

WRITTEN ONLY

TESTIMONY BY KALBERT K. YOUNG
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
STATE OF HAWAII
TO THE SENATE COMMITTEE ON WAYS AND MEANS
ON
HOUSE BILL NO. 2487, H.D. 1, S.D. 1

March 29, 2012

RELATING TO THE EMPLOYEES' RETIREMENT SYSTEM

House Bill No. 2487, H.D. 1, S.D. 1, amends Sections 88-73, 88-74, 88-81, 88-335, and 88-338 of the Hawaii Revised Statutes to correct errors; harmonize service retirement, ordinary disability retirement and ordinary death benefits for members of the Employees' Retirement System (ERS) who become members of the ERS after June 30, 2012; restore parity with respect to age and service requirements for current members who become judges after June 30, 2012; and prevent unexpected increases in pension benefits and in the unfunded actuarial accrued liability of the ERS by limiting the amount of compensation included in "average final compensation" and requiring employers to pay the additional costs resulting from spiking.

The Department of Budget and Finance strongly supports this Senate draft, which combines language from two Administration bills (House Bill No. 2487 and House Bill No. 2488) which will correct errors; harmonize service retirement and benefits; restore parity in judges' age and service requirements; and allow the ERS to minimize the effect of spiking on the \$8.164 billion (as of June 30, 2011) unfunded actuarial accrued liability of the ERS.

The strategy of spiking is not the only contributing factor of the unfunded liability of the ERS, but there is no doubt that individuals whose retirement pensions are bolstered as a result of spiking, have contributed to the overall system's

unfunded liability. Spiking can, and does, occur within all governmental employers in the State and is an inequitable financial advantage to certain ERS beneficiaries that is to the detriment of all other beneficiaries of the ERS. House Bill No. 2487, H.D. 1, S.D. 1, limits the amount an employee's salary can contribute to determining their annual pension amount if an employee is determined to have spiked their compensation, but also places certain responsibility and accountability on employers whose employees' compensation is spiked in the immediate years prior to retirement. Such spiking action is the most detrimental to the funding liability of the ERS. Employers and employees contribute to the ERS amounts equal to a percentage of compensation; however, when employees' compensations are spiked just prior to retirement, pension benefits are enhanced beyond a rate of what either the employer or employee have contributed to the ERS. This contributes to the unfunded liability and is inequitable to the detriment of other beneficiaries because it compromises the overall viability of the ERS.

This Senate draft is very timely and relevant considering that the Senate Special Committee on Accountability is also in the process of reviewing potential abuses in overtime and over payments. Spiking and its contribution to the unfunded liability in the ERS is just one example of how excessive overtime is detrimental to other employees and affects the financial stability of the organization. The Administration believes that stability in the level of benefits received is an important factor in facilitating the ERS' ability to eventually eliminate its unfunded liability and ensure the long-term viability of the system.

The Department of Budget and Finance encourages the Senate Committee on Ways and Means to support House Bill No. 2487, H.D. 1, S.D. 1.

TESTIMONY BY WESLEY K. MACHIDA
ADMINISTRATOR, EMPLOYEES' RETIREMENT SYSTEM
STATE OF HAWAII
TO THE SENATE COMMITTEE ON WAYS AND MEANS
ON
HOUSE BILL NO. 2487, H.D. 1, S.D. 1

MARCH 29, 2012

RELATING TO EMPLOYEES' RETIREMENT SYSTEM

Chair Ige and Members of the Committee,

H.B. 2487, H.D. 1, S.D. 1, proposes to amend sections 88-74, 88-81, 88-335, and 88-338 of the Hawaii Revised Statutes to correct typographical errors and to harmonize service retirement, ordinary disability retirement and ordinary death benefits for members of the Employees' Retirement System (ERS) who become members of the ERS after June 30, 2012.

The ERS Board of Trustees supports this bill.

This bill makes the following amendments to clarify benefit changes made by Act 163, Session Laws of Hawaii 2011:

- Deletes from section 88-74(f) reference to water safety officers. Section 88-74(f) applies to individuals who join the ERS as contributory plan members after June 30, 2012. The category of water safety officers who are Contributory Plan members and who become members of the ERS after June 30, 2012 does not exist.
- Corrects errors in sections 88-74(i) and 88-81(a) and (f).
- Amends section 88-335 to apply the same benefit multiplier (1.75%) for service retirement benefits and ordinary disability benefits for Hybrid Plan members who become ERS members after June 30, 2012.
- Amends section 88-338(a) to make 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 (10 years) as the

service requirement for an inter vivos withdrawal by the member after the member has terminated service.

