JOSH GREEN, M.D.
GOVERNOR

THOMAS WILLIAMS
EXECUTIVE DIRECTOR

KANOE MARGOL
DEPUTY EXECUTIVE DIRECTOR

STATE OF HAWAII
EMPLOYEES' RETIREMENT SYSTEM

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

TO THE SENATE COMMITTEES ON LABOR AND TECHNOLOGY

ON

SENATE BILL NO. 211

February 10, 2023
3:00 P.M.
Conference Room 224 & Videoconference

RELATING TO THE EMPLOYEES' RETIREMENT SYSTEM

Chair Moriwaki, Vice Chair Lee and Members of the Committee,

S.B. 211 proposes to add a new section which provides that service or compensation awarded to an employee by a final court decision, arbitration award, or court-approved settlement shall be considered "service" under Hawaii Revised Statutes (HRS) section 88-21 or "compensation" under HRS section 88-21.5.

While the ERS Board of Trustees has not had the opportunity to review the bill, the ERS staff believes that the Board would strongly oppose the measure.

1. Negative Impact on ERS's Tax Qualified Status

a. ERS's Tax Qualified Status

The ERS is a qualified governmental plan under the Internal Revenue Code ("IRC"). To maintain its qualified governmental plan status, the ERS plan must be administered according to its "plan provisions" or "plan documents" set forth at HRS Chapter 88 (including HRS section 88-22.5), as well as IRC section 401(a). Section 88-22.5 provides that "the [ERS] shall be administered in accordance with the requirements of section 401(a)… of the Internal Revenue Code of 1986, as amended." ERS membership, service credit, compensation, retirement eligibility, and other ERS benefits

are governed by, and therefore may only be provided pursuant to, HRS Chapter 88 and ERS administrative rules.

As long as the ERS continues to meet the qualification requirements, the members of the ERS will receive favorable federal income tax treatment of their ERS benefits, and the ERS will receive favorable tax treatment on its investment earnings. Should the ERS be administered in a manner that is inconsistent with HRS Chapter 88 and IRC § 401(a), the ERS's status as a qualified governmental plan would be placed at risk.

The ERS risks disqualification if it fails to follow its plan provisions, including HRS Chapter 88 and ERS administrative rules. *See* 26 C.F.R. sec. 1.401-1(b)(3) (stating "The law is concerned not only with the form of a plan but also with its effects in operation"). *See also DNA Pro Ventures, Inc. Emp. Stock Ownership Plan v. Comm'r of Internal Revenue*, 856 F.3d 557, 559 (8th Cir. 2017) ("A plan may be disqualified for operational failures, which occur if a plan fails to operate in accordance with § 401(a) statutory requirements or fails to follow the terms of the plan document"). *See, e.g., Forsyth Emergency Servs., P.A. v. Comm'r of Internal Revenue,* 68 T.C. 881, 891 (1977) (plan that operated in variance with its terms was disqualified by the IRS).

The Legislature has recognized the importance of "[protecting] the status of the Employees' Retirement System (ERS) as a tax-qualified retirement plan" and that disqualification of the plan would negatively impact ERS members and the State of Hawaii:

> Hawaii's ERS is currently a tax-qualified retirement plan under the IRC. Loss of this status would be detrimental to both the ERS and its members, resulting in the pre-tax treatment on member contributions to be eliminated and requiring ERS members to pay federal income taxes annually on the value or increase in value of a member's account without receiving a distribution. This could amount to thousands of dollars in taxes for members.

H.S.C.R. No. 343 (2011).

b. <u>Violation of Definitely Determinable Requirement</u>

IRC § 401(a)(25) provides that "[a] defined benefit plan shall not be treated as providing **definitely determinable benefits** unless, … the amount of any benefit is to be determined … in a way which **precludes employer discretion**." (emphasis added)

"A pension plan within the meaning of section 401(a) is a plan established and maintained by an employer primarily to provide systematically for the payment of **definitely determinable benefits** to his employees over a period of years, usually for life, after retirement. Retirement benefits generally are measured by, and based on, such factors as years of service and compensation received by the employees." *See* Treas. Reg. section 1.401-1(b)(1)(i). (emphasis added).

