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March 25, 2016

Mr. Adam M. Cloud, Treasurer
Office of the City Treasurer
City of Hartford
550 Main Street
Hartford, CT 06103

Re: City of Hartford MERF Funding

Treasurer Cloud:

As a follow up to the email you forwarded to us from the City's Chief Operating Officer, Darrell V. Hill, we have calculated the potential reduction if the July 1, 2015 liability were amortized over 30 years rather than the current fixed schedule of 25 years for the 7/1/2013 unfunded liability and 15 years for changes since 7/1/2013. If that change in amortization policy were adopted the Actuarially Determined Employer Contribution (ADEC) calculated for 2016-2017 in the 2015 Actuarial Valuation would drop by **$2.08 million** to $38.77 million.

Since the amortization policy was recently changed, we would recommend that any new change to that policy be discussed with all relevant stakeholders (rating agencies, auditors, etc.) since it raises the question of whether a stated fixed amortization period is truly fixed. That change in combination with contributions less than the ADEC could require the City to complete a depletion date analysis. GASB 68 requires pension plans to disclose a "depletion date" if it's funding policy is not expected to be adequate to maintain its funded status. The combination of the City's long-standing history of paying 100% of the ADEC combined with the closed 25-year amortization period adopted in 2013 meant that such an analysis was not needed for FYE 2015. If the City moves to a funding policy that includes contributions less than the ADEC and/or resets the amortization period used for the ADEC calculation, then it is possible that a depletion date would need to be disclosed and a different and lower interest rate would need to be used for the City's GASB 68 liabilities.

With regard to contribution policies that allow for paying less than the ADEC, while we are aware of some Connecticut municipalities with such policies, it is certainly not recommended. Pension obligations can be thought of as bond debt issued at the long-term assumed rate of return which is currently 7.75%. Each year's ADEC pays for the current cost of benefits and also pays down a portion of that "debt" (the unfunded past service liability). Since the pension liabilities are discounted at 7.75% any shortfall in the current contribution must be paid back later with 7.75% interest. MERF's funding method spreads the shortfall over 15 years. As a result, the increase in the contributions over that 15 year period is significantly more than the initial contribution shortfall.

Mr. Hill's email requested that we show the impact of two contribution shortfall scenarios. The first was a $20 million reduction each year for the next five fiscal years. The second scenario was one with a shortfall pattern for five years as follows: $5 million, $10 million, $15 million, $10 million, $5million. The attached displays show he impact on ADEC and the cumulative shortfall as it increases and is eventually paid down under each scenario.

As you can see on the displays, the contribution shortfall scenarios both require future contribution amounts that are nearly double the short term contribution reductions. The attached analysis assumes the fund will consistently earn its long-term rate of return. As a result, it does not reflect the potential lost opportunity of investing following a market downturn or the impact of lower contributions on liquidity and the ability of the fund to achieve its long-term rate of return. A separate analysis from the fund's investment advisor would be needed to provide that information.

Please let us know if you have any questions or need additional information.

Sincerely,

Timothy A. Ryor, FSPA, FCA, MAAA, EA
Senior Vice President and Consulting Actuary

Attachments: Contribution Shortfall Analysis

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