Included in the prior version of this bill was an amendment to restore the age and service retirement requirements under section 88-73(b) and 88-74(c) and (d) for current members who become judges after June 30, 2012 to the same age and service retirement requirements as other Contributory Plan members who became ERS members prior to July 1, 2012. As it was intended to restore parity with respect to the requirements for all other groups of current members, the Committee on Ways and Means may wish to consider reinstating this amendment.

In addition to changes and corrections, this draft proposes measures to curtail "pension spiking," a process whereby public sector employees significantly increase their compensation (through overtime, etc.) in the years immediately preceding retirement in order to receive a larger pension that they otherwise would be entitled to receive, by limiting the amount of non-base pay compensation that may be included in a member's "average final compensation" and to require that employers contribute towards the additional costs associated with these benefit inequities.

The ERS Actuary has determined that the estimated present value of potential savings for the current group of employees who meet the bill's definition of pension spiking is \$116.2 million. In addition, the ERS Actuary has estimated that the impact on future reductions to the pension liabilities for new hires is about 5% for Police and Fire employees, 15% for the "25 years and out" employees, and 2% for general employees. In other words, if pension liabilities were to grow by \$5 billion over the next 10 years for these new employees, then approximately \$150 to \$200 million would be reduced from the growing pension liabilities by addressing pension spiking.

After reviewing the recommendations by the ERS Actuary and the pension spiking laws enacted by other states, the ERS Board took a conservative and balanced approach in its unanimous endorsement of the pension spiking criteria included in this bill:

- For employees who become ERS members after June 30, 2012: Limit the amount of compensation that can be included in the calculation of the member's retirement benefits if the member's non-base pay (such as overtime or bonuses) during the member's "high-five" years exceeds limits based on the average of the member's non-base pay during the last 10 years of the member's service.
- For existing members: Limit 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; however, this calculation would only be applied to periods after June 30, 2015.
- For existing members: Require the member's last employer to pay the additional costs resulting from sudden increases in the member's non-base pay during the member's final years of employment.

The ERS Board of Trustees believes that this proposed legislation is necessary to (1) correct, clarify and harmonize the benefit changes made in Act 163, Session Laws of Hawaii 2011, and (2) to help with the ERS' pension and unfunded liabilities. The overall goal is to ensure the sustainability of the ERS and the sufficiency of monies to pay promised benefits. Therefore, the ERS Board strongly supports the passage of this bill.

Thank you for the opportunity to testify on this important measure.

POLICE DEPARTMENT
CITY AND COUNTY OF HONOLULU

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OUR REFERENCE MN-VYH

March 29, 2012

The Honorable David Y. Ige, Chair
and Members
Committee on Ways and Means
The Senate
State Capitol
Honolulu, Hawaii 96813

Dear Chair Ige and Members:

Subject: House Bill No. 2487, HD1, SD1, Relating to the Employees'
Retirement System (ERS)

I am Mark M. Nakagawa, Assistant Chief of the Administrative Bureau of the Honolulu Police Department (HPD), City and County of Honolulu.

The HPD opposes House Bill No. 2487, HD1, SD1. We find that this bill will have a disproportionate and adverse impact on police officers due to the requirements of their duties and assignments, some of which routinely require the expenditure of overtime to complete any given tasks on hand or assigned.

A meeting was held with the ERS to better understand the proposals of and the calculations used as the basis of this bill. Based on the information provided, our concerns about police officers being adversely affected by this bill for merely performing their duties have been validated.

We additionally discovered that the data utilized by the ERS to try and localize "spiking" was reflective of a time slice in which bargaining units 11 (firefighters) and 12 (police officers) were receiving negotiated pay increases beyond the other bargaining units. The use of this time slice resulted in faulty unfunded liability impact assumptions being made by the ERS.

Our analysis of the spiking tests have found that the first test will be an automatic "fail" for most officers assigned to patrol duties due to holiday work and court overtime.