"[I]f, in the case of a defined benefit pension plan, the benefits on behalf of each participant are determined in accordance with a stipulated formula that is **not subject to the discretion of the employer**," the definitely determinable benefit requirements of section 1.401-1(b)(1)(i) of the regulations are satisfied. Rev. Rul. 74-385, 1974-2 C.B. 130 (1974) (emphasis added). On the other hand, if the terms of the plan specifically allow the employer to vary the employee's compensation used in the benefit formula, the plan would violate the definitely determinable rule. *See id.*

In *Fratinardo v. ERS*, 129 Hawai'i 107, 114-15, 295 P.3d 977, 984–85 (App. 2013), the court acknowledged that the ERS must comply with the I.R.C.'s "definitely determinable benefit" rule. The court stated that the definition of compensation in HRS section 88-21.5 was intended to "satisfy the Code's requirement that a member's benefit be 'definitely determinable.'" The court noted that "[i]n 2004, the Legislature made several amendments to HRS Chapter 88 to conform to the requirements of section 401(a) of the Internal Revenue Code of 1986 (Code). Stand. Comm. Rep. No. 692, in 2004 Senate Journal, at 1358-59." *See* Act 182, 2004 Haw. Sess. Laws. *See also* C.C.R. 122-04, S.S.C.R. 2143, and S.S.C.R. 2692 in 2004 Senate Journal.

S.B. 211 applies to court-approved settlements, as well as judgments and arbitration awards. Even if a settlement is court-approved, it is up to the employer to decide whether to enter into a settlement and whether to agree to specific settlement terms. It appears that S.B. 211 may give employers discretion to vary the employee's service credit or compensation used in the benefit formula by arbitrarily designating the dates, nature, and amounts of payments. An employer doing so would violate the definitely determinable requirement, especially in the absence of personnel and payroll records required by the employer reporting requirements of HRS section 88-103.7, which enable the ERS's calculation of monthly service and monthly compensation in remuneration therefor.

Example 1 (compensation): Proposed section (1)(B)(i) provides that if the employee challenges compensation and is subsequently awarded a retroactive pay differential, then "the pay differential that is awarded shall constitute compensation."

For Tier 1 employees, compensation includes "differentials" without restriction. *See* HRS section 88-21.5(a)(2). For Tier 2 employees, compensation only includes shortage differentials and twelve-month differentials for Department of Education employees. See HRS section 88-1.5(b)(1)(B), (b)(1)(D), and (b)(2).

If an employer agrees to a settlement for a Tier 2 member that purports to include a differential that is prohibited for Tier 2, this would be a prohibited exercise of discretion by the employer. S.B. 211 would allow the employer to vary the employee's compensation used in the benefit formula, in violation of the definitely determinable requirement.

Example 2 (compensation): Proposed section (1)(B)(ii) provides that if the employee challenges compensation and is subsequently awarded back pay, then "the

amount of back pay that constitutes compensation shall include normal salary adjustments and shall be based on the number of workdays between the date the employee's absence began until the employee's date of reinstatement and shall not exceed what the employee would have received had the employee not been suspended or terminated."

(c) Under the employer reporting requirements of HRS section 88-103.7(a), employers must "[a]llocate payments, including bonuses, salary adjustments, payments for compensatory time, and workers' compensation, to monthly or other periods as requested by the system."

If an employer agrees to a settlement that purports to include salary adjustments or pay raises, this may be a prohibited exercise of discretion by the employer, to the extent there is no (1) information about class, position upon which membership is based, pay type, payment dates (which month); (2) personnel and payroll records, and/or (3) indicia of compensation available to other similarly situated employees, available by pay schedule, or comparable to the employee's own history of compensation. S.B. 211 would allow the employer to vary the employee's compensation used in the benefit formula, in violation of the definitely determinable requirement.

(2) Overtime, bonuses, and lump sum salary supplements are included in Tier 1 compensation but are not included in Tier 2 compensation. See HRS section 88-21.5(a)(2), (a)(3) and 88-21.5(b)(2).

If an employer agrees to a settlement for a Tier 2 employee that purports to include overtime, bonuses, and lump sum salary supplements, these items are not authorized Tier 2 compensation. This would be a prohibited exercise of discretion by the employer. S.B. 211 would allow the employer to vary the employee's compensation used in the benefit formula, in violation of the definitely determinable requirement.

If an employer agrees to a settlement for a Tier 1 employee that purports to include overtime, bonuses, and lump sum salary supplements, this would require speculation as to (1) whether the employee would have worked overtime, when, and how much; (2) whether the employee would have received bonuses, when, for what purpose, and how much; or (3) whether the employee would have received supplemental payments, when, for what purpose, and how much. This would be a a prohibited exercise of discretion by the employer. S.B. 211 would allow the employer to vary the employee's compensation used in the benefit formula, in violation of the definitely determinable requirement.

Example 3 (compensation): If settlement provides a retroactive lump sum for back pay, the employer could arbitrarily designate the timing and amounts of pay (including overtime for Tier 1), so that more of the back pay falls within the employee's last three/five years. This would appear to be in contemplation of retirement and would artificially inflate the average final compensation and the retirement allowance. This would be a prohibited exercise of discretion by the employer. S.B. 211 would allow the

employer to vary the employee's compensation used in the benefit formula, in violation of the definitely determinable requirement. As discussed below, S.B. 211 may also encourage pension spiking.

