

Honolulu, Hawaii

MAR 23 2012

RE: H.B. No. 2487
H.D. 1
S.D. 1

Honorable Shan S. Tsutsui
President of the Senate
Twenty-Sixth State Legislature
Regular Session of 2012
State of Hawaii

Sir:

Your Committee on Judiciary and Labor, to which was referred
H.B. No. 2487, H.D. 1, entitled:

"A BILL FOR AN ACT RELATING TO THE EMPLOYEES' RETIREMENT
SYSTEM, "

begs leave to report as follows:

The purpose and intent of this measure is to harmonize the service retirement, ordinary disability retirement, and ordinary death benefits for members of the Employees' Retirement System who become members after June 30, 2012, and restore parity with respect to age and service requirements for retirement for current members who become judges after June 30, 2012. Specifically, this measure:

- (1) Restores parity between judges and other contributory plan members with respect to age and service requirements for retirement;
- (2) Deletes water safety officers from the list of individuals who join the Employees' Retirement System as contributory members after June 30, 2012, as this category no longer applies because officers becoming members after June 30, 2012, are Hybrid Plan members;
- (3) Applies the same benefit multiplier for service retirement benefits and ordinary disability benefits for



Hybrid Plan members who become members of the Employees' Retirement System after June 30, 2012;

- (4) Makes the service requirement for payment of the Hybrid Plan hypothetical account balance as an ordinary death benefit for an individual who becomes a member after June 30, 2012, the same as the service requirement for an inter vivos withdrawal by the member after the member has terminated service; and
- (5) Makes various housekeeping amendments to correct typographical errors and avoid confusion.

Prior to the hearing of this measure, your Committee posted a proposed S.D. 1 for review and comment. The proposed S.D. 1 creates two parts, retaining the language of this measure under part I and inserting into part II language from S.B. No. 2750, S.D. 1 (Regular Session of 2012) that addresses the Employees' Retirement System's unfunded liability and helps ensure the system's future sustainability by:

- (1) Requiring a public employee's last state or county employer to pay to the Employees' Retirement System the present value of additional benefits resulting from spiking; and
- (2) Limiting the amount of compensation included in the average final compensation of Employees' Retirement System members by excluding from the calculation of average final compensation late career spikes in an employee's compensation attributable to non-base pay compensation, such as overtime, by establishing the following criteria:
 - (A) For employees who become members after June 30, 2012: Limits the amount of compensation that can be included in the calculation of the member's retirement benefits if the member's non-base pay during the member's high-five years exceeds limits based on the average of the member's base pay during the last ten years of the member's service; and
 - (B) For employees who become members before July 1, 2012: Limits the amount of compensation that can



be included in the calculation of the member's retirement benefits if the member's non-base pay during the member's high-three or high-five years exceeds limits as noted above; provided that this limitation will apply only to compensation, pay, or salary that will be earned after June 30, 2015.

Your Committee received testimony in support of the proposed S.D. 1 from the Department of Budget and Finance, Employees' Retirement System, and one private individual. Testimony in opposition to the proposed S.D. 1 was submitted by the Police Department of the City and County of Honolulu; Department of Fire and Public Safety of the County of Maui; Honolulu Fire Department of the City and County of Honolulu; United Public Workers, AFSCME Local 646, AFL-CIO; Hawaii Government Employees Association, AFSCME Local 152, AFL-CIO; and Hawaii Fire Fighters Association, IAFF Local 1463, AFL-CIO. The Emergency Services Department of the City and County of Honolulu, and Department of Budget & Fiscal Services of the City and County of Honolulu submitted comments.

Your Committee finds that the proposed S.D. 1 makes several amendments to the pension and retirement laws in order to clarify benefit changes made under Act 163, Session Laws of Hawaii 2011. The purpose of Act 163 was to make various revisions to the Employees' Retirement System in order to reduce the system's unfunded liability. These amendments harmonize the service requirements and ordinary death benefits for individuals who become members of the Employees' Retirement System after June 30, 2012, as a result of Act 163.

In particular, your Committee notes that prior to the enactment of Act 163, Session Laws of Hawaii 2011, the age and service requirements for retirement for judges were the same as for other contributory plan members who became members of the Employees' Retirement System at the same time. However, Act 163 establishes more stringent age and service requirements for retirement by individuals who become members after June 30, 2012, and for current system members who become judges after June 30, 2012. As a result, current system members who become judges after June 30, 2012, are subject to more stringent age and service requirements than other contributory plan members of the system at the same time. In light of the Employees' Retirement System's reported \$8,164,000,000 unfunded liability as of June 30, 2011, your Committee finds that "grandfathering" in existing system members who become judges after June 30, 2012, so that the more



stringent service and age requirements do not apply to these members is counterproductive to the reduction of the unfunded liability.

Your Committee further finds that the Employees' Retirement System is anticipating increases in the system's unfunded liability. The continuing volatility and uncertainty of the investment markets, increasing longevity of Employees' Retirement System members, and declining payroll produce significant increases in the system's unfunded liability. If these trends continue without significant increases to the investment portfolio, more solutions will be necessary to prevent the investment corpus from depletion.

As a result, the proposed S.D. 1 addresses the anticipated increases in benefits of Employees' Retirement System members and in the unfunded liability of the system by limiting the amount of compensation included in the average final compensation of new and current members (delayed by three years) and by requiring employers of current members to pay the costs attributable to the additional benefits resulting from pension spiking. Pension spiking is a process whereby public sector employees significantly increase their compensation, through overtime or other similar opportunities, in the years immediately preceding retirement in order to receive a larger pension than they otherwise would be entitled to receive. If an employee's pay increases substantially in the final years of employment, the employee's retirement benefits, which are based on the employee's three or five highest paid years, can be increased dramatically without the years of contributions required to fund this increase. In turn, this spike in compensation increases the unfunded actuarial accrued liability of the Employees' Retirement System.

Your Committee recognizes that the proposed S.D. 1 places a certain level of responsibility and accountability on employers whose employees' compensation is spiked in the immediate years prior to retirement. As a result, employers will be forced to manage overtime and work productivity more efficiently and effectively.

Your Committee has amended this measure by adopting the proposed S.D. 1 and further amended it by:

- (1) Deleting the provisions that restore parity between judges and other contributory plan members with respect

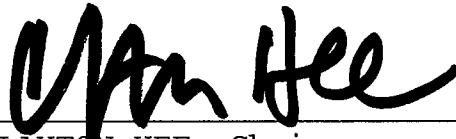


to age and service requirements to receive a retirement allowance after service is terminated;

- (2) Changing the effective date to July 1, 2050, to ensure further discussion; and
- (3) Making technical, nonsubstantive amendments for the purposes of clarity and consistency.

As affirmed by the record of votes of the members of your Committee on Judiciary and Labor that is attached to this report, your Committee is in accord with the intent and purpose of H.B. No. 2487, H.D. 1, as amended herein, and recommends that it pass Second Reading in the form attached hereto as H.B. No. 2487, H.D. 1, S.D. 1, and be referred to the Committee on Ways and Means.

Respectfully submitted on
behalf of the members of the
Committee on Judiciary and
Labor,



CLAYTON HEE, Chair