The Honorable David Y. Ige, Chair
and Members
Page 2
March 29, 2012

These officers are the first of the first responders in our community. We find that the second test has a very narrow tolerance level that causes as little as a two percent deviation in the relationship between non-base pay and base pay to meet the "spiking" definition¹. Most importantly, the formula used in the second test is mathematically flawed in that a numerical result cannot be obtained from an employee who does not receive non-base pay during the "comparison period."

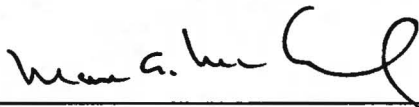
The HPD fully recognizes the exigency of the unfunded liability facing the ERS and appreciates the effort to address the issue. We also do not condone any malicious effort by any employee to "play" the system for personal gain. We do however remain very concerned that this attempt to address so called "spiking" employees will ensnare many of our employees who are merely performing those duties that are required of our department in meeting public safety needs.

As a result, we are requesting the Committee on Ways and Means to hold this bill.

Thank you for the opportunity to testify.

APPROVED:

Sincerely,



for LOUIS M. KEALOHA
Chief of Police



MARK M. NAKAGAWA, Assistant Chief
Administrative Bureau

¹ As an example, an employee receiving a base pay rate of \$50,000 per year with an additional \$4,500 of non-base pay during the comparison period would fail the test by averaging \$5,500 in non-base pay during the average final compensation period.

March 27, 2012
Committee on Ways and Means
Senator David Y. Ige, Chair
Senator Michelle N. Kidani, Vice Chair

Re: HB 2487 HD1, SD1 RELATING TO THE EMPLOYEE'S RETIREMENT SYSTEM

Dear Chair Ige and Members of the Committee,

This testimony is submitted on behalf of the City and County of Honolulu Emergency Services Department ("ESD") and its Divisions, Emergency Medical Services ("EMS") and Ocean Safety. My name is Mark K. Rigg, and I am the Deputy Director of ESD. Prior to this appointment, I worked for EMS since 1983, from the time of my internship as an entry level EMT, on through the management ranks, most recently as a District Chief. As a result of my experiences as field level personnel, a line operations supervisor, and today as a cabinet-level administrator, I believe I am well versed in the issues concerning ESD with respect to this proposed legislation.

While ESD and its Divisions support the intent of HB 2487 HD1, SD1 in theory, the Department has concerns regarding the impact that passage of such a measure might have on a number of critical elements in our public service agency, including the possible effect on current personnel, retirees, and upon departmental budget and operations. In so much as ESD has only recently seen this bill, and has not been privy to the financial models and analysis employed in support of the proposed legislation, we are unable to effectively evaluate the potential impact upon our Department. As with many of our fellow public service agencies, ESD would like to be involved in any future discussions concerning this issue in order to effectuate a fair and equitable solution.

Due to the nature of our work, we will always incur some degree of overtime. Both EMS and Ocean Safety provide critical services to our community. The delivery of these services is expected by the public and necessary for the well-being and safety of our community. Our operations proceed 24 hours a day, seven days a week, without regard for time, weather, or a litany of other known and unknown conditions that may impact the public. The very nature of staffing a public safety function with a workforce that is primarily subject to a collective bargaining agreement has many built-in constraints. From first-hand experience, I can attest that managing an around-the-clock public safety function while attempting to control and mitigate overtime, is difficult.

Because of the highly inflexible nature of our staffing needs, the line supervisor's toughest decisions often come in the form of deciding which personnel may be "stuck" or unable to leave at the end of their eight-hour shift due to the unavailability of personnel. When faced with the choice between cost containment and the delivery of critical public safety functions, EMS and Ocean Safety management has chosen to permit use of overtime rather than risk the public's health, safety or welfare.

Overtime is also necessary since we have been unable to find sufficient qualified personnel to fill vacant positions. Kapiolani Community College graduates up to 40 EMT students a year and many of them apply to Honolulu City and County EMS for jobs. Unfortunately, after the interview process, suitability, and physical examinations, we are only able to hire between 20 and 25 EMT's a year.

Also, every January the division pulls about 15 EMT's out of field operations to send them to paramedic school for a year. This loss of field personnel has an immediate effect on increasing our overtime.

There is usually a gap of 2 – 3 months that takes place between the start of this class and the finishing of the class that preceded it. It is during this time that the staffing in the department is critically challenged.

It has not helped that attrition rate has been so high for EMT's. (This is a training level just below paramedic). From 2008 to 2009 we hired 34 EMT's but lost 37 EMT's. For a profit/loss total of (-3).