Example 4 (service; credited service): Proposed section (a)(1)(A) provides that service awarded to an employee shall be considered service under HRS section 88-21. Section (a)(1)(A)(a)(i) provides that if the employee appeals an involuntary termination or unpaid suspension and is subsequently awarded back pay and is retroactively reinstated to employment or has the suspension rescinded, then service credit shall be for the period of retroactive employment for which back pay is awarded and the amount of service credited to the employee shall not exceed the period of absence that the employee would have worked but for their suspension or termination.

Service is distinct from credited service. Credited service reflects length of service and is measured in terms of months and years of service. Credited service is used in determining eligibility for service retirement (vesting). *See, e.g.*, HRS section 88-73(a). Credited service is also part of the formula for calculating the retirement allowance (average final compensation and the number of years of credited service). *See* HRS section 88-74(b).

If an employer agrees to a settlement agreement that states that the employee will be reinstated and awarded back pay for 18 months, this does not automatically entitle the employee to 18 months of credited service. In the calculation of credited service pursuant to HAR section 6-21-4, the employee would not be entitled to credited service for any fractional month of employment where the employee worked less than 15 days during the month (or 14 days for February). Absent personnel and payroll records showing whether the employee actually worked at least 15/14 days in a particular month, it would be arbitrary and speculative to assume that all of the 18 months qualify for credited service. This would be a prohibited exercise of discretion by the employer. S.B. 211 would allow the employer to vary the employee's years of credited used in the benefit formula, in violation of the definitely determinable requirement.

c. Violation of Exclusive Benefit Rule

The "exclusive benefit rule" is set forth at IRC section 401(a)(2) and HRS section 88-22.5(a)(1). IRC section 401(a)(2) provides that a tax qualified plan must make it "impossible, … for any part of the corpus or income to be … used for, or diverted to, purposes other than for the exclusive benefit of his employees or their beneficiaries." HRS section 88-22.5(a) provides that "[t]he system shall be administered in accordance with the requirements of section 401(a)… (2) … of the Internal Revenue Code of 1986, as amended." HRS section 88-22.5(a)(1), in turn and consistent with the IRC section 401(a)(2) "exclusive benefit rule," also clearly provides that "no part of the corpus or income of the system shall be used for or diverted to purposes other than for the exclusive benefit of members and their beneficiaries." IRC section 401(a)(2) and HRS

section 88-22.5(a) therefore require the ERS to make it impossible for ERS monies to benefit counties and other State agency employers.

The ERS should not be bound by the employer's and employee's characterization of back pay as compensation. To the extent that a settlement does not include compensation as defined in HRS section 88-21.5, the ERS should not have to assume a portion of the employer's liability for its alleged wrongful conduct (discrimination, suspension, termination of claimant, etc.). It appears that the exclusive benefit rule bars any mandate by S.B. 211 that the ERS's corpus and income be used for the benefit of the employer by assuming a portion of the employer's liability for its alleged wrongful conduct.

Thus, S.B. 211 may require the ERS to confer service, credited service and other retirement benefits in a manner that is not authorized by HRS Chapter 88 and ERS administrative rules. This would place the ERS's tax qualified status at risk with potentially severe negative consequences for the ERS and ERS members and beneficiaries.

The ERS has consulted with its tax counsel regarding the potential impact of S.B. 211 on the ERS's tax qualified status and they have indicated in writing that they share our concerns.

d. Impermissible Cash or Deferred Election.

A governmental defined benefit plan generally will not satisfy the requirements of Internal Revenue Code section 401(a) if it includes a cash or deferred arrangement. See Treas. Reg. section 1.401(k)-1(a)(1). A cash or deferred arrangement is any direct or indirect election by an employee to have the employer either provide an amount to the employee in cash that is not currently available or contribute an amount to a trust or provide an accrual or other benefit under a plan deferring the receipt of compensation. *See* Treas. Reg. section 1.401(k)-1(a)(3)(i).

A settlement between an employee and an employer could provide an employee with discretion as to how a monetary award should be structured. For example, a settlement could be structured to provide the employee with ERS compensation and service as proposed under S.B. 211. Also, a settlement could be structured to provide the employee with a lump sum award that is considered damages and would not result in service or compensation under ERS statutes.

2. Pension Spiking

HRS section 88-100 was enacted to address pension spiking, which the statute calls "significant non-base pay increases." *See* C.C.R. No. 115-12 (2012). Section 88-100 was intended to place a certain level of responsibility and accountability on employers whose employees' compensation is spiked in the immediate years prior to retirement. *See* S.S.C.R. No. 3008 (2012).

S.B. 211 may facilitate settlements made in contemplation of retirement and retirement benefits. It may encourage pension spiking because it would allow an employer and employee to arbitrarily allocate the timing (year/month) and amounts from a lump sum so that more of the back pay falls within the employee's last three/five years.

