Manchester Employees' Contributory Retirement System
Funding Policy

Goals Statement: The Manchester Employees' Contributory Retirement System, (MECRS) recognizes that the main financial objective of a public employee defined benefit plan is to fund the long-term costs of benefits to members. As part of this objective, and to be consistent with the government budgeting process, it is the stated intent of this policy to achieve relatively stable and consistent employer pension contribution levels so as to reduce contribution volatility from year to year. Annual contributions should, to the extent reasonably possible, maintain a close relationship to the both the expected cost of each year of service and to variations around that expected cost. To realize these objectives, this Funding Policy defines a risk management framework, actuarial cost method, actuarial assumptions, asset valuation method, amortization method, a funding objective and a funding target which are consistent with the desired outcome. Terms not defined herein are those used or defined in the annual actuarial valuation.

Statutory Framework:

Funding for the MECRS is provided for in state statute. The obligation of the contributing employers of the City of Manchester to fund the MECRS was established by the New Hampshire Legislature in State of New Hampshire Laws of 1973, Chapter 218 which has gone through numerous subsequent amendments and is uncodified. Chapter 218 provides for both an employee retirement benefit as well as a medical subsidy. Chapter 218 provides the following:

> 218:8 Contributions by the City.
> The city shall appropriate annually to the retirement board the amounts required to fund the benefits set forth in the act as determined by the retirement board on the basis of an actuary's valuation, which shall be based on sound actuarial funding methods, assumptions, and principles.

In addition, under Chapter 218:28, after taking into account the member 1.25% contribution, the city is obligated to fund the remaining cost of funding the 401(h) subtrust based on methods and assumptions determined by the board.

Risk Management Framework:

The policies for managing identified risks are outlined in this section.

> **Funding Risk:** Regular valuations provide data that informs decisions impacting employer contribution rates to reflect actual experience as it emerges. The Board of Trustees has adopted a policy of annual valuations to determine employer contribution rates and for financial reporting purposes.
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> **Investment Risk:** Investment risk for MECRS is managed in part through the use of formal Investment Policy Guidelines which are maintained collaboratively with the MECRS Investment Advisor. The Investment Policy Guidelines conform to the Asset Allocation Policy, also maintained collaboratively with the Investment Advisor and both are reviewed at least annually to ensure that they reflect changes in economic reality and conditions within the Plan. In addition to the use of an Investment Policy Guidelines, MECRS uses asset smoothing across a five-year period in its valuations to damper the effect of market price volatility.

Demographic Risk: Demographic risk for MECRS is managed by conducting actuarial valuations annually and also by performing an actuarial experience study at least once every five years. In addition, MECRS helps to control benefit costs through to use of formal regulations and practices for determining cost of living adjustments (COLAs).

Benefit Risk: To the extent that benefits increase either by legislative change to the MECRS or by COLAs above the assumed rate, there is likely to be an adverse impact on the ability of MECRS to fund the long-term costs of promised benefits. The Board of Trustees has historically not proposed legislation enhancing MECRS benefits. There is no statutory requirement that legislation impacting MECRS funding be presented to the Board of Trustee for review and comment. To the extent that the Board of Trustees becomes aware of proposed legislation impacting benefits or is asked by proponents of new legislation to comment, the Board of Trustees has historically commented on the potential legal, administrative, Tax Code compliance and funding impact on the System. MECRS has promulgated Administrative Rule 7, Cost of Living Adjustments, which prescribes a methodology for the determination of the inflation rate and the sufficiency of funds through earnings to pay for COLAs. A yearly cost of living adjustment in the amount of 1.00% is part of the MECRS actuarial assumptions. In addition, MECRS currently has a tiered benefit structure with the ultimate tier being more costly than the initial tier. As a result, benefit liabilities will increase as members under the initial tier are replaced by new members entitled to benefits at the higher tier. Members at the lower tier also have the ability to upgrade their benefits to the upper tier prior to termination of employment under Chapter 218:12,VI which increases employer contribution liability.