Furthermore, we are recovering from a huge loss of paramedic personnel in 2005 and 2006 when a "perfect storm" of conditions led to the loss of 15 paramedics to Honolulu Fire Department, plus Hickam Fire/EMS Department and Federal Fire Department when those agencies started up EMS Advanced Life Support ambulance services on the military bases. Honolulu EMS reeled for many years with the loss of so many paramedic level personnel at one time. Rebuilding the paramedic roster is, and will continue to be a challenge as other agencies "shop" for the best personnel to suit their respective organizations. In 2010, Federal Fire Department again recruited away from Honolulu EMS to the tune of seven paramedics.

I would also like to mention that our overtime management is also constrained by our collective bargaining agreements. Simply put, there is little to no management discretion or leeway with respect to the protocol for extending offers of overtime. Any diversion from the specific process, either intentional or as a result of operational necessity, the departments are automatically subject to a potential grievance.

Using EMS as an example, Unit assignments are based upon seniority, as determined through an annual bid. Certain units, often in the more rural or more remote parts of the island, are statistically less busy than their more urban counterparts. In theory, personnel with greater seniority have the ability to choose locations where the pace of work may be slower and more conducive to maintaining the mental and physical energy needed to work overtime assignments. Likewise, there is issue of filling vacant shifts, which may arise due to sickness, vacation, or industrial injury. EMS and Ocean Safety are physically and emotionally demanding job functions, and it is often difficult, at best, to find individuals who are even willing to accept an overtime offer due to fatigue, family obligations or other competing interests.

In closing, we are actively monitoring our use of overtime and taking steps to recruit and train additional personnel in order to reduce the necessity for overtime. However, because we must respond with sufficient personnel whenever an emergency or natural disaster strikes, some degree of overtime is inevitable.

Together with the other public safety agencies, ESD will be seeking further dialogue with ERS board representatives in order to gain a better understanding of this proposal and its impact on our Department and we hope to actively participate in future discussions on this bill.

Thank you for the opportunity to provide this testimony on behalf of ESD.

Sincerely,

MARK K. RIGG
DEPUTY DIRECTOR
CITY AND COUNTY OF HONOLULU
EMERGENCY SERVICES DEPARTMENT

DEPARTMENT OF BUDGET & FISCAL SERVICES
CITY AND COUNTY OF HONOLULU

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PETER B. CARLISLE
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MICHAEL R. HANSEN
DIRECTOR

NELSON KOYANAGI, JR.
DEPUTY DIRECTOR

March 29, 2012

The Honorable David Y. Ige, Chair
and Members of the Committee on
Ways and Means
The Senate
State Capitol
Honolulu, Hawaii 96813

Dear Chair Ige and Members:

Subject: House Bill 2487, House Draft 1, Senate Draft 1
Relating to the Employee's Retirement System

The City and County of Honolulu supports efforts to address the \$8 billion unfunded liability of the Employees' Retirement System (ERS) in a comprehensive manner. However, we have serious concerns about the anti-spiking provisions in House Bill 2487, House Draft 1, Senate Draft 1, which are intended to address a single factor related to the unfunded liability.

We note that the provisions in this bill are similar to those contained in the anti-spiking measures that have been introduced this year. In prior testimony related to these anti-spiking measures, the ERS has noted that, using the definition under the bill, they estimate that over a three year period, "spiking" has added \$39.6 million to the unfunded liability. This is approximately 1/2% of the total unfunded liability. The City understands the value of counting each dollar. The City also understands why the ERS Board—with its focus on reducing the unfunded liability—would advocate for a solution that will bring in additional dollars and limit the monies being paid out. However, we believe the provisions require further review and, perhaps more importantly, we believe a broader viewpoint is needed to analyze the impacts of the proposal—particularly given its disproportionate effects on our public safety and health employees and their agencies.

We believe the following areas of concern and options need to be addressed:

Concerns regarding the additional employer contribution:

- Employers would be required under the bill to pay more than their fair share for their employees who are deemed to have spiked their pensions. Our understanding is that past "spiking" was considered in the setting of the contribution rates—accordingly, employers are already paying for past spiking.

