STATE OF HAWAIʻI
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HOUSE COMMITTEE ON FINANCE
The Honorable Sylvia Luke, Chair
The Honorable Ty J.K. Cullen, Vice Chair

H.B. NO. 1462, H.D. 1, RELATING TO UNFUNDED LIABILITIES

Hearing: Wednesday, February 27, 2019, 11:00 a.m.

The Office of the Auditor has no position regarding the merits of the study required in H.B. No. 1462, H.D. 1. **However, we suggest that we are not the appropriate agency to perform the study.**

H.B. No. 1462, H.D. 1, requires us to conduct a study on the feasibility of providing health benefits to state and county employees using a self-insured model. Specifically, the bill requires us to examine the potential impacts of transitioning health benefits to a fully self-insured model, partially self-insured model, or other risk retention model including:

1. Risks to the State from acting as its own insurer, including but not limited to:

   (A) Uncontrolled utilization; and

   (B) Cost increases from catastrophic claims events;
2. Investment returns on reserves in the employer-union health benefits trust fund;
3. Administrative cost savings, including any federal tax or fee savings;
4. Fiduciary and legal obligations of the State;
5. Benefits available for employees and other insured persons;
6. Changes in provider reimbursement levels, capitation, and care management practices;
7. Any other factors or impacts the state auditor deems to be relevant;
8. Risk assumptions used and analysis of the assumptions; and
9. The funding model proposed under part II, which involves a rate stabilization reserve fund, maximum levels of employer contributions to the other post-employment benefits trust fund, the diversion of the excess in employer contributions to the employees' retirement fund, and the use of transient accommodations tax revenues to supplement deficient county public employer contribution amounts.

The bill would also require us to collect an assortment of data relating to health benefits, including, among other things, historical census data, health benefit premium rates, contributions, and health plan documents.

Our office does not have the expertise to conduct this study. Our work primarily is performance audits, meaning we evaluate a department or program's operations against appropriate criteria, such as relevant statutes, administrative rules, policies, procedures, and best practices.

The study contemplated by this bill requires different skills and expertise from those required to audit a department or agency's operations. While we appreciate that the bill includes an appropriation to hire a consultant, we do not have an estimate for how much time and resources would be necessary to complete such an expansive study.

We suggest that another agency – such as the Employer-Union Health Benefits Trust Fund (EUTF) or the Legislative Reference Bureau – may be better suited to perform the requested study and recommend that the bill be amended to reflect the more appropriately suited agency to perform the work.

Thank you for considering our testimony related to H.B. No. 1462, H.D. 1.

DAVID Y. IGE
GOVERNOR

EMPLOYEES' RETIREMENT SYSTEM
HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
OFFICE OF THE PUBLIC DEFENDER

STATE OF HAWAII
DEPARTMENT OF BUDGET AND FINANCE
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RODERICK K. BECKER
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ADMINISTRATIVE AND RESEARCH OFFICE
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FINANCIAL ADMINISTRATION DIVISION
OFFICE OF FEDERAL AWARDS MANAGEMENT (OFAM)

TESTIMONY BY RODRICK K. BECKER
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
TO THE HOUSE COMMITTEE ON FINANCE
ON
HOUSE BILL NO. 1462, H.D. 1

February 27, 2019
11:00 a.m.
Room 308

RELATING TO UNFUNDED LIABILITIES

House Bill No. 1462, H.D. 1:

- Requires the State Auditor to study the feasibility of providing health benefits to State and county employees using a self-insured model, and makes an unspecified general fund appropriation to the State Auditor for that purpose;
- Establishes the Rate Stabilization Reserve Fund (RSRF) to provide reserve funding to stabilize the Hawaii Employer-Union Health Benefits Trust Fund (EUTF) at times when the EUTF has insufficient moneys to cover the costs of providing health and other benefit plans for active employees and retirees and their beneficiaries;
- Requires all unencumbered and unexpended moneys in excess of $2.0 billion remaining in the EUTF at the end of each fiscal year be transferred to the RSRF;
- Provides that when the separate accounts for each public employer within the Other Post-Employment Benefit (OPEB) Trust Fund have a combined balance of $2.0 billion, any earnings from the $2.0 billion remaining in the OPEB Trust Fund be transferred to the separate accounts for each public employer in the RSRF at the end of each fiscal year; and

- Amends the definition of “annual required contribution” (ARC) by deleting references to the normal cost and the amortization payment for the unfunded liability.