S.B. 211 does not preclude the imposition of the remedies provided in HRS section 88-100.

3. Administrative Burden

S.B. 211 would impose an administrative burden on the ERS. To the extent that a judgment or settlement does not comply with the reporting requirements of HRS section 88-103.7, the ERS is hindered in calculating monthly service credits and compensation, average final compensation, and retirement allowance. The ERS needs the required information (class, position, pay type, which month, etc.).

4. Actuarial Concerns (Increases in the ERS's Unfunded Liability)

Compliance with awards and settlements as provided in S.B. 211 may result in the ERS's loss of actuarial value should there be untimely/retroactive employer and employee contributions, or employee accrual of benefits. Compliance with such awards and settlement may result in unanticipated and unjustified increases to the ERS's unfunded liability, should there be ex post facto adjustments of purported service, purported compensation, or other factors influencing ERS benefit eligibility and calculations, made in anticipation of the employee's retirement and/or receipt of ERS retirement benefits under the terms of an award or settlement, so as to have the ERS bear the cost of resolving disputes between employees and employers.

The ERS asked its actuary, Gabriel, Roeder, Smith & Company ("GRS"), about the potential impact of the bill on the ERS. GRS indicated that the regular contributions required under the bill may be reasonable for a mid-career employee, but not for one who is near retirement.

For example, a police or fire employee was terminated after approximately 10 years of service but 5 years later was reinstated and awarded back pay and service.

Example 1: The employee is not close to retirement. GRS indicated that the regular contributions required under the bill may be reasonable for a mid-career employee, but not for one who is near retirement.

Example 2: The employee is in his early 50s and has 23 years and 3 months of service, and eligible for retirement with 25 years of service. If the employee is near retirement, GRS estimates the cost to the ERS if the 5 years of service were restored to be approximately $90,000, which is roughly 50% of this employee's compensation of $170,262.36.

Example 3: If an employee has his service reinstated retroactively to a period that occurred 12-17 years ago, GRS estimates that the expected actuarial loss to the ERS would be approximately $213,000. Even though interest would be charged on the employer contributions from the date they should have been made to the date they are actually received by the ERS (12 to 17 years later), this does not cover the cost to the ERS because the member will go from not being eligible to retire to for another 21 months to being eligible to retire immediately.

In these examples, GRS used the current contribution rates to the ERS. In the third example, if the employer contribution rates from 2005-2010 were used, this would increase the actuarial loss to the ERS even more, since those rates were significantly lower than the current 41% of pay employer rates for police and fire employees.

Accordingly, employer and employee contributions should be based on the actuarial value of such contributions, rather than as proposed in sections (2) and (3) of Section 2 of S.B.211. Settlement may be years after the time to which the back pay is designated, with a corresponding negative impact on the ERS's unfunded liability.

The ERS respectfully requests that S.B. 211 be deferred. In the alternative, the ERS requests that the Committee consider the attached proposed amendments to S.B. 211, which contain safeguards intended to protect the ERS's tax qualified status and prevent negative impacts on the ERS's unfunded liability.

Thank you for this opportunity to provide testimony.

Attachment (5 pages): Proposed amendments to S.B. 211

Proposed amendments to S.B. 211

SECTION 1. The purpose of this Act is to ensure that [~~compensation~~] employment, work and pay eligible for the purpose of calculating retirement benefits [~~and service time~~] includes [~~pay and service~~] retroactive reinstatement, retroactive rescission of suspension, retroactive pay differential, and back pay that are restored to an employee as part of an administrative, arbitral, or judicial proceeding[~~.~~], subject to certification that the retroactive reinstatement, retroactive rescission of suspension, retroactive pay differential and back pay that are restored otherwise satisfy the requirements of Chapter 88, Hawaii Revised Statutes, including (1) the definition of service in section 88-21; (2) the calculation of credit for a year of service in section 88-50; (3) the definition of compensation in section 88-21.5 (as enacted by Act 182 (2004) to prevent significant non-base pay increases) (and as amended in this Act); (4) compliance with the employer reporting requirements of section 88-103.7; (5) payment of the actuarial value of employee contributions; and (6) and payment of the actuarial value of employer contributions.

