DEPARTMENT OF BUDGET & FISCAL SERVICES

CITY AND COUNTY OF HONOLULU

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PETER B. CARLISLE
MAYOR

MICHAEL R. HANSEN
DIRECTOR

February 8, 2011

The Honorable Karl Rhoads, Chair
and Members of the Committee on Labor
and Public Employment
The House of Representatives
State Capitol
Honolulu, Hawaii 96813

Dear Chair Rhoads and Members:

Subject: House Bills Nos. 1037, 1038, 1142 and 1143
Relating to Employer Contributions to the Employees' Retirement System

The City and County of Honolulu (City) is well aware of the serious challenges the Retirement System is facing and recognizes the need for significant course corrections. The City views House Bills 1037, 1038, 1142 and 1143 as part of a package of bills proposing changes aimed at addressing the Retirement System's unfunded liability. The City does not support **these bills unless they are part of a package designed to address the unfunded liability issue in a comprehensive manner**—with reasonable changes to benefits as well as increases in the Employer contribution rates.

The increases in the Employer contribution provided in HB 1037 will have a severe negative impact on our budget going forward. House Bill 1143 may also negatively affect our budget. However, this is balanced by the provisions included in HB 1038 and HB 1142 that update the benefits structure making it more realistic and sustainable. This comprehensive approach will, we hope, ultimately result in a system that is more stable and Employer costs that are more predictable. We note that other bills to reform the System, including, House Bill 1042 and House Bill 589, a Hawaii Council of Mayors bill to separate teachers from other general employees, are not being heard today. We view these bills as an important part of the reform package and we urge the Committee to schedule them for hearing.

We realize this Committee is facing very difficult decisions on many matters, including this one. We urge the Committee to take the comprehensive approach needed to set the Retirement System on a sustainable path.

Thank you for the opportunity to testify on these measures.

Yours truly,

Michael R. Hansen, Director
Department of Budget & Fiscal Services

Noel T. Ono, Director
Department of Human Resources

TESTIMONY BY WESLEY K. MACHIDA
ADMINISTRATOR, EMPLOYEES' RETIREMENT SYSTEM
STATE OF HAWAII
TO THE HOUSE COMMITTEE ON LABOR & PUBLIC EMPLOYMENT
ON
HOUSE BILL NO. 1038

FEBRUARY 8, 2011

RELATING TO THE EMPLOYEES' RETIREMENT SYSTEM

Chair Rhoads and Members of the Committee:

H.B. 1038 provides for retirement benefit changes for State and County employees who become members of the Employees' Retirement System of the State of Hawaii (ERS) after June 30, 2012. The ERS Board of Trustees strongly supports this bill.

The ERS Board would accept a contribution only solution to the current ERS financing issues. However, because the increases in employer contributions necessary to amortize the ERS's unfunded actuarial accrued liability (UAAL) within a 30-year period may not be feasible at this time, the ERS Board of Trustees has been working with its Actuary to design a benefit structure for new employees that reduces the long-term costs of the ERS, and also provides a reasonable retirement package to State and county employees when combined with other retirement vehicles such as Social Security. This bill is the result of those efforts.

This measure seeks to reduce future liability by making changes for future State and County employees, which will provide for reasonable changes to employer contribution rates while State and county employers face challenging budgets. Changes are being proposed for all employee groups to reduce the benefit multiplier, post retirement increase, and Hybrid Plan account; increase the vesting period, average final compensation (AFC) period, and employee contribution rate. The estimated dollar impact of these changes on the fiscal year 2013 contributions is as follows:

All Other Employees:

Area	Change	Estimated Dollar Impact to Contributions
Benefit Multiplier	2% to 1.75%	$17.3 million
Post Retirement	2.5% to 1.5%	$12.8 million
Hybrid Plan Account Multiplier	150% to 120%	$4.4 million
Average Final Compensation Period	3 years to 5 years	$7.1 million
Vesting Period	5 years to 10 years	$4.8 million
Employee Contribution Rate	6% to 8%	$36.1 million

Police & Fire:

Area	Change	Estimated Dollar Impact to Contributions
Benefit Multiplier	2.5% to 2.25%	$2.2 million
Post Retirement	2.5% to 1.5%	$2.3 million
Average Final Compensation Period	3 years to 5 years	$1.4 million
Vesting Period	5 years to 10 years	$.1 million
Employee Contribution Rate	12.2% to 14.2%	$3.6 million

All of these changes will result in cost savings, which will help to prevent further increases to the employer contribution requirements that would otherwise be necessary to amortize the ERS's UAAL within a 30-year period. The following cost savings (or reduced contribution savings) estimated by the ERS Actuary for the next 5 fiscal years are anticipated if all of the benefit changes for new hires are implemented:

FY 2012: $54 million
FY 2013: $92 million
FY 2014: $95 million
FY 2015: $98 million
FY 2016: $101 million

The passage of this bill, along with H.B. 1142 will result in employer contribution rates stabilizing over the next several years as follows:

All Other Employees (current rate at 15% of payroll; 6% for normal cost and 9% for unfunded liability):

FY 2012: 15%
FY 2013: 15.5%
FY 2014: 16%
FY 2015: 16.5%
FY 2016: 17%
FY 2017: 17%

Police and Fire (current rate at 19.7% of payroll; 6% for normal cost and 13.7% for unfunded liability):

FY 2012: 19.7%
FY 2013: 22%
FY 2014: 23%
FY 2015: 24%
FY 2016: 25%
FY 2017: 25%

Without the passing of H.B.1038 and H.B. 1142, the employer contribution rates would require immediate increases in FY2012 from 15% to 17% for all other employees and from 19.7% to 23% for Police & Fire to meet the 30-year amortization period for paying down the UAAL. These rates would be expected to increase to 19% for all other employees and 27% for Police and Fire over the next several fiscal years as the remaining investment losses from fiscal year 2009 are recognized.

As a result, the ERS Board of Trustees strongly supports the passage of H.B. 1038. Thank you for the opportunity to testify on this important measure.

TESTIMONY OF COLBERT MATSUMOTO
Chairman of the Board of Trustees
Employees' Retirement System of the State of Hawaii

HOUSE COMMITTEE ON LABOR & PUBLIC EMPLOYMENT
Representative Karl Rhodes, Chair
Representative Kyle Yamashita, Vice Chair

February 8, 2011
9:00 a.m.
State Capitol, Conference Room 309

House Bill No. 1038
House Bill No. 1142
House Bill No. 1143

On behalf of the Board of Trustees of the Employees' Retirement System of the State of Hawaii ("ERS"), I offer this testimony in support of the above-referenced bills that are aimed at ameliorating the rapidly rising public employees pension contribution burden faced by the State and counties.

The unfunded liability of the ERS will continue to place a rapidly escalating financial burden on the State and the counties ("Public Employers") as the annual required contribution ("ARC") grows both as to the required rate of contribution as well as the dollar amounts. This would not be a concern if the Public Employers were readily able to satisfy the ARC. However, doing so will be increasingly daunting as the rising number of retirees and the pension benefits payable to them accelerates beyond the expected rate of growth of both Hawaii's economy and public revenue sources.

If the invested assets of the ERS stood at a much higher level rather than its presently low funded ratio, the burden on the Public Employers would not be as great since the ERS would be able to generate greater cash returns on its larger investment base. The fact that the assets of ERS have declined from 95% to a 61% funded ratio means that fewer dollars generated from investments are available to pay the current pension benefits owed to our rapidly increasing pool of public employee retirees.

To depict the problem simplistically, imagine if the ERS were fully funded with $18 billion, the targeted 8% rate of return would generate almost $1.5 billion in total return. That would likely be enough to meet the approximately $1 billion in cash benefits payable to current retirees. However, because the ERS only has $11 billion in assets, a targeted 8% rate of return would generate less than $900 million in total return. Since most of the total return is illiquid, not enough cash is generated to fund required pension payments. That is why the ARC from the Public Employers is critical to ensure that the ERS has sufficient cash to pay the pension benefit obligations without having to sell off more investments and further undermine its funded ratio.

Consequently, the Public Employers must today contribute 15% of payroll for general employees and 20% of payroll for police and fire employees rather than merely the 6% "normal cost" for currently accruing pension benefit liabilities. The dollar contributions have grown at an annual double-digit rate from $166 million in FY 2002 to $550 million in FY 2010.

Unless something in the current design of the public employees pension plan changes, the ERS will soon need to seek an increase in the rate of contributions from the Public Employers to 19.5% of payroll for general employees and 28.5% of payroll for police and fire employees to maintain the financial integrity of the plan design.

Recognizing that the annual payments required of the Public Employers are growing at a rate that could overwhelm their financial resources and consequently, the stability of the ERS, the Board of Trustees of the ERS have put forth proposals to modify the design features of the public employees pension plan as set forth in the above-referenced House Bills.

The proposed legislation will only affect new public employees by reducing the pension benefits they would accrue as compared to that of current public employees. No doubt these changes will not be popular. Moreover, the fiscal impact and the relief derived from these changes will be slight in the near term. However, without these modifications, the Public Employers can expect that the pension contribution burden they are struggling with today will worsen in years ahead.

On behalf of the Board of Trustees of the ERS, I urge you to support HB 1038, HB 1142 and HB 1143 with the recognition that the measures they contain are important steps in dealing with the grave financial challenges facing the State and the counties.

House Committee on Labor and Public Employment
Tuesday, February 8, 2011
9:00 a.m.

HB 1038, Relating to Employees' Retirement System.

Dear Chairperson Rhoads and Committee Members:

On behalf of the University of Hawaii Professional Assembly (UHPA), our union is opposed to HB 1038. This proposed legislation will establish a retirement system that will diminish the compensation of new employees by providing less retirement benefits than guaranteed current employees. This can impede the recruitment and retention of future faculty by creating an inequity in the conditions of employment.

UHPA is concerned about the numerous proposed changes to the ERS without appropriate information as to the impact and potential consequences to current and future public employees, employers, and the State. If changes are necessary to the ERS, then a studied approach should be employed that will allow full assessment and debate over reform efforts. UHPA hopes the legislature will convene such a group to give such an important issue the attention it deserves.

Respectfully submitted,

Kristeen Hanselman
Associate Executive Director

UNIVERSITY OF HAWAII
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TESTIMONY BY KALBERT K. YOUNG
INTERIM DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
STATE OF HAWAII
TO THE HOUSE COMMITTEE ON LABOR AND PUBLIC EMPLOYMENT
ON
HOUSE BILL NO. 1038

February 8, 2011

RELATING TO THE EMPLOYEES' RETIREMENT SYSTEM

House Bill No. 1038 provides for retirement benefits for State and county employees who become members of the Employees' Retirement System of the State of Hawaii after June 30, 2012, that are different from the retirement benefits of current employees.

The Department of Budget and Finance supports the intent of this Administration bill which will help to control increases in the cost of employee benefits for State and county employers by changing retirement benefits to employees who become members of the Employees' Retirement System after June 30, 2012.

Although this measure will differentiate benefits within the Employees' Retirement System between employees based on their hire date, the Administration recognizes that such action is necessary to ensure the long-term viability of the Employees' Retirement System.