# State of New Hampshire

GENERAL COURT

CONCORD

# MEMORANDUM

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| **DATE:** | **December 1, 2017** |
| **TO:** | **Honorable Christopher Sununu, Governor**<br>**Honorable Gene G. Chandler, Speaker of the House**<br>**Honorable Chuck W. Morse, President of the Senate**<br>**Honorable Paul C. Smith, House Clerk**<br>**Honorable Tammy L. Wright, Senate Clerk**<br>**Michael York, State Librarian** |
| **FROM:** | **Former Representative David Hess, Chairman** |
| **SUBJECT:** | **Interim Report of the Decennial Retirement Commission; RSA 100-A:57** |

Pursuant to RSA 100-A:57, enclosed please find the Interim Report of the Decennial Retirement Commission.

If you have any questions or comments regarding this report, please do not hesitate to contact me.

Enclosure

cc. committee members

# INTERIM REPORT

## Decennial Retirement Commission

## RSA 100-A:57, Laws of 2017

## December 1, 2017

Under RSA 100-A:57, the Decennial Retirement Commission (the Decennial Commission) was charged with making recommendations to ensure the long-term viability of the New Hampshire Retirement System (NHRS). The governing statute specifies twelve specific charges in addition to this general charge.

Former Rep. David Hess was designated by Governor Sununu to serve as the chairman of the Commission, in consultation with the Senate President Morse and the Speaker Shawn Jasper. The other members of the Commission include state legislators, the Executive Director of the NHRS, members representing employer and employee groups, a member representing retirees, and four public members "with recognized expertise in finance, financial management, or the governance and oversight of large endowments or public funds". The Commission met 13 times between August 31, 2017 and November 29, 2017.

Commission members reviewed and discussed extensive material and testimony presented by members of the staff of the NHRS – George Lagos, Executive Director, Marty Karlon, Public Information Officer and Larry Johansen, Director of Investments - representatives of the NHRS employee and employer groups, and reports commissioned from the Center for Retirement Research at Boston College (CRR) and Gabriel Roder Smith (GRS), the actuarial firm employed by NHRS. During the course of their three months of work, the Commission voted to adopt twelve recommendations.

A detailed final report is currently being drafted that will include background on all of the major findings of the Commission. It will be filed on or after December 8, 2017. This interim report lists the twelve recommendations that have been adopted by a majority vote of the Commission.

### *Decennial Retirement Commission Timeframe for Work*

1. The Commission recommends amending the statute that establishes the Decennial Retirement Commission to permit the work of the Commission to begin earlier and thus provide more time overall for its work; no specific timeframe recommended.

   Moved by Mr. Corrigan, seconded by former Rep. Christie, **adopted 13-0,** October 12

**Mr. Corrigan's summary:** The Commission unanimously felt that it has been unduly rushed to comply with its statutory deadline and still consider all relevant issues in sufficient detail. Some other states that implement similar commissions and committees allocate a whole year to complete their work. States with longer timeframes for retirement commissions may tend to receive and implement recommendations that are better considered and more far reaching after hearing in-depth testimony and reports unavailable in shorter timeframes such as the one this Commission was forced to operate under.

***Extending Terms of Office; NHRS Board of Trustees***

2. The Commission recommends the terms of office for members of the Board of Trustees of the New Hampshire Retirement System be changed from two to three years, with provision for staggered terms to achieve implementation.

Moved by Dr. Gustafson, seconded by former Rep. Christie, **adopted 12 – 0,** October 26

**Dr. Gustafson's summary:** The NHRS Board of Trustees has 13 seats. Four members are from employee representative organizations, four members are from employer representative organizations, and four members are independent public members. All these members currently serve two-year terms upon the nomination of Governor and appointment by the Executive Council. The Treasurer of the State of New Hampshire is an ex office member and serves by virtue of office. All Trustees must have familiarity with or experience in finance or business management.

With members serving two-year terms, approximately one half of the Board comes up for appointment or reappointment every year. This has presented challenges in keeping Board positions filled and is a near continuous process of bringing forward names for consideration. It is not unusual to have several positions either vacant or in the process of reappointment at any given time. While the NHRS has a highly functioning Board, the short two-year terms work against coherence and continuity.

SB 140, effective on August 15, 2017, established three-year terms for the five members of the NHRS Independent Investment Committee ("IIC"), with the provision for reappointment. Prior to this legislation, terms on the IIC were open-ended. Three members are appointed by the Governor and the Executive Council, and two members from the NHRS Board of Trustees are appointed by the NHRS Board Chair. All IIC members must have extensive professional experience in the field of institutional investments or finance.

Amending RSA 100-A: 14, I. to provide three-year terms for NHRS Trustees would align Trustee terms with those of the Independent Investment Committee, promote continuity, and improve administrative efficacy.

