November 5, 2020
Minutes #576

**Minutes of the Board of Trustees' Meeting -1-**

**Special Notice: Due to the COVID-19 outbreak, this meeting of the MECRS Board of Trustees was conducted exclusively as a conference call due to social distancing requirements.**

**Pursuant to RSA 91-A:2 III (B), Executive Order 2020-04, Section 8 and Emergency Order #12, Section 3, Chairman Molan has determined that an emergency exists due to the worldwide COVID-19 pandemic and, therefore, a physical presence of a quorum is not practical.**

**Pursuant to the Attorney General's Public Guidelines by Emergency Order #12, Section 4, the requirement that the public body still provide a physical location to allow public access was waived. All votes taken during a meeting at which any member participates electronically must be a roll call vote, listing all members participating and their vote on each motion.**

**Conference call connection details were provided to invited participants, and would have been provided to members of the public seeking to attend but no such requests were received.**

**Call to Order:** Chairman Molan called the meeting to order at 10:01 a.m.

Before moving forward with the agenda items Mr. Fleury referenced the SPECIAL NOTICE regarding the COVID-19 Pandemic, and read it into the minutes.

**Linked Via Conference Call:**

Executive Director Fleury conducted a roll call for those participating via conference call.

Participating Remotely: Chairman Molan, Trustee Gagne, Trustee Ntapalis, Bunker and Trustee Wickens. All trustees stated that they were alone during the remote session.

Also linked remotely, in addition to Mr. Fleury were, MECRS staff members, Sandi Aboshar and Suzanne Wilson, Attorney John Rich from McLane Middleton Professional Association, Mr. Ken Alberts, Kevin Noelke, Carrie Hilgendorf and Heidi Barry all from Gabriel, Roeder, Smith & Co., Mr. Mark LaPrade and Mr. Tyler Butler both from Berry Dunn as well as Mr. Kevin Leonard from NEPC.

Not Participating: Mayor Joyce Craig

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**New Business:**

Presentation of Experience Study – Representatives from Gabriel, Roeder, Smith & Co were linked remotely to deliver the results of the board commissioned, 3-Year Experience Study.

Chairman Molan stated that the sole purpose of the Special meeting of the Board is to hear the presentation on the Experience Study, conducted by the Systems Actuary GRS. He then invited Mr. Alberts and his team to begin.

First, Mr. Alberts introduced his colleagues, who also were instrumental in working on the Experience Study.

Before he began his presentation, Mr. Alberts referred to the recent change in the composition to the MECRS Board and offered to go through an actuarial one-on-one, if the board was so inclined. All trustees stated that they were familiar with actuarial concepts and agreed to have Mr. Alberts and his team begin the presentation.

Mr. Alberts directed the trustees to turn to page A-1 of the Experience Study booklet explaining the actuarial valuation model and the need for actuarial assumptions. He detailed factors such as financing the funding obligations, the level percentage of payroll contributions and how it is computed, as well as the MECRS's member demographic characteristics.

Mr. Alberts then turned the presentation over to Kevin Noelke to explain the demographic Experience. Mr. Noelke referred to the charts on page B-1, first explaining the aggregate summary of active decrements experience between 2017-2019 and how that those demographics, provided results in the second chart, History of Pension Gains (Losses). He reported that the pension accrued Liability in 2012 was approximately $260 million and in 2019 the pension accrued liability was approximately $370 million.

Mr. Alberts noted that in reviewing assumptions, his team looked back at the previous experience study and found that experience is moving in the same direction for nearly every assumption. In a few cases, he indicated that they relied on the experience over the combined period to base the recommendations, such as the disabilities and the load for lump sum (compensations) payments prior to retirement.

Mr. Noelke continued explaining the different assumptions in Section B and he informed the trustees that the pages in the booklet following the demographic chart, explain each demographic in detail, for the trustee's further review.

Next, Mr. Noelke turned the trustee's attention the chart on page B-5 inclusive of a list of the System's current assumptions such as rates of withdrawal, rates of disability, marriage assumption, rates of retirement, mortality rates as well as economic assumptions. He explained that given past experience and current economic rates, GRS is recommending the three alternative assumptions at the bottom of page B-5 be taken into consideration by the MECRS Board.

Mr. Fleury offered a synopsis regarding Section B of the presentation, noting that GRS is providing recommendations on some of the factors that could be changed in a particular direction. He stated that that there is a relevant range within each factor that can be adjusted and that GRS is comfortable with that range it is recommending and is looking to the board as decision makers, on whether to accept the recommendations or to find an increment that may be slightly different from the recommendation. Inevitably, the factors adopted by the Board, so long as they are within GRS's conform range, will form the basis for future valuations. Mr. Alberts and Mr. Noelke agreed that Mr. Fleury's statement was correct.