The Department of Budget and Finance (B&F) would like to point out that the intent of Part II of the bill is unclear. Although the purpose section for Part II indicates that the bill caps public employer prefunding, the specific amendments in Part II do not appear to establish a cap of $2.0 billion. All the amendments do is specify that amounts over $2.0 billion are to be transferred to the RSRF. Further, the bill does not modify requirements that the public employers make ARC payments. The bill only deletes specific references to what the ARC payments consist of which makes the definition ambiguous.

If the intent of Part II of the bill is to reduce the amount of future ARC payments, then B&F has strong reservations because it will extend the funding period for the State’s unfunded actuarial accrued liability for OPEB beyond the 30-year period set by Act 268, SLH 2013, and will significantly increase future OPEB costs. This will also negatively impact the State’s bond rating.

In closing, B&F strongly urges that the Legislature maintain the commitment to address the State’s OPEB unfunded liability that was established by the passage of Act 268, SLH 2013.

Thank you for the opportunity to provide our comments.

DAVID Y. IGE
GOVERNOR

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TESTIMONY BY DEREK MIZUNO
ADMINISTRATOR, HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
DEPARTMENT OF BUDGET AND FINANCE
STATE OF HAWAII
TO THE HOUSE COMMITTEE ON FINANCE
ON HOUSE BILL NO. 1462 H.D. 1

February 27, 2019
11:00 a.m.
Room 308

RELATING TO UNFUNDED LIABILITIES

Chair Luke, Vice Chair Cullen, and Members of the Committee:

The Hawaii Employer-Union Health Benefits Trust Fund (EUTF) Board of Trustees opposes Part II of this bill and will be providing comments on Part I.

Part I. Under Section 87A-16(b), Hawaii Revised Statutes (HRS), the EUTF Board is able to self-insure its health benefit plans. The following is a summary of the funding methodology for the EUTF's health benefit plans:

1. Fully-insured – Kaiser medical and prescription drug, and USAble/Securian life insurance plans.
2. Self-insured – prescription drug, administered by CVS and SilverScript, and supplemental medical and prescription drug, administered by HMA, plans.
3. Fully-insured with one-way risk sharing – HMSA medical, HDS dental and VSP vision plans.

Under the fully-insured with one-way risk sharing model, the EUTF Board negotiates a premium with the contracted carrier. Should claims and expenses exceed the premiums collected, the loss is borne by the carrier. However, should premiums exceed claims and expenses, the surplus is refunded to the EUTF. This can also be viewed as EUTF self-insuring up to the premium amount with insurance (i.e. stop loss insurance) above the premium.

The decision to self-insure or fully-insure is made by the EUTF Board in consultation with the EUTF's benefit consultant, Segal Consulting, as part of the request for proposals process to contract medical, prescription drug, dental, vision and life insurance carriers in accordance with Chapter 103D, HRS. The EUTF Board, EUTF staff and benefits consultant examine the proposed premiums including expenses and federal taxes under a fully-insured model versus the projected claims, proposed fees, federal taxes and risk under a self-insured model to determine the funding method. Request for proposals are conducted at least every three years for medical and prescription drug plans and every four years for dental, vision and life insurance plans.