Benefit Security Risk: The use of contribution rates determined annually through the actuarial valuation process do not guarantee the security of the promised benefits due to extraordinary events beyond the control of the Board of Trustees which could have a detrimental impact on investments. Such events include geopolitical events such as wars, terrorist attacks, political unrest and instability, stock market crashes, interest rate shocks, hyperinflation, currency devaluation, food and energy shortages, earthquakes, hurricanes and other natural disasters.

When the Board adopts valuation results and certifies the rates listed in that report, the Board considers whether they are aware of any extraordinary events, or unidentified changes to demographic trends and assumptions that could result in significant changes in liabilities and therefore, to the security of the member benefit expectation. If the Board Trustees becomes aware of such situations, it will consider whether it is appropriate to ask the actuary to revisit the contribution rates which appear in the valuation.

Actuarial Cost Method:

Various cost methods are employed by pension funds and certain methods tend to be more relevant for defined benefit public plans. MECRS has adopted the "Individual Entry-Age Actuarial Cost Method" as the method to be used by its actuary, which means that normal costs are calculated using benefits based on projected service and salary at retirement and allocated over an individual's career as a level percentage of payroll. The Actuarial Accrued Liability under this cost method is the accumulation of normal costs accrued prior to the actuarial valuation date. The Actuarial Accrued Liability represents the theoretical amount of assets required to fund benefits earned on members' past service. The normal cost represents the cost required to fund benefits accruing during the current year. The normal cost is computed based on the MECRS tiered benefit structure. As a result, the normal cost rate is expected to increase as the members affected by the initial tier are replaced by new members, or when members upgrade their prior service.

Actuarial Assumptions:

Actuarial assumptions are revisited as part of the annual valuation process and formally reviewed as part of a 5-year Experience Study Process commissioned by the Board of Trustees. Large and frequent changes to the assumptions are not made. Changes tend to be minor adjustments intended to tweak the assumptions in response to experience as it emerges.

Assumptions include: the rates of investment income and salary increases, along with rates of mortality, disability, turnover and retirement. The rates of investment income are reviewed in collaboration with the Investment Advisor while the rate of salary increases are based upon several factors including pay grade tables derived from collective bargaining agreements between employees and the contributing employers of the city.

The target rate of investment return, (which can differ from the actual return) is 6.75% per year, compounded annually (net of investment expenses). This assumption is used to make money payable at one point in time equal in value to a different amount of money payable at another point in time. The assumed real rate of return (the net return in excess of the wage inflation rate) is 4.25%.

If the number of active members remains constant, then the total active member payroll will increase 2.50% annually, the base portion of the individual salary increase assumptions. This increasing payroll was recognized in amortizing unfunded Actuarial Accrued Liabilities.

Asset Valuation Method:

Each previous year's valuation assets are increased by contributions and reduced by refunds, benefit payments, and expenses. An amount equal to the assumed investment return for the year is then added. Differences between actual return on a market value basis and an assumed return are phased-in over a five-year smoothing period.

Amortization Method:

Unfunded Actuarial Accrued liabilities are amortized by level (principal and interest combined) percentage of payroll contributions over a declining number of future years for pension benefits and also for health subsidy benefits. The amortization period is closed for both pension benefits and health subsidy benefits

Funding Objective and Funding Target:

The funding objective of the MECRS is to establish and receive contributions which, when expressed as a percentage of active member payroll, will remain approximately level from year to year and will accumulate sufficient assets over each member's working lifetime to finance promised benefits throughout his or her retirement. The funding target is to achieve 100% funding. For this purpose, 100% funding means that the Actuarial Value of Assets equals the Actuarial Accrued Liability. The Board of Trustees reviews progress toward the funding target annually in connection with the adoption of the valuation. The MECRS objective is to reach 100% funding by 2042. In addition, it is the intention of the MECRS to reach 75% funding on or before December 31, 2030.