Mr. Alberts turned the board's attention to the Section C of the presentation, Economic Activity. He explained that GRS performed the economic analysis using a building block method which begins with an analysis of price inflation. Once the price inflation assumption is established, he indicated that GRS adds an assumption of real return to get to the normal assumed rate of investment return, or they add a real wage growth to get to the assumed wage inflation and then add a merit and longevity increase assumption to get to the total assumed pay increases.

Mr. Alberts detailed the table on page C-1, stating that actual price inflation was below the assumed price inflation in four of the last five years. In 2019, experience was effectively equal to the assumption (actual price inflation exceeded assumed by 4 basis points).

After explaining the forward-looking price inflation forecasts detailed in the Experience Study, Mr. Alberts stated that GRS is recommending changing the price inflation in the range of 1.75% to 2.25%.

Mr. Alberts explained that the current assumption of wage inflation at 2.75% and price inflation at 2.25% implies that wage inflation exceeds price inflation by .50% and that GRS is generally comfortable with the wage inflation assumption exceeding the price inflation assumption by 0.50% to 1.00%.

Mr. Alberts reviewed charts detailing the difference between the increase in National Average Earnings and price inflation over various periods, ending December, 2019 and worked through a table showing the change in average pay for MECRS's members.

Mr. Alberts stated that given the disruption in employment caused by the response to the pandemic during 2020, it is currently unclear whether the national trend or the MECRS trend should be given more credibility. He stated that GRS is recommending a decrease of 0.25% from the current assumption.

The next part of the presentation Mr. Alberts continued, is the MECRS Investment Return segment. He reported that the last 5-year historical returns for the System have been below the assumed return while the last 10-years have been right at the assumed return (on a market value basis). During this period, he stated the future expectations have continued to decrease, in general. The Experience Study analyzed the System's policy asset allocations as of December 31, 2019 with the capital market assumptions from thirteen nationally recognized investment consultants to model forward looking expectations. It is important to note Mr. Albers stated, that in general, the asset classes provided by different investment consultants will not coincide exactly. Moreover, there are differences in investment horizons, price inflation, the treatment of investment expenses excess manager performance, geometric vs. arithmetic averages, and other technical differences.

Based on forward looking assumptions for investment returns as well as historical trends in price inflation. Mr. Alberts informed the board of a recommended price inflation assumption between 1.75% and 2.25% and an investment return assumption between 5.75% and 6.75%.

Regarding the recommended rate of return assumption of 6.75%, Trustee Ntapalis asked Mr. Alberts if the 6.75% rate seems to be the direction taken with other clients in the public plans sector, to which Mr. Alberts responded, yes, and it also has to do with each clients' asset allocation as well. Overall, he stated the rate of return assumption have decreased.

Mr. Fleury asked Mr. Alberts if the earnings assumption is reduced, will there be a significant correlation as to what the employer contribution rate will be, to which Mr. Alberts replied, absolutely. Mr. Fleury stated that he is concerned that once a set of assumptions is adopted by the Board and it causes the employer rate to increase that it will not be well received by the City Board of Mayor and Aldermen.

Mr. Alberts cautioned the board on selecting a recommendation and to choose the one that best reflects the Board's expectations over a long-term.

Trustee Gagne agreed with Mr. Fleury's concerns on the increase in the employer contribution rate however he stated that adopting a set of recommended assumptions now will prevent steeper changes over the long term. All of the Trustees expressed a willingness to decrease the investment return assumption but concerns were also expressed as to the impact on the City budget and the related implications.

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Mr. Alberts spoke on the merits of considering the recommended rates of investment return over the long-term and suggested that there were other strategies available to address the amount of money required to be contributed by the City. He suggested working with the City and possibly developing a funding policy procedure or possibly incorporating a smoothing contribution change rather than choosing an alternative set of assumption rates.

The trustees and the representatives from GRS continued to discuss the impact of the recommended investment return assumptions on the City contribution rate along with the impact to the City of the increase in the State Retirement System cost.

Chairman Molan stated that as fiduciaries, the Board has to insure that the System runs appropriately. He felt it best to re-visit the investment return assumption conversation at the November 10, 2020 Board of Trustees meeting whereby an NEPC representative will be in attendance to offer input on future investment return assumptions.

Mr. Alberts directed the board members to turn to page B-6 Cost of Living Adjustments. He stated that the Retirement System does not have a provision for granting automatic Cost-of-Living Adjustments (COLA) after retirement. However, the System does have a history of grating ad-hoc COLA's. Given previous experience and forward-looking expectations of price inflation, GRS believes a reasonable range for this assumption would be between 0.80% and 1.20%. He stated that the recommendation is that the Board consider the current economic conditions and likelihood of future COLA's before adopting a specific assumption. He noted that the current assumption is 1.00%.