SECTION 2. Chapter 88, Hawaii Revised Statutes, is amended by adding a new section to part II, subpart B, to be appropriately designated and to read as follows:

"§88- Service credit and compensation; back pay. (a) [~~Service or compensation~~] Retroactive reinstatement, retroactive rescission of suspension, retroactive pay differential or back pay awarded to an employee pursuant to the final adjudication of a court of competent jurisdiction, as defined in section 88-21, shall be considered service under section 88-21 and/or compensation under section 88-21.5, respectively, ~~under the following conditions:~~ upon certification by the system that:

(1) For:

(A) Service, the employee appeals an involuntary termination or unpaid suspension, [~~and is subsequently awarded back pay and~~] is retroactively reinstated to employment or has the suspension rescinded in whole or in part, and is awarded back pay, pursuant to the final adjudication of a court of competent jurisdiction; provided that:

[~~(i)~~ ~~The service credit shall be for the period of retroactive employment for which back pay is awarded; and~~]

[~~(ii)~~ ~~The amount of service credited to the employee shall not exceed the period of absence that the employee would have worked but for their suspension or termination; or~~]

(i) The days of retroactive employment for which back pay is awarded pursuant to the final adjudication of a court of competent jurisdiction and paid by the State or county shall be considered service;

(ii) The days of service shall not exceed the number of days the employee would have provided service if the individual had not been suspended or terminated; and

(iii) The service shall be credited to the extent it meets the requirements for credit provided in this chapter; or

(B) Compensation, the employee challenges compensation and is subsequently awarded[~~.~~] a retroactive pay or back pay differential pursuant to the final adjudication of a court of competent jurisdiction; provided that:

(i) The amount of a [~~A~~] retroactive pay differential awarded pursuant to the final adjudication of a court of competent jurisdiction [~~then the pay differential that is awarded shall constitute compensation;~~] and paid by the State or county shall be considered a differential, not to exceed the amount and type of differential available to other similarly situated employees, available by pay schedule, or comparable to the employee's own history of pay differential; and

(ii) The amount of [~~Back~~] back pay awarded pursuant to the final adjudication of a court of competent jurisdiction [~~then the amount of back pay that constitutes compensation shall include normal salary adjustments and shall be based on the number of workdays between the date the employee's absence began until the employee's date of reinstatement~~] and paid by the State or county shall be considered pay, not to exceed the amount and type of pay under normal salary adjustments available to other similarly situated employees, available by pay schedule, or comparable to the employee's own history of compensation, not to exceed pay attributable to the number of workdays between the date the employee's absence began until the employee's date of reinstatement, and [~~shall~~] not to exceed [~~what~~] the pay that the employee would have received had the employee not been suspended or terminated; and

(iii) Differential or pay shall be considered compensation to the extent the type of differential or pay meets the requirements of section 88-21.5;

(2) The requirements of section 103.7 are met with respect to any retroactive reinstatement, retroactive rescission of suspension, retroactive pay differential or back pay awarded pursuant to the final adjudication of a court of competent jurisdiction and paid by the State or county.

(~~2~~) (3) The employee makes [~~contributions~~] lump sum payment to the system [~~based on the applicable ate set forth in section 88-45 and~~] in the amount of the actuarial present value, as determined by the system, of contributions that the employee would have contributed had the employee's employment not been suspended or terminated[;],and compound interest thereon at the assumed rate of return, provided that service shall be credited at no cost for class C service;

(~~3~~) (4) The employer makes lump sum payment to the system [~~based on the contribution rate or rates in effect for the plan during the period of service covered by the back- pay award, and~~], in the amount of the actuarial present value, as determined by the system, of contributions the employer would have contributed pursuant to sections 88-123 through 88-126 had the employee's employment not been suspended or terminated. along with compound interest [~~at the actuarial valuation rate for contributions payable from the date the contribution was due until paid~~] thereon at the at the assumed rate of return; and

~~(4)~~ (5) If the employee was terminated, the employee repays:
(A) [~~Any~~] The actuarial present value, as determined by the system, of any amount in employee contributions that were refunded to the employee; and
(B) [Any] The actuarial present value, as determined by the system, of any service or disability allowance that was paid to the employee, at the time of the employee's termination.

[~~(b) Upon satisfaction of the requirements under subsection (a), the employee shall be entitled to all the membership rights and service credit that would have accrued but for the member's challenged suspension or involuntary termination upon receipt by the system of the full amount due."~~]

SECTION 3. Section 88-21, Hawaii Revised Statutes, is amended by:
1. Adding a new definition to be appropriately inserted and to read as follows:
"Final adjudication of a court of competent jurisdiction" means:
(1) The final decision of a court, an administrative proceeding, or an arbitration proceeding from which no appeal may be filed or which no appeal has been filed within the time allowed;
(2) A stipulated judgment;
(3) A court-approved settlement;
(4) A settlement adopted by court order or referenced in an order of dismissal;
(5) A third-party arbitrator decision from which no appeal may be filed or from which no appeal has been filed within the time allowed; or
(6) Other final resolution of an appeal or challenge from which no appeal may be filed or from which no appeal has been filed within the time allowed."

