Special Account, to bring the COLAs up to the CPI-U.

3. Create a Retirement Stabilization Account

The purpose of the fund is to augment the annual 2% COLA when the CPI-U exceeds 2%. The assets in the current Special Account would be transferred to a Retirement Stabilization Account (RSA). No additional funds would enter the RSA until the NHRS funding level reaches 80%. HB 653 uses the threshold of 85%, which is closer to the national average for public pension funds. At that point, asset gains in excess of 2 ½ % above the earnings assumption rate would be put aside to support the Stabilization Fund.

Pension Benefits

The pension benefits are modest. The most valuable aspect of a defined benefit plan is that you can't out live it. That's why it's essential to include COLAs.

| Average Pensions in 2005 Valuation | Employee, Male | Employee, Female | Teacher, Male | Teacher, Female | Police, Male | Police, Female | Fire, Male | Fire, Female |
|---|----------------|------------------|---------------|-----------------|--------------|----------------|------------|--------------|
| Ages 58-62 | | | | | | | | |
| Annual amount | \$17,724 | \$11,109 | \$23,657 | \$18,987 | \$34,399 | \$13,752 | \$36,752 | \$15,400 |
| Monthly amount | \$1,477 | \$925 | \$1,971 | \$1,582 | \$2,866 | \$1,146 | \$3,062 | \$1,283 |
| Ages 93-95 | | | | | | | | |
| Annual amount | \$7,979 | \$5,816 | \$12,053 | \$9,933 | \$15,954 | | \$18,283 | |
| Monthly amount | \$665 | \$484 | \$1,004 | \$827 | \$1,329 | | \$1,523 | |

| Average Pensions GRS report 2-6-07 | Employee, State | Employee, Subdivision | Teachers | Police, State | Police, Subdivision | Fire, State | Fire, Subdivision | Overall Average |
|---|-----------------|-----------------------|----------|---------------|---------------------|-------------|-------------------|-----------------|
| All ages, annual | \$11,580 | \$8,886 | \$18,971 | \$35,248 | \$37,839 | \$34,985 | \$38,651 | \$17,640 |
| Monthly amount | \$965 | \$740 | \$1,580 | \$2,937 | \$3,153 | \$2,915 | \$3,220 | \$1,470 |

Group II pensions are higher than Group I pensions, but...

- Group II members contribute more to NHRS to build the higher pensions.
- They do not get Social Security for the time they are in Group II.
 - Public employers do not contribute the 6.2% FICA on behalf of Group II members.
 - If Group II members work in Social Security covered employment before of after the public service, the Social Security they receive from that job will be reduced based on a formula in the Social Security law. Their spouses' Social Security may also be reduced. Many Group II members are unaware of these provisions in federal law. Employers are now required to inform new hires about these provisions, but that requirement is recent.
- Group II members may start collecting earlier, but they don't live as long as Group I members. In 2005, there were 63 employees, 119 teachers, 3 police officers, and one firefighter in the 93-97 age range.

Group I members also contribute to Social Security, and receive Social Security payments

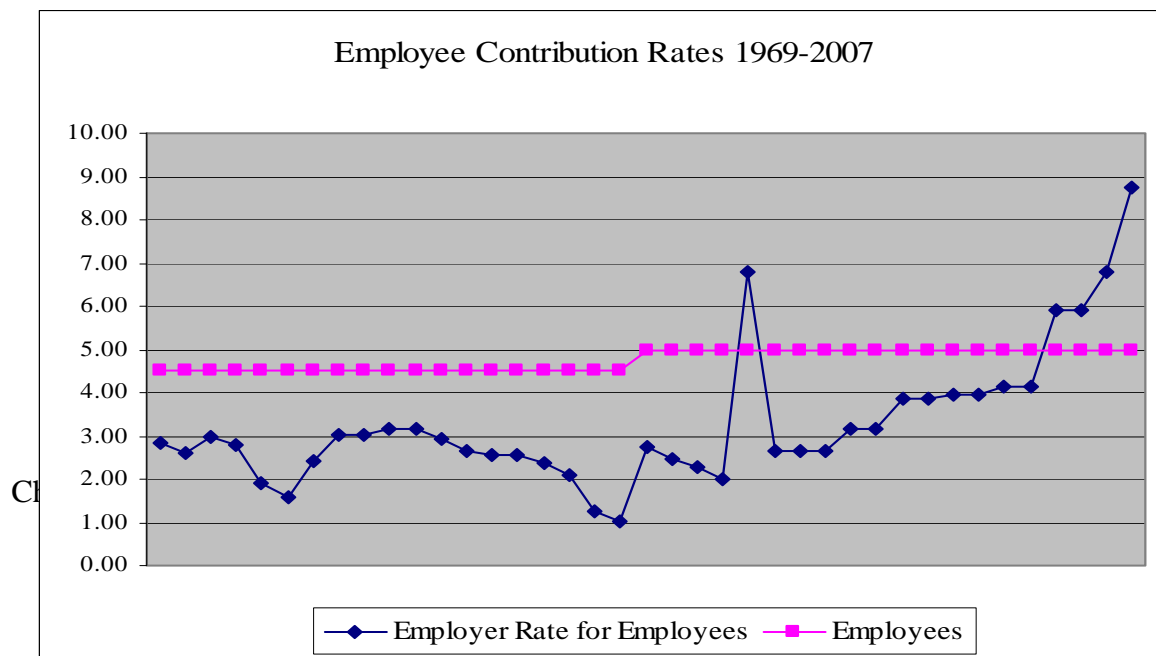
| | Group I | Group II |
|-----------------------------|---------|----------|
| NHRS Current Contribution | 5.00% | 9.3% |
| Social Security | 6.2% | 0 |
| 2008 proposed increase NHRS | 2% | 3.7% |
| Total | 13.2% | 13% |

Sources: GRS report to the Fiscal Committee, February 2007; 2005 Valuation, pp D-9-D15; CAFR www.nhrs.org

Summary: The NHRS Defined Benefit Plan Works

The Working Group of employers and employees unanimously supported the continuation of a defined benefit plan for New Hampshire public employees. Defined benefit plans give the best bang for the buck you'll find. The State of New Hampshire, its cities, towns and counties are able to attract and retain quality public employees while contributing less than 25% of the cost of the retirement benefit. Three quarters of the cost is paid by employee contributions and investment gains. In order to get this kind of a bargain; funding employee benefits at a quarter on the dollar, adequate amounts must be put into the trust fund, steadily, over long periods of time. The trust fund is somewhat like a mortgage. The more money you put in early, the less it will cost in the long run. Conversely, if you don't put in enough, it will cost more later on. That's the case with the NH Retirement System - there is a need to play catch up with the employer rates.

Employee/Employer Contribution Rates on Behalf of Employees



Note: Employer rates on behalf of teachers were even lower.