- Employers would be required to pay, up front, the additional amount added to the unfunded liability for employees who fail the spiking tests.
- Employees who fail the spiking test will have their pension benefits limited.
 - Employees who fail the spiking tests will receive a refund of their contributions paid, but not used due to the pension limit.
 - Employers will not receive a refund or credit for the employer contributions paid, but not used, due to the pension limit.
 - This additional amount is excess—over and above that which is necessary to fund any unfunded liability due to the spiking.
- Employers have no guaranteed end to the additional payment.
 - There is no end date for the additional contributions.
 - If the tests are enforced, the additional contributions should diminish and end at some point.
 - If the tests are successfully challenged; however, the additional payments will not end until all “grandfathered” employees retire.
 - In light of our understanding that the law is likely to be challenged and our belief that employers will be forced to pay unequal amounts, there should be an end date to the payments.
- Employers have to make the payment all at once—not over a period of time.
 - Employers should be provided some relief regarding the additional payments by allowing the payments to be made over a period of time.
- Employers are charged for the spiking whether or not it occurred “on their watch”.
 - Employers should be charged for when the spiking occurred.

Options for addressing concerns regarding the employer contribution:

- Include a requirement that the assessment of the additional payments will end three years after they begin.
 - This will ensure that if the law is successfully challenged, employers will not be subject to these additional assessments for an extended period of time.
 - This will ensure that those employers assessed excess contribution amounts will have an end to the excess assessments.
- Include a 10 year payment period for the additional assessment amount.
- Replace the requirement that the last employer of the employee be charged for the spiking with a requirement that the employer who employed the employee while spiking occurred will be charged for the spiking.

Concerns regarding the tests:

- The tests do not provide for a level playing field for employees in 24/7 operations.
 - The tests do not adequately consider the overtime payments to employees in 24/7 operations that have more of the characteristics of base pay rather than non-base pay.
- The tests do not consider the unique situations created when employees must respond to declared states of emergency—like the recent flooding.
- The tests do not consider law enforcement employees who must be assigned to different shifts, but must report to court during normal court hours.

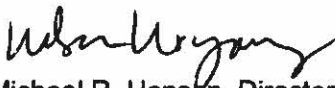
Options for addressing concerns regarding the tests:

- Include in the definition of base pay the following for employees in operations that run 24/7 all year:
 - Holiday overtime since these operations must be staffed on all days of the year, employees in these operations must work on Holidays so Holiday Overtime for these employees is more of a recurring payment.
 - Overtime when an employee's normal scheduled hours of work include overtime— Fire Fighters on 24 hour shifts work a schedule that automatically results in overtime. This is a recurring payment.
- Exclude from the spiking tests the following types of payments.
 - Overtime earned during a declared Federal, State or City/County emergency or disaster.
 - Overtime earned by law enforcement personnel who must attend court during their off-duty hours.

We note that even if changes can be made to address the concerns we have been able to identify so far, ultimately we believe the question remains as to what is the acceptable number of good employees, who did their jobs with no intent of gaming the system, who should be given the derogatory label of "spiker" and monetarily penalized with a reduced pension.

In light of the above, the City believes there may be other approaches to address the unfunded liability that may be more equitable to employers and employees. In closing, we would like to reiterate our willingness to continue discussions with the ERS board, other stakeholders and the legislature on the unfunded liability issue and potential ways to address this critical issue.

Yours truly,



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



Noel T. Ono, Director
Department of Human Resources

ALAN M. ARAKAWA
MAYOR



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CHIEF

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March 28, 2012

The Honorable David Ige, Chair
Committee on Ways and Means
State Senate
State Capitol, Room 215
Honolulu, Hawaii 96813

Dear Chair Ige:

Subject: H.B. 2487, H.D. 1, S.D. 1 Relating to the Employees' Retirement System

I am Jeffrey A. Murray, Fire Chief of the County of Maui, Department of Fire & Public Safety (MFD). The County of Maui received additional information from the Employees' Retirement System and is in the process of evaluating the impact of this bill on the county and its employees. The MFD opposes this bill and requests your consideration of the following concerns.

The MFD's overtime is operationally driven due to emergency services provided on a 24 hours per day, 7 days per week basis. The MFD budgets holiday and nonholiday overtime costs, which involves work on state holidays. Employees on a 56-hour workweek schedule are allotted three hours of overtime per week and together with holiday overtime, this amounts to an approximate ten percent increase of the employee's base salary. These costs are determined through collective bargaining agreements. Nonholiday overtime is controlled and approved by the Department's executive staff to prevent abuse.