2. Amending the definition of [~~"base pay" and~~] "service] to read as follows:

[~~"Base pay" means the normal periodic payments of money for service, the right to which accrues on a regular basis in proportion to the service performed; recurring differentials; [and] elective salary reduction contributions under sections 125, 403(b), and 457(b) of the Internal Revenue Code of 1986, as amended[.]; back pay pursuant to section 88- ; and pay differential pursuant to section 88- ;~~]

"Service": service as an employee paid by the State or county, and also: [~~service~~]
(1) Service during the period of a leave of absence or exchange if the individual is paid by the State or county during the period of the leave of absence or exchange; [~~and service~~]

(2) Service during the period of an unpaid leave of absence or exchange if the individual is engaged in the performance of a governmental function or if the unpaid leave of absence is an approved leave of absence for professional improvement; provided that, for the period of the leave of absence or exchange without pay, the individual makes the same contribution to the system as the individual would have made if the individual had not been on the leave of absence~~[.]~~; and

(3) Service pursuant to section 88- . Cafeteria managers and cafeteria workers shall be considered as paid by the State regardless of the source of funds from which they are paid."

SECTION 4. Section 88-21.5, Hawaii Revised Statutes, is amended to read as follows:

"**§88-21.5 Compensatio**n. (a) For a member who became a member before July 1, 2012[, ~~unless~~]:

(1) Unless a different meaning is plainly required by context, "compensation" as used in this part[~~, compensation~~] means:

[~~(1)~~] (A) Normal periodic payments of money for service the right to which accrues on a regular basis in proportion to the service performed;

[(~~2~~)] (3) Overtime, differentials, and supplementary payments;

[(~~3~~)] (C) Bonuses and lump sum salary supplements;

[~~and~~]

[(-~~4~~)] (D) Elective salary reduction contributions under sections 125, 403(b), and 457(b) of the Internal Revenue Code of 1986, as amended[--]; and

(E) Back pay or retroactive pay differentials [~~considered as compensation pursuant to section 88~~] of those payments authorized in subsections (a)(1)((A), (B), (C) and (D), and certified pursuant to section 88- ; and

(2) Bonuses and lump sum salary supplements shall be deemed earned when payable; provided that bonuses or lump sum salary supplements in excess of one-twelfth of compensation for the twelve months prior to the month in which the bonus or lump sum salary supplement is payable, exclusive overtime, bonuses, and lump sum salary supplements, shall be deemed earned:

[~~(1)~~] (A) During the period agreed-upon by the employer and employee, but in any event over a period of not less than twelve months; or

[(~~2~~)] (B) In the absence of an agreement between the employer and the employee, over the twelve months prior to the date on which the bonus or lump sum salary supplement is payable.

(b) For a member who becomes a member after June 30, 2012, unless a different meaning is plainly required by context, "compensation" as used in this part:

(1) Means:

(A) The normal periodic payments of money for service, the right to which accrues on an hourly, daily, monthly, or annual basis;

(B) Shortage differentials;

(C) Elective salary reduction contributions under sections 125, 403(b), and 457(b) of the Internal Revenue Code of 1986, as amended; [~~and~~]

(D) Twelve-month differentials for employees of the department of education; and

(E) Back pay or retroactive pay differentials [~~considered as compensation pursuant to section 88-~~] of those payments authorized in subsections (b)(1)(A), (b)(1)(B), (b)(1)(C) and (b)(1)(D), and certified as compensation pursuant to section 88- ; and

(2) Shall not include any other additional or extra payments to an employee or officer, including overtime, supplementary payments, bonuses, lump sum salary supplements, allowances, or differentials, including differentials for stand-by duty, temporary unusual work hazards, compression differentials, or temporary differentials, except for those expressly authorized pursuant to subsection (b) (1) (B), (b)(1)(C), [&~8] (b)(1)(D)[.], and (b)(l)(E)."

SECTION 5. Statutory material to be repealed is bracketed and stricken. New statutory material is underscored.

SECTION 6. This Act shall take effect upon its approval.

DEPARTMENT OF HUMAN RESOURCES

CITY AND COUNTY OF HONOLULU

650 SOUTH KING STREET, 10TH FLOOR • HONOLULU, HAWAII 96813
TELEPHONE: (808) 768-8500 • FAX: (808) 768-5563 • INTERNET: www.honolulu.gov/hr

RICK BLANGIARDI
MAYOR

NOLA N. MIYASAKI
DIRECTOR

FLORENCIO C. BAGUIO, JR.
ASSISTANT DIRECTOR

February 10, 2023

The Honorable Sharon Y. Moriwaki Chair
The Honorable Chris Lee, Vice Chair
and Members of the Committee on Labor and Technology
State Senate
State Capitol, Room 224
415 South Beretania Street
Honolulu, Hawaii 96813

Dear Chair Moriwaki, Vice Chair Lee, and Members of the Committee:

SUBJECT: Senate Bill No. 211
Relating to the Employees' Retirement System

Senate Bill No. 211 requires the Employees' Retirement System of the State of Hawaii (ERS) to include in its benefit eligibility determinations and benefits calculations periods of retroactive service and back pay awarded pursuant to any administrative, arbitral or judicial proceeding, or agreed to by the employee and their State or County employer in a negotiated settlement, that resolves an employment dispute.