***Amortization of the UAAL***

3. The Commission affirms that the amortization of the existing UAAL should not be extended beyond 2039.

   Moved by Rep. McGuire, seconded by Mr. Kaloogian, **adopted 13-0,** October 12

**Rep. McGuire's summary:** This recommendation prevents "kicking the can down the road" by stretching payment of the existing UAAL (generated between 1990 and 2008) beyond 2039. Any such action increases total costs and violates intergenerational equity, since the plan already requires the children of the beneficiaries to pay for the decisions made decades ago.

***Layered Amortization***

4. The Commission recommends that the Legislature authorize layered amortization for any future gain or loss for a fixed period that is between 15 and 20 years.

Moved by Rep. McGuire, seconded by Commissioner Hodgdon, **adopted 8-3,** October 12

**Rep. McGuire's summary:** This recommendation institutes a different amortization method than the NHRS currently uses, and one recommended as "best practices" by the society of pension actuaries. When calculating the UAAL, layered amortization keeps each change separate and amortizes it over a fixed period appropriate for its cause. For example, a change in benefits should be amortized over the working life of the affected employees, typically 20 years; a significant change in investment performance (up or down) should be amortized over a shorter period.

This process has several advantages. First, by applying the appropriate amortization period, it improves intergenerational equity since those getting the benefit of the change pay for it. Secondly, it helps prevent extreme changes in funding requirements. Finally, it makes it easier to understand the effects of changes by keeping the layers separate.

***Change in Calculation of Amortized Payments***

5. The Commission sees a potential benefit in a level dollar amortization schedule and therefore recommends that the legislature form a study committee to look at the advantages and disadvantages of moving from a level percentage of payroll to the level dollar amortization plan.

   Moved by Mr. Dunn, seconded by Rep. Ohm, **adopted 12-2**, November 29

**Mr. Dunn's comments**: The Commission adopted this recommendation in recognition of the need for further study by the Legislature of the potential benefits of changing the current UAAL amortization of level percentage of payroll to a level dollar amortization. Taking into account the short period of time that the Commission has had to meet, make recommendations and finalize a report, we do not feel that there has been sufficient time to study this thoroughly. However, the Commission does feel there may be some potential benefit in moving towards this model. Also, taking into account the various bills (ie. HB 413) that have been introduced to reinstate the state subsidy to municipalities and political subdivisions, it may be worthwhile for the state to considering funding the cost of moving to a level dollar amortization instead of subsidizing the contributions again.

***State Subsidy for Local Employers***

6. The Commission recommends that the Legislature reestablish a state subsidy for local subdivision contributions.

   Moved by Sen. Watters, seconded by Dr. Gustafson, **adopted 9-4,** October 12

   **Sen. Watters' summary:** In response to a Commission request, the New Hampshire Retirement System produced a document setting forth the ways that employer rates could be more stable and predictable going forward. One option was to reinstitute the State's subsidy for the political subdivisions' contribution for police, fire and teachers. The elimination of this subsidy had a significant impact on employer contribution rates for municipalities and other political subdivisions. Reinstituting a subsidy at 15%, as proposed in HB 413 earlier this year, would have shaved more than $40 million from municipal pension costs for that fiscal year by adding it to the state budget. This subsidy was eliminated as part of the changes made to the retirement system and the state funding contribution in 2011 subsequent to the economic downturn. Municipalities have claimed that this "downshifting" of retirement contribution costs was not adequately offset and was a retreat on state obligations to the pension obligations to these employees.

   HB 413 proposed that the state pay 15% of Group I and Group II municipal employee "normal contribution" and "accrued liability contribution." The fiscal note for this bill projects a net impact on state expenditures under this formula of $43.37 million in FY2020 and $44.70 in FY2021, resulting in a net reduction of that amount for local subdivision contributions to the NHRS.

   The Decennial Commission makes no recommendation as to the size of a reestablished state subsidy or the source of funding. The motion adopted recognizes the reestablishment as a means to reduce employer rates for political subdivisions.

***Retirees Returning to Work***

7. The Commission recommends future legislation which enhances the reporting and compliance criteria to aid the NHRS in enforcing the law addressing retired members working part-time after retirement.

   Moved by Commissioner Hodgdon, seconded by Sen. Carson, **adopted 13-0,** October 12

   **Commissioner Hodgdon's summary**: This recommendation would provide some enforcement powers to the NHRS which has limited power now to stop offenses from occurring. There is an onerous reporting process in place; the NHRS sends out letters, but there are no consequences when this occurs to either the employee or the employer.

8. The Commission recommends that the current 32 hour weekly limitation provision be replaced by an annual calendar year limit of 1,040 hours and that participating employers be required to report retiree work hours and compensation on an annual basis.

   Moved by Commissioner Hodgdon; seconded by Rep. McGuire, **adopted 11-1,** November 21

   **Commissioner Hodgdon's summary**: This greatly eases the administrative burden for employers and the NHRS. It eliminates the disconnect between the employer's payroll cycle and the tracking and reporting cycles that exist under current law. The annual work hours would provide greater flexibility to employers in making work schedules and staffing decisions. The Commission asked the NHRS to look at a number of other states' part time work hour ceilings and 1,040 was a very reasonable threshold with many states at 1,040 or lower.

