

TESTIMONY BY WESLEY K. MACHIDA
ADMINISTRATOR, EMPLOYEES' RETIREMENT SYSTEM
STATE OF HAWAII
TO THE HOUSE COMMITTEE ON FINANCE
ON
SENATE BILL NO. 1341, S.D. 2, H.D. 1

MARCH 31, 2011

RELATING TO THE EMPLOYEES' RETIREMENT SYSTEM

Chair Oshiro and Members of the Committee:

S.B. 1341, S.D. 2, H.D. 1 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 a certain date. The ERS Board of Trustees strongly supports this bill as it seeks to improve the ERS' funded status.

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 ERS also proposes or supports additional changes to raise the retirement age and to reduce the "regular interest" paid on employee contributions. 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 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%

If the bill is not passed, 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.

Another change to the bill that the ERS requests would reduce the investment return rate assumption from 8% to 7.75% and authorizes the ERS Board of Trustees to set the investment return rate assumption after June 30, 2011, based on the recommendations of the actuary. The ERS Board of Trustees supports this change as it seeks to set a realistic investment return rate assumption.

The ERS Board of Trustees has the fiduciary responsibility of adopting actuarial assumptions that impact the funding of the ERS. The ERS Board of Trustees has the statutory authority to adopt all of the actuarial assumptions except for the investment return rate. The investment return rate is currently set by Hawaii state statute at 8%. The ERS exceeded the assumed 8% investment return rate for five of the past ten years; however, it fell below the 8% return rate for the other five years, resulting in an average return rate of approximately 3% for the past ten years. Although the past ten years may not be a

reliable indicator for the future, several ERS investment managers have indicated that it will be extremely difficult to achieve an 8% average investment return rate over the next ten years. Many public pension plans have decreased or are contemplating a reduction to their investment return rate to 7.75% or even 7.5%. Based on analysis and the recommendations of the ERS Actuary and Investment Consultant, the ERS Board of Trustees approved a decrease in the investment return rate assumption from 8% to 7.75%.

The ERS Board of Trustees should be allowed to establish the investment return rate based on recommendations by its Actuary and Investment Consultant. The investment return rate assumption is used to determine the funding level of ERS and contribution rates for employers. If the investment return rate assumption is not realistic, the funding level of the ERS could either be understated or overstated, and employer contribution rates may not be set at levels appropriate to meet the long-term costs of the ERS. If the investment return rate assumption is set by statute, then the Board may be required to assume additional risk to meet this rate. The additional risk could result in achieving the statutory rate; however additional risk could also result in severe underperformance during difficult economic times, thereby further increasing the ERS's unfunded actuarial accrued liability, which is currently reported at \$7.1 billion.

As a result, the ERS Board of Trustees strongly supports the passage of S.B. 1314, S.D. 2, H.D. 1. Thank you for the opportunity to testify on this important measure.

TESTIMONY BY KALBERT K. YOUNG
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
STATE OF HAWAII
TO THE HOUSE COMMITTEE ON FINANCE
ON
SENATE BILL NO. 1341, S.D. 2, H.D. 1

March 31, 2011

RELATING TO THE EMPLOYEES' RETIREMENT SYSTEM

Senate Bill No. 1341, S.D. 2, H.D. 1, provides for retirement benefits for State and county employees who become members of the Employees' Retirement System (ERS) 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 strongly supports this bill which will help to control increases in the cost of employee benefits for State and county employees who become members of the ERS after June 30, 2012.

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