The City and County of Honolulu is in strong support of this measure, which is part of the Mayor's legislative package.

As background, Unions and the employees they represent frequently resolve challenges to employee suspensions, terminations, and/or compensation through the judicial, administrative, or arbitral process that result in either awards or settlements. These awards and settlements may require the provision of "make whole" relief involving the rescission of a suspension or termination and/or payment of back pay. In such cases, the City submits its employer contribution and the employee contribution (deducted from the back pay) to the ERS. The City does so with the understanding that the ERS would include the employee's retroactive service as creditable service and the back pay as compensation for the purpose of determining the employee's pension eligibility and benefits. We note that a number of states require, to differing degrees, their employees' retirement system to base their pension calculation on retroactive service credits and/or back pay that are provided through such settlements and awards.

On December 17, 2021, the ERS issued a memorandum advising the State and County employers that "ERS benefit eligibility determinations and calculations may not be made, and ERS benefits may not otherwise be provided, pursuant to awards and settlement agreements that resolve claims between employees and employers...." According to the ERS, the Hawaii Revised Statutes (HRS) Chapter 88, the ERS's administrative rules and the Internal Revenue Code require, among other things, that pension benefits be based on an employee's service that was actually rendered and compensation that was made in normal periodic payments as remuneration for service. Further, non-compliance with these laws may jeopardize the ERS's tax-exempt status. These concerns resulted in the ERS's advisory to the employers.

The ERS memo presented a significant departure from what the City understood as the ERS' long-standing past practice of crediting awards and settlements for service credits and benefits determination purposes. As noted above, the ERS' practice is consistent with their counterparts in other states. Senate Bill No. 211 codifies and authorizes continuing this practice and removes any uncertainty as to how service time and back pay from settlements and awards will be counted and credited.

Based on the foregoing, we ask for your support in advancing this measure.

Thank you for the opportunity to testify in strong support of Senate Bill No. 211.

Sincerely,

Nola N. Miyasaki
Director

S H  P O

STATE OF HAWAII ORGANIZATION OF POLICE OFFICERS

" A Police Organization for Police Officers Only "
Founded 1971

February 8, 2023

VIA ONLINE

The Honorable Sharon Y. Moriwaki
Chair
The Honorable Chris Lee
Vice-Chair
Senate Committee on Labor and Technology
Hawaii State Capitol, Rooms 215, 219
415 South Beretania Street
Honolulu, HI 96813

Re: **SB 211 – Relating to the Employee's Retirement System**

Dear Chair Moriwaki, Vice-Chair Lee, and Honorable Committee members:

I serve as the President of the State of Hawaii Organization of Police Officers ("SHOPO") and write to you on behalf of our Union in strong **support** of SB 211. This bill seeks to ensure that compensation eligible for the purpose of calculating retirement benefits and service time includes pay and service that are restored to an employee as part of an administrative, arbitral, or judicial proceeding.

As you may know, the Employer and Union negotiated a collective bargaining agreement ("CBA") wherein an arbitrator is empowered and authorized to issue a final and binding decision as to whether the Employer has violated, misinterpreted, or misapplied any of the sections of the agreements between the Union and the Employer. In addition, Hawaii law provides that "an arbitrator may order such remedies as the arbitrator considers just and appropriate under the circumstances of the arbitration proceeding." See HRS § 658A-21. Where deemed appropriate, arbitration awards in this context will often include provisions stating that the wrongfully terminated member is entitled to be made whole by restoring to them any and all benefits denied to them since their termination, including but not limited to lost pay, retirement credits and benefits, time in grade, and any and all promotions and privileges due to them. This is the employee's primary avenue of recourse as negotiated by the parties which avoids lawsuits and unnecessary litigation and resolves these types of matters through private arbitration.