Other overtime is determined according to the nature of the work performed and such overtime is earned when emergency callouts occur. The MFD consistently operates within its budget on holiday and nonholiday overtime costs.

While we respect the legislature's attempt to minimize the impact of spiking by government employees, the MFD believes that what may be an acceptable limit of overtime in one assignment may not be applicable to another duty assignment. Under

The Honorable David Ige, Chair
Page 2
March 28, 2012

these circumstances, employees with normally high overtime should not be classified or penalized for what may appear as spiking.

We have concerns regarding the proposal that employers would be required to pay more than their fair share for their employees who are deemed to have spiked their pensions. Our understanding is that past spiking was considered in the setting of the contribution rates, so employers are already paying for past spiking. We also understand that employees who fail the spiking test will have their pension benefits limited. MFD employees earn overtime on a year-round basis due to the emergency life safety services provided for citizens who face life-threatening situations and conditions. In addition, special events, or a large-scale emergency operation, can directly impact an employee's overtime; however, the overtime is in the performance of essential public safety duties.

Senate Concurrent Resolution 167, Senate Resolution 97 and House Concurrent Resolution 152 requests that a task force convene to investigate, discuss, and review possible methods to reduce the amount of overtime used by county and state employees. The task force is requested to submit a report of its findings and recommendations to the Legislature no later than 20 days prior to the Regular Session of 2013 convening. We support and believe that the task force will assemble relevant information from many stakeholders in order for the legislature to consider a fair and equitable solution to the ERS' unfunded liability. We believe this may minimize the unforeseen consequences of a solution that has not been carefully examined

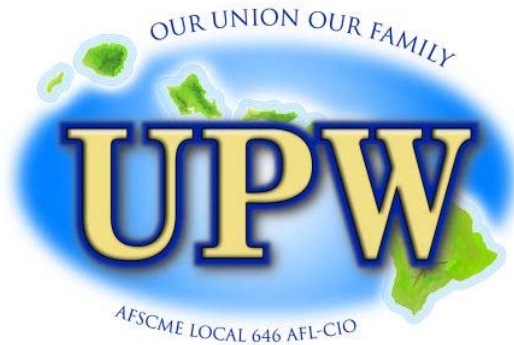
The MFD urges your committee's consideration of our comments and suggests a cautious approach to the passage of any version of H.B. 2487, H.D. 1, S.D. 1.

Should you have any questions, please contact me at (808) 270-7561.

Sincerely,



JEFFREY A. MURRAY
Fire Chief



THE HAWAII STATE SENATE
The Twenty-Sixth Legislature
Regular Session of 2012

COMMITTEE ON WAYS AND MEANS
The Honorable Sen. David Y. Ige, Chair
The Honorable Sen. Michelle N. Kidani, Vice Chair

DATE OF HEARING: Thursday, March 29, 2012
TIME OF HEARING: 9:00 a.m.
PLACE OF HEARING: Conference Room 211

**TESTIMONY ON HB 2487 HD1 SD1 RELATING TO THE EMPLOYEES'
RETIREMENT SYSTEM**

By DAYTON M. NAKANELUA,
State Director of the United Public Workers,
AFSCME Local 646, AFL-CIO ("UPW")

My name is Dayton M. Nakanelua and I am the State Director of the United Public Workers, AFSCME, Local 646, AFL-CIO (UPW). The UPW is the exclusive representative for approximately 11,000 public employees, which include blue collar, non-supervisory employees in Bargaining Unit 1 and institutional, health and correctional employees in Bargaining Unit 10, in the State of Hawaii and various counties. The UPW also represents about 1,500 members of the private sector.

UPW opposes HB 2487 HD1 SD1, particularly Part II of the bill, which prevents unexpected increases in pension benefits and in the unfunded actuarial accrued liability of the Employees' Retirement System by limiting the amount of compensation included in "average final compensation" and requiring employers to pay the additional costs resulting from "spiking".

Our members are hard working citizens that provide critical services to the State of Hawaii and its residents. Historically the UPW, through the collective bargaining process, has worked with employers to keep overtime at a reasonable level. In an effort to save money, employers chose to increase overtime versus hiring more staff. Let me be clear that overtime is approved and scheduled by management and not our members.

Thank you for the opportunity to testify on this measure.