The health care industry is always changing and the recommendations from a study today may not be applicable to the future. For example, during the most recent medical RFP (for retiree plans beginning January 1, 2018 and employee plans beginning July 1, 2018), the largest medical insurer in the state was currently in the process of changing its reimbursement model for its primary care providers, the EUTF experienced significant movement of our employee employment from the HMSA 80/20 plan to the HMSA 75/25 PPO plan, and there were discussions at the federal level of terminating the Affordable Care Act. Current events have significant impact on a decision whether to self-insure or fully-insure.

Also, the State Office of the Auditor's testimony suggested that another department, namely the EUTF or Legislative Reference Bureau, conduct the study described in this Part I. In practice, the EUTF's benefits consultant conducts an analysis or study every three years to assist the EUTF Board in assessing whether to follow a fully insured, self insured or fully insured with one-way risk sharing.

Part II. Act 268, Session Laws Hawaii 2013 (Act 268) established a mechanism to fund the unfunded actuarial accrued liability (UAAL) of the State and counties related to other post-employment benefits (i.e. retiree health benefits) or also known as OPEB, by requiring the employers to contribute the annual required contribution (ARC) which is comprised of the normal cost and an amortization payment to pay off the UAAL in 30 years. Under Act 268, the State's OPEB liability is projected to be fully funded by June 30, 2044. Additionally, the State's funded ratio (assets / actuarial accrued liability) has increased from 0% at July 1, 2013 to 12.1% at July 1, 2018 and is expected to increase by 3-4% each year under Act 268. This bill will no longer require that the State and counties fund the normal cost and amortization payment. It is unclear what the ARC is defined as in this bill. One could assume the ARC includes only the annual retiree premiums. However, the estimated $140 million in investment income from the $2 billion Rate Stabilization Reserve in combined employer assets will do little to address the employers' retiree premiums in the future – projected to be $474 million in the fiscal year ended June 30, 2018 and $1.0 billion in 10 years. Additionally, with the elimination of the Act 268 funding mechanism, the State's actuary may use a much lower investment return rate (i.e. high quality, municipal bond rates approximately 3.6%) to value the actuarial accrued liability. This could result in a significant increase in the State's July 1, 2018 UAAL of $9.3 billion (e.g. a 1% decrease in the rate of return increases the UAAL by $1.6 billion). Lastly, the elimination of Act 268 could negatively impact bond ratings.

It is unclear what Part II of this bill is accomplishing in addressing the State and counties' long-term unfunded OPEB liabilities.

Thank you for the opportunity to testify.

LEGISLATIVE TAX BILL SERVICE

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304 Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: MISCELLANEOUS, Rate Stabilization Reserve Fund for OPEB

BILL NUMBER: HB 1462, HD-1

INTRODUCED BY: House Committee on Labor & Public Employment

EXECUTIVE SUMMARY: The Foundation's testimony relates to Part II only.

Part II establishes the Rate Stabilization Reserve Fund within the Hawaii Employer-Union Health Benefits Trust Fund to help subsidize the costs of providing health and other benefit plans for active employees and retirees and their beneficiaries. Caps employer contributions to the Other Post-Employment Benefits (OPEB) trust fund, which are made to prefund the unfunded actuarial accrued liability of the Employer Union trust fund, when the separate accounts for each public employer within the OPEB trust fund have a combined balance of at least $2,000,000,000. Provides for the use of a portion of transient accommodations tax revenues to supplement deficient county public employer contribution amounts.

This bill deals with other post-employment benefits for state workers – meaning ERS and EUTF. Act 268, SLH 2013, established a mechanism to pay down the unfunded liabilities over time. The bill recites that it can deal with those problems without raising taxes, affecting workers' benefits, or laying off people. The reality, however, is that at its core, the bill tosses away the fiscal discipline of Act 268, instead relying upon a pay-as-you-go mentality. In addition, key pieces of this legislation conflict with federal law and the terms of the existing OPEB trust instruments.

SYNOPSIS: The following summarizes Part II of the bill.

