

Honolulu, Hawaii

FEB 17 2012

RE: S.B. No. 2750
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
S.B. No. 2750 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 address the
Employees' Retirement System's unfunded liability and help ensure
the system's future sustainability. Specifically, this measure:

- (1) Requires 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) Limits 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 system 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 this measure from the Office of the Governor; the Department of Budget and Finance; the Department of the Attorney General; and the Employee's Retirement System. Testimony in opposition to this measure was submitted by the United Public Workers, AFSCME Local 646, AFL-CIO; the Hawaii Government Employees Association, AFSCME Local 152, AFL-CIO; the University of Hawaii Professional Assembly; the Hawaii Fire Fighters Association, IAFF Local 1463, AFL-CIO; the Hawaii State Teachers Association; the State of Hawaii Organization of Police Officers; and one private individual. Your Committee received comments on this measure from the Department of Budget & Fiscal Services of the City and County of Honolulu; the Honolulu Fire Department of the City and County of Honolulu; and the Police Department of the City and County of Honolulu.

Your Committee finds that the Employees' Retirement System is anticipating increases in the system's unfunded liability, which was reported at \$8,164,000,000 as of June 30, 2011. The continuing volatility and uncertainty of the investment markets, increasing longevity of Employees' Retirement System members, and declining payroll have a significant impact on increasing 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, this measure 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 this measure 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. However, testimony submitted by several public employee unions in opposition indicate a lack of understanding of how the calculations in this measure were derived, concerns on how this measure will impact their union members' future benefits; and a desire for all stakeholders to discuss this measure and work out an equitable solution.

Your Committee further recognizes that additional time is needed to research the impact this measure may have on existing pension and retirement laws, especially on the laws relating to the determination of employer normal cost and accrued liability contributions, and the amount of annual contributions by the State and counties. Also, your Committee needs further time to consider applying similar fiduciary responsibilities under the federal Employee Retirement Income Security Act to the Board of Trustees of the Employees' Retirement System. A higher level of fiduciary duty may hold the Board of Trustees more accountable when making decisions that address the system's unfunded liability and future pension benefits of all public employees in the State. Your Committee encourages further discussion on these matters by the Committee on Ways and Means.

As such, your Committee has amended this measure by:

- (1) Inserting an effective date of July 1, 2050, to ensure further discussion; and



- (2) 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 S.B. No. 2750, as amended herein, and recommends that it pass Second Reading in the form attached hereto as S.B. No. 2750, 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



The Senate
Twenty-Sixth Legislature
State of Hawai'i

Record of Votes
Committee on Judiciary and Labor
JDL

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|--|--|------------------------|-----|----------|
| Bill / Resolution No.:* SB 2750 | Committee Referral: JDL, WAM | Date: 2/8/12 | | |
| <input type="checkbox"/> The committee is reconsidering its previous decision on this measure. If so, then the previous decision was to: _____ | | | | |
| The Recommendation is: <input type="checkbox"/> Pass, unamended 2312 <input checked="" type="checkbox"/> Pass, with amendments 2311 <input type="checkbox"/> Hold 2310 <input type="checkbox"/> Recommit 2313 | | | | |
| Members | Aye | Aye (WR) | Nay | Excused |
| HEE, Clayton (C) | ✓ | | | |
| SHIMABUKURO, Maile (VC) | ✓ | | | |
| GABBARD, Mike | ✓ | | | |
| IHARA, Jr., Les | ✓ | | | |
| SLOM, Sam | | | | ✓ |
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| TOTAL | 4 | | | 1 |
| Recommendation: <input checked="" type="checkbox"/> Adopted <input type="checkbox"/> Not Adopted | | | | |
| Chair's or Designee's Signature: | | | | |
| Distribution: Original Yellow Pink Goldenrod File with Committee Report Clerk's Office Drafting Agency Committee File Copy | | | | |

*Only one measure per Record of Votes