9. The Commission recommends that a penalty be enacted which would authorize the NHRS to suspend the state portion of a retiree's annuity benefit for a 12 month period if the retiree exceeds the annual 1,040 hour threshold. The retiree shall be required to track his or her hours worked.

   Moved by Commissioner Hodgdon; seconded by Rep. McGuire, **adopted 9-5,** November 21

   **Commissioner Hodgdon's summary**: This puts the burden of tracking the work hours on the employee as they could be working for multiple employers that are participating NHRS employers and the individual employers may not be aware of the others. The NHRS would notify the retirees subject to the penalty no later than April 1st and the retiree would have a 45 day period to appeal. NHRS auditing of work hours would still occur before any penalties were imposed. This is a serious penalty, but we want the employee to understand the importance of complying with this limitation on annual working hours. Penalties would begin with the July payroll and continue for 12 months.

10. The Commission recommends that a retiree shall not return to part-time employment for any participating NHRS employer for a minimum of 60 days from the effective date of retirement.

    Moved by Commissioner Hodgdon motion; seconded by Rep. McGuire, **adopted 13-1,** November 21

    **Commissioner Hodgdon's summary**: There is general knowledge of employees that are retiring only to turn around and be back at work within a matter of days, often time doing the same job they did when they worked full time. It has become an accepted practice, when in fact it is not and puts the employer/government agency at risk. While there are rare exceptions when this might make sense, in so many cases, it is lack of preparation and the easy way out. It doesn't force the employer to adequately prepare for knowledge transfer to protect the agency, to allow junior level employees promotional opportunities, and we often pay the part timers at premium rates close to their hourly salary when they left. We really need to prepare for someone's retirement as if they are not coming back, ensuring documentation and training have taken place for those left behind.

***Pension Adjustment at Age 65***

11. The Commission recommends legislative action to defer the reduction in benefit for Group I active employees at age 65 until age 67.

    Moved by Ms. Stacey; seconded by former Rep. Christie, **adopted 10-4,** November 21

    **Ms. Stacey's summary**: The Commission is aware the reduction in benefit at age 65 is now coincidental to and not linked specifically to the eligibility of Social Security benefits. As the age of eligibility for Social Security benefits has increased, the Commission encourages the legislature to defer the NHRS benefit adjustment to age 67 for current Group I active employees in consideration of Social Security benefit eligibility.

    The Commission requested GRS to provide cost estimates for calculating the cost of: A. Elimination of the reduction at age 65 for all Group I retirees and current employees; and B. Deferral of the reduction in benefit for Group I active employees to age 67. Cost analysis was performed utilizing the current UAAL amortization schedule payoff of 2039.

    The Commission reviewed the cost analysis pertaining to the increases in Employer rates based upon the current 2039 amortization schedule and determined the following:

    *Scenario A*: The elimination of the reduction for Group I at age 65 for all current retired and active members is estimated to cost $788.2 million based upon the current 2039 amortization schedule for the UAAL. The impact on current employer rates would increase 2.26% for employees and 3.11% for teachers.

*Scenario B*: Deferral of the reduction for Group I active employees to age 67 is estimated to cost $45 million based upon the current 2039 amortization schedule for the UAAL. The impact on current employer rates would increase 0.17% for employees and 0.22% for teachers.

There was sentiment to remove the reduction in its entirety, but the reality of budget constraints and taxpayer burden coupled with the UAAL amortization schedule of 2039 make that option unrealistic at this time. Should a layered amortization schedule be implemented in the future, the removal of the reduction in its entirety could be revisited.

***Temporary Supplemental Allowance***

12. The Commission recommends that the legislature make a one-time payment of $500 per retiree in 2018, and whenever funding is available.

Moved by Rep. McGuire; seconded by Sen. Watters, **adopted 10-4,** November 21

**Rep. McGuire's summary:** This recommendation addresses the problem that a defined benefit pension, however generous it may seem at the time of retirement, is continually eroded by inflation, particularly with retirees living longer and longer (many living 20 or 30 years after retirement) and medical costs rising. Even if a retiree receives Social Security benefits as well, those inflation adjustments have been less than the cost increases experienced by retirees.

A true, compounded cost of living allowance (COLA) is prohibitively expensive. Even a modest 1.5% increase on only the first $30,000 of pension benefits for active and retired members, after compounding, would increase the UAAL by over $1.5 billion. A one time temporary supplemental allowance creates no future obligations, and can be funded in the normal budget process. $500 is an amount that is large enough to be helpful, while still low enough that the total cost (approximately $8 million) is reasonable to consider in the context of other demands for funding.

In the long run, funding for extra expenses after retirement will need to be funded by additional employee savings. Even modest amounts saved over a working career, invested in a tax sheltered account, can become substantial sums. However, current retirees and those close to retirement do not have this opportunity.