Adds a new section to HRS chapter 87A that establishes a rate stabilization reserve fund. The fund is to provide reserve funding to stabilize the fund when there is insufficient money in the fund to cover the costs of providing health and other benefit plans for employee-beneficiaries and dependent-beneficiaries. Unless otherwise specified by law, the rate stabilization reserve fund shall not be subject to appropriations for any purpose and shall not be subject to claims by creditors of the employers.

Provides that any balance in the employee benefits trust fund under section 87A-31 will be transferred to the new rate stabilization reserve fund.

Deletes the language providing that a public employer's required contribution to the employee benefits trust fund includes an amortization payment that is designed to fund the unfunded actuarial accrued liability over the next thirty years. Adds language stating that no public employer contribution shall be required if the separate accounts for each public employer within the employee benefits trust fund have a combined balance of at least $2 billion.

EFFECTIVE DATE: January 1, 2050.

STAFF COMMENTS: These comments relate to Part II.

The state long ago agreed to pay post-employment benefits to its workers. ERS, or Employees' Retirement System, represents the retirement benefits. EUTF, the Employer-Union Health Benefits Trust Fund, represents the medical benefits. At June 30, 2013, ERS had an "unfunded actuarial accrued liability" of about $8.4 billion. For EUTF, the number was about $18.2 billion. Those numbers represent the present value of what we taxpayers owe for these future benefits. In comparison, the total annual state general fund budget is $5.5 billion.

Faced with these staggering numbers, Act 268, SLH 2013, was enacted. Act 268 requires public employers to pay actuarially determined annual required contributions to fund the present cost of the benefits and to eat away at the unfunded balance over thirty years' time. If the public employers do not pay their required contribution, the general excise tax would be sequestered to pay it if the delinquent employer was the state; if the delinquent employer was one of the counties, that county's share of the transient accommodations tax would be sequestered. Again, the idea was to pay down the unfunded liability over a period of several years.

The bill proposes to deal with the issue by establishing a new fund to "stabilize" the system when there is insufficient money. The first issue, of course, is figuring out how to fund this fund.

To accomplish this trick, the bill basically proposes to do away with the amortization built into Act 268. "Clearly, given current and projected revenues, the State and the counties cannot afford to prefund both health and pension unfunded liabilities, which are projected to total more than $800,000,000 per year in later years," as stated in the preamble to the bill as introduced, and "[b]y not requiring other post-employment benefits prefunding through 2049, this Act will free up moneys for important state, county, and other public employee services, projects, and needs." In other words, the bill proposes to deal with the unfunded liabilities problem by denying that it's a problem. "Don't worry," it's telling everyone. "We can pay the current year's costs of the post-employment benefit programs we created. There won't be any rainy day. So just go about your business."

This might be fine if there is in fact no rainy day, and the economy chugs along giving us enough money to pay these obligations. But if bad things happen – we've recently had to face crippling economic recessions as well as natural disasters – then we might deeply regret ever having gone into pay-as-you-go mode.

In addition, one of the central premises behind the proposed stabilization fund is that it won't be raided, ever. The reality, however, is that nice, fat funds make for very tempting raid targets for a future legislature. However well-intentioned this legislature is, it can't bind a future one.

Next, the bill proposes that the stabilization fund be fed by transfers from the existing funds. Nominally such transfers would accomplish nothing, being payments of money from the State's right pocket to its left pocket, but, as testifiers in previous years have pointed out, such transfers would violate the trust instrument that establishes the trust funds in the first place; they would violate the Internal Revenue Code, a federal law that cannot be modified by state law; and would also potentially violate ERISA, a federal law that has been held to have a very broad preemptive sweep. If enacted, then, it seems clear that key pieces of the plan won't work.