While recent experience suggest that the current COLA assumptions is reasonable Mr. Alberts stated, in light of the recommendation to lower the price inflation assumption, it may be reasonable to lower the COLA assumption. He noted that a reduction of 25 basis points would decrease the employer contribution rate by 0.75% to 1.00% of payroll.

Moving on to the lump sums payable at retirement, Mr. Albert reported that currently normal and early retirement costs are adjusted by 10% to recognize lump sum payments for severance payouts at retirement. He referred to a chart on page B-6 detailing data over the 5-year period which indicates that the average increase over the expected Final Average Earnings resulting from these lump sums at retirement is just under 13%, while the 10-year average is just over 12%. When the prior Experience Study was conducted, he reported, GRS recommended that the Board adopt a 12% load based on actual experience. At that time, Mr. Alberts indicated that there was some concern on the Board's part that an early retirement program offered during that period may have temporarily influenced experience and that experience was expected to reduce going forward.

The Board adopted a 10% load assumption with the provision that this assumption continue to be monitored and the experience study be performed 3 years later. While experience has come down, Mr. Alberts reported the experience still supports a 12% load and it is therefore recommended the current assumption of 10% be increased to a 12% load.

Mr. Alberts stated that GRS is not recommending a change in the health valuation assumption.

Regarding the merit salary increases, Mr. Alberts stated a recommended adjustment to lower the overall assumed salary rate increases and he illustrated charts on pages D-13 and 14.

Working through his presentation, Mr. Alberts addressed the amortization period/funding policy. He stated that the current financing policy is to amortize all unfunded actuarial accrued liabilities (UAAL). As of 2019 valuation, he stated, the closed period is 20 years. He explained that since a closed period results in every year's change in liabilities (due to gains/losses, plan changes, and /or assumptions changes) having a larger effect on the contribution rate, GRS is recommending adding a layered feature to the amortizations. He informed the board that the process would continue to be repeated with each experience study. While the initial amortization period of each layer is a matter of Board policy, it is recommended closed periods starting at 25 years for each new base.

Mr. Fleury commented that utilizing the layering concept, in conjunction with an Experience Study every 5 years, seems to push out being 100% funding almost indefinitely. Is it possible to ever achieve 100% funding Mr. Fleury asked? And how does layering differ from restarting the amortization period?

Mr. Alberts replied yes, it is possible to reach 100% funding. What is happening with the layered approach, as it approaches the end of the normal amortization period only, the results from the layering remains and he cautioned about restarting the amortization period because it can be interpreted as never intending to fund the liability and it triggers the need to substitute a much lower earnings assumption.

Mr. LaPrade concurred that there would be complications with restarting the amortization period.

Mr. Fleury asked if he understood correctly that layering will avoid the GASB implications that re-starting the amortization period would entail, to which Mr. Alberts stated is a correct observation.

Ms. Heidi Barry from GRS elaborated further on the layering process and how the it is possible to reach the 100% funding and she also cautioned that the alternative assumption resulting from restarting the amortization period would require use of a rate slightly above 2%.

Moving on, Mr. Alberts directed the trustees to charts on pages B-8 which reflected the proposed demographic assumptions changes of the three alternative recommendations. Page B-9, he indicated, reflects the layered amortization schedule.

Attorney Rich asked Mr. Alberts to re-cap the concept of the layered approach and the impact on the Plan, which Mr. Alberts did.

Mr. Alberts responded that GRS is recommending the layered approach however, he stated the he is not necessarily recommending that the layered approach become effective with the other recommendations, and it is something that the board may want to consider in the future.

Mr. Fleury asked Mr. Alberts when he would need a decision from the Board on the recommended assumptions, since they will impact future valuations beginning with the upcoming one.

Mr. Alberts responded that GRS does not need a decision today, He explained that the deadline for the decision is the second week in January, 2021when the Retirement System forwards member data for the next valuation.

After brief discussion and consideration of the recommended changes the trustees agreed that no decisions were reached as it became obvious that more discussion on the Study would be needed at a subsequent meeting.

Chairman Molan thanked all those participants attending the meeting remotely.

**Motion to Adjourn:**

Trustee Gagne moved to adjourn the meeting at 11:57, a.m. seconded by Trustee Wickens.

Mr. Fleury conducted a roll call vote.

Ayes: Chairman Molan, Trustee Gagne, Trustee Ntapalis, Trustee Bunker and Trustee Wickens.

Nays: None

Motion carried.

Respectfully Submitted,

Gerard E. Fleury
Executive Director