

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.

The Honorable Karl Rhoads, Chair
and Members of the Committee on Labor
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The House of Representatives
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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,

A handwritten signature in black ink, appearing to read "Michael R. Hansen".

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

A handwritten signature in black ink, appearing to read "Noel T. Ono".

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. 1142

FEBRUARY 8, 2011

RELATING TO THE EMPLOYEES' RETIREMENT SYSTEM

Chair Rhoads and Members of the Committee:

H.B. 1142 increases the retirement age eligibility for State and county government employees who become members of the Employees' Retirement System (ERS) after June 30, 2012. The ERS Board of Trustees strongly supports this bill.

This bill addresses current ERS financing issues by reducing the long-term costs of ERS benefits. The ERS Board would accept a contribution only solution to current ERS financing issues. However, because the necessary increases in employer contributions 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.

Changes to all employee groups are being proposed as follows:

| Employee Group | Current Retirement Age | Proposed Retirement Age | Estimated Dollar Impact to Contributions |
|---------------------|---|-------------------------|--|
| All Other Employees | 55 or 62 | 60 or 65 | \$16.9 million |
| Police & Fire | No age requirement with 25 years of service | 55 | \$3.1 million |
| Elected Officials | No age requirement with 10 years of service | 55 | \$0.1 million |

The change to the retirement age eligibility will result in cost savings, which will help to prevent further increases to the

employer contribution requirements that would otherwise be required 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 the retirement age change for new hires is implemented:

| | |
|----------|----------------|
| FY 2012: | \$20.1 million |
| FY 2013: | \$20.7 million |
| FY 2014: | \$21.4 million |
| FY 2015: | \$22.0 million |
| FY 2016: | \$22.8 million |

The cost savings shown above are based on the stand alone passage of H.B. 1142 and do not reflect any of the cost savings which may occur if other coordinated legislation is enacted.

The passage of this bill, along with H.B. 1037 and H.B. 1038 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 FY 2012 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. 1142. 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.



ALAN M. ARAKAWA

MAYOR

OUR REFERENCE

YOUR REFERENCE

LATE

POLICE DEPARTMENT
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GARY A. YABUTA
CHIEF OF POLICE

CLAYTON N.Y.W. TOM
DEPUTY CHIEF OF POLICE

February 7, 2011

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

RE: House Bill No. 1142, Relating to the Employees' Retirement System

Dear Chair Rhoads and Members of the Committee:

The Maui Police Department opposes the passage of H.B. No. 1142. This bill provides for the retirement age for state and county employees who become members of the ERS after June 30, 2012. This will diminish the retirement benefits for the future of our police workforce and will negatively impact both the quantity and quality of professional law enforcement.

The Maui Police Department asks for your support in opposing H.B. No. 1142.

Thank you for the opportunity to testify.

Sincerely,

GARY A. YABUTA
Chief of Police