Re: **SB 211 – Relating to the Employee's Retirement System**

Until recently, the long-established policy, practice and procedure of the Employees' Retirement System of the State of Hawaii ("ERS") recognized and complied with final and binding arbitration decisions by calculating and crediting service credits for employees/members who have been reinstated after being wrongfully terminated. However, as it currently stands, the ERS has abruptly and without warning overturned decades of its own established policy, practice and procedure and has taken a completely new position that refuses to appropriately credit members with service credits who were wrongfully terminated and subsequently reinstated through the grievance procedure agreed to by the Employers. This refusal to properly credit a reinstated member, who should have never been terminated in the first place, is alarming, especially when the members and employers upon reinstatement have paid in their full contributions to the ERS, which the ERS accepted, maintained in its possession for years, and presumably used to invest and perpetuate the retirement fund. Moreover, this position contravenes and runs afoul of the law and the ERS' obligations as an arm of the State, which is a party and signatory to our and many other public employee CBAs. See HRS § 26-8 (stating that the ERS as constituted by chapter 88 is placed within the Department of Budget and Finance ("DBF"), State of Hawaii, for administrative purposes). By refusing to abide by and comply with arbitration decisions and orders that mandate retirement and service credits be restored to make a wrongfully terminated member whole, the State is in essence depriving a member of being made whole and penalizing the member for having been wrongfully terminated. Respectfully, this position is without grounds, inequitable, and violates the applicable CBA's and lawful arbitration decisions (and court orders where confirmed). Unfortunately, despite our best efforts to convince the ERS otherwise, it refuses to reconsider its position on service credits and reinstate its decades long application of its prior rule and has dug in its heels in making wrongfully terminated members at risk of suffering the financial retirement consequences of their Employer's initial erroneous termination decision. The ERS has provided no valid basis for this inequitable outcome.

This bill seeks to amend HRS chapter 88 to include a new section which codifies the ERS' long-established practice to deem service or compensation awarded to an employee pursuant to the final adjudication of a court of competent jurisdiction as "service" as defined under HRS § 88-21 or compensation as defined pursuant to HRS § 88-21.5 under certain enumerated conditions. This bill also defines "final adjudication of a court of competent jurisdiction" and amends the statutory definition of "base pay" and "service" under HRS § 88-21 and "compensation" under HRS § 88-21.5. This bill not only seeks to clarifies the long standing interpretation and application of the current statutes, but also assures fairness for employees who are found to be innocent of the charges brought against him or her, and/or when the charges against an employee are deemed unfounded, without support, or excessive, and allows the presiding body to more closely make employees "whole" as contemplated by the relevant CBAs, due process, and fundamental fairness.

Re: **SB 211 – Relating to the Employee's Retirement System**

These changes are urgently needed, and we strongly support these amendments to HRS chapter 88 as they will make clear that pay and service that are restored to an employee as part of an administrative, arbitral, or judicial proceeding qualifies as compensation eligible for the purpose of calculating retirement benefits and service time.

We thank you for allowing us to be heard on this very important issue and we hope your committee will unanimously support SB 211.

Respectfully submitted,

ROBERT "BOBBY" CAVACO
SHOPO President

RC jmo

The Thirty-Second Legislature, State of Hawaii
The Senate
Committee on Labor

Testimony by the Hawaii Fire Fighters' Association, Hawaii Government Employees Association, AFSCME Local 152, AFL-CIO, Hawaii State Teachers Association, State of Hawaii Organization of Police Officers, University of Hawaii Professional Assembly, and United Public Workers

February 9, 2023

S.B. 211 — RELATING TO THE EMPLOYEES' RETIREMENT SYSTEM

The Hawaii Fire Fighters' Association, Hawaii Government Employees Association, AFSCME Local 152, AFL-CIO, Hawaii State Teachers Association, State of Hawaii Organization of Police Officers, University of Hawaii Professional Assembly, and United Public Workers strongly support the purpose and intent of S.B. 211, with amendments that will ensure that compensation eligible for the purpose of calculating retirement benefits and service time includes pay and service that are restored to an employee through a final and binding arbitration decision issued pursuant to a collective bargaining agreement's grievance procedure, and legally binding settlement agreements with the employers.

Contrary to long standing policy, practice and procedure, the State of Hawaii Employees' Retirement System ("ERS") recently took an about-face on its decades long position and is refusing to appropriately credit members who were wrongfully terminated and reinstated through a final and binding arbitration decision achieved through the grievance procedure with service credits. The ERS's refusal to properly credit a reinstated member, who should never have been suspended or terminated in the first place, is reckless and appalling, especially when the members and employers upon reinstatement paid in their full contributions to the ERS, which the ERS accepted, maintained in its possession for years, and assumingly used to invest and perpetuate the retirement fund.

The ERS's new position also contravenes and runs afoul of the law and its obligation as an arm of the State, which is a party and signatory to our collective bargaining agreements.

Thank you for the opportunity to testify in strong support of S.B. 211.

Respectfully submitted,

Bobby Lee, President
Hawaii Fire Fighters Association

Randy Perreira, Executive Director
Hawaii Government Employees Association

Ann Mahi, Executive Director
Hawaii State Teachers Association

Robert Cavaco, State Director
State of Hawaii Organization of Police Officers

Christian Fern, Executive Director
University of Hawaii Professional Assembly

Kalani Werner, State Director
United Public Workers

SB-211
Submitted on: 2/9/2023 12:48:12 PM
Testimony for LBT on 2/10/2023 3:00:00 PM

Submitted By	Organization	Testifier Position	Testify
Frances Pitzer	Individual	Support	Written Testimony Only

Comments:

This is just and should be passed. Mahalo.