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TESTIMONY BY WESLEY K. MACHIDA
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TO THE SENATE COMMITTEE ON WAYS AND MEANS
ON
HOUSE BILL NO. 2445, H.D. 1, S.D. 1

April 4, 2016
2:00 p.m.

RELATING TO PUBLIC EMPLOYEES

House Bill No. 2445, H.D. 1, S.D. 1, adds a new chapter to the Hawaii Revised Statutes (HRS), to ensure future Employees' Retirement System (ERS) benefits for public employees who are terminated from public employment due to the privatization of their positions.

The Department of Budget and Finance strongly opposes this measure which provides for the continuation of accruing benefits for persons who are no longer employed by the State due to privatization of their positions.

As detailed in the testimony of the ERS, this measure may have dire consequences for the ERS by jeopardizing its status as a governmental plan which would subject the ERS to federal tax rules applicable to private employer plans, for which the ERS is not compliant. In addition, employee members will be negatively impacted as their contributions would now be subject to federal tax instead of receiving favorable pre-tax treatment.

Furthermore, it is unclear who will make contributions for the employer, including the costs to pay for the current unfunded actuarial accrued liability.

Finally, this measure could be considered a benefit enhancement, which is contrary to Section 88-99, HRS.

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STATE OF HAWAII
EMPLOYEES' RETIREMENT SYSTEM

TESTIMONY BY THOMAS WILLIAMS
EXECUTIVE DIRECTOR, EMPLOYEES' RETIREMENT SYSTEM
STATE OF HAWAII

TO THE SENATE COMMITTEE ON WAYS AND MEANS
ON

HOUSE BILL NO. 2445, H.D. 1, S.D. 1

APRIL 4, 2016, 2:00 P.M.

RELATING TO PUBLIC EMPLOYEES

Chair Tokuda, Vice Chair Dela Cruz and Members of the Committee,

H.B. 2445, H.D. 1, S.D. 1 provides for continued Employees' Retirement System (ERS) membership "special benefit coverage" for full-time public employees for whom employment terminates due to privatization of the employee's position upon the assumption of the operation of the government function or facility by an employer other than the State or its political subdivisions or if the facility is purchased by an employer other than the State or its political subdivisions.

The Board of Trustees of the Employees' Retirement System (ERS) opposes H.B. 2445, H.D. 1, S.D. 1.

This bill jeopardizes the ERS's status as a "governmental plan" under IRC 414(d) by allowing employees to continue to accrue benefits while employed by a private employer. Loss of "governmental plan" status would mean that the ERS would be subject to federal tax rules applicable to private employer plans and subject the ERS to the Employee Retirement Income

Security Act of 1974, as amended ("ERISA"). The ERS would not be compliant with the federal tax rules applicable to private employer plans. This could lead to the loss of the ERS's status as a "tax-qualified plan" which would be extremely harmful to its entire membership. Contributions received from employee members would no longer have the favorable pre-tax treatment; instead, employees' contributions to the ERS would be entirely subject to federal tax at the time of contribution. In addition, all members would be taxed on the value of their total accrued retirement benefits at the time they vest rather than when they receive their retirement benefits.

ERS's tax-qualification issue aside, the Board is already grappling with how to deal with the huge negative funding situation created by Act 103, SLH 2015. The loss to the ERS of ongoing employer and employee contributions, even absent of other special provisions, is forecast to increase the plan's unfunded liability substantially. This increase in the unfunded liability may result in higher contribution requirements or the maintenance of existing contributions for a longer period of time.

The Board emphasizes its unwavering position that any benefit provided must include the funding necessary to cover its cost and/or amortize the cost of the benefit over time thereby avoiding any increase in the plan's unfunded liability. A preliminary review of H.B. 2445, H.D.1, S.D. 1 by the ERS actuary determines that the ERS would expect to see a decrease in its unfunded actuarial accrued liability (UAAL) of approximately $35 million due to the termination of the impacted employees. However, the expected impact on ERS funding due to the loss of payroll for the employees and the employer will be significantly greater. With the loss of approximately $100 million in covered payroll, the ERS will receive $11 to $15 million less in contributions in fiscal year 2017 towards the payment of its UAAL. The present value of these lost future contributions over the next 26 years is approximately $213 million. In order to make the ERS whole, the contribution rates for the remaining employers would need to increase by an additional .39 percent.

Peripherally, H.B. 2445, H.D. 1, S.D. 1 also presents many unanswered questions. It does not specify or define what the continuing coverage of the terminated employee would be. If not defined, the employee could continue to accrue ERS benefits indefinitely while also accruing retirement benefits under the new or even a subsequent employer's plan, based on compensation over which the State has no control and which may have no correlation to the employee's public sector compensation. ERS benefits are dependent on the transmittal of not only personnel and payroll information by the employer, but also the required employer and employee retirement contributions. Due to these ambiguities and the tax-qualification risk to the ERS, the Board of Trustees opposes H.B. 2445, H.D.1, S.D. 1.

On behalf of the Board of Trustees and staff of ERS we wish to thank you for the opportunity to testify.