Digested 2/25/2019

BEFORE THE

HOUSE COMMITTEE ON FINANCE

Representative Sylvia Luke, Chair
Representative Ty J.K. Cullen, Vice Chair

HB1462 RELATING TO UNFUNDED LIABILITIES

TESTIMONY OF
PAUL KAISER
Chief Operating Officer,
Hawaii-Western Management Group

February 27, 2019, 11:30 a.m.
State Capitol Conference Room 308

Chair Luke, Vice Chair Cullen, and Committee Members:

My name is Paul Kaiser, the Chief Operating Officer for Hawaii-Western Management Group (HWMG). HWMG supports HB1462.

By way of background, HWMG is a small, kamaʻaina third-party administrator providing health insurance management services for a wide range of organizations including Hawaii Medical Assurance Association (HMAA), Charter Communications, Hawaii Electricians Local Union 1186, and labor unions. HWMG is proud to be 100% employee-owned through its Employee Stock Ownership Plan (ESOP).

HWMG manages numerous self-insured plans for its clients. Self-insured or self-funded plans have a number of potential advantages over fully insured plans, including allowing employers to (i) customize the plan to meet the specific needs of its workforce, (ii) maintain control over the health plan reserves and enabling the maximum interest income to reinvest in the needs of the workforce (that would otherwise be generated by an insurance carrier through the investment of premium dollars) on workforce-specific wellness programs and other initiatives to benefit the employees, (iii) not have to prepay for coverage, thereby providing for improved cash flow, (iv) avoid the Affordable Care Act tax, (v) contract freely with providers or a provider network that is best suited to meet the healthcare needs of its employees. All these benefits allow the employer to lower health care costs while still maintaining a level of health benefits.

Accordingly, HWMG respectfully urges the passage of this measure. Thank you for the opportunity to testify on this matter of critical importance.

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HB-1462-HD-1
Submitted on: 2/26/2019 6:59:09 AM
Testimony for FIN on 2/27/2019 11:00:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Kendrick Farm	Individual	Support	Yes

Comments:

February 26, 2019

The Honorable Rep. Sylvia Luke, Chair
Finance Committee
Hawaii State Capitol
415 South Beretania Street, Room 306
Honolulu, HI 96813

Dear Chair Luke and members of the Committee:

I am in strong support of **House Bill 1462 Relating to Unfunded Liabilities** which will be heard by the Labor & Public Employment Committee on February 27, 2019.

Our state faces a shortfall of over $12 billion in health unfunded liabilities. Act 268 (2013) requires the State and counties to pre-fund Other Post-Employment Benefits (OPEB) annual required contributions to cover the Employer Union Health Benefits Trust Fund (EUTF) unfunded liability. The pre-funding amount is about $500 million per year for the next 30 years.

As of 2018, the total pre-funded amount is $2.37 billion. However, paying down the billions of dollars in unfunded liability may require drastic measures such as raising General Excise Tax (GET) and property taxes; laying-off state and county employees; cutting back benefits for state and county employees; increasing employee contributions; or using a combination of the aforementioned solutions. None of these drastic measures apply in HB 1462.

HB 1462, when enacted into law, could potentially save over $500 million each year for the next 30 years. These savings may be used to fund much-needed state and county projects and provide a welcomed relief for taxpayers.

Part I of HB 1462 also requires a feasibility study to determine the advantages of providing health benefits to state and county employees under a self-insured model. Over 300 businesses and organizations in Hawaii have successfully converted to self-insured from fully-insured. In addition, research has shown that 29 states that converted from a fully-insured health program to self-insured were able to control costs, save money and customize benefits. Part II of HB 1462 is the implementation to convert fully-insured to self-insured model should the study justifies conversion just like the 29 states under self-insured concept..

For the above reasons, I respectfully ask that your committee pass **House Bill 1462 Relating to Unfunded Liabilities** to help the state meet its unfunded health care obligations for current public workers, retirees, future retirees and their dependents.

Sincerely,
Leo Gozar

HB-1462-HD-1
Submitted on: 2/26/2019 1:03:52 PM
Testimony for FIN on 2/27/2019 11:00:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Dylan P. Armstrong	Individual	Support	No

Comments: