



**TESTIMONY OF  
THE DEPARTMENT OF THE ATTORNEY GENERAL  
TWENTY-SIXTH LEGISLATURE, 2012**

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**ON THE FOLLOWING MEASURE:**

H.B. NO. 2488, RELATING TO THE EMPLOYEES' RETIREMENT SYSTEM.

**BEFORE THE:**

HOUSE COMMITTEE ON LABOR AND PUBLIC EMPLOYMENT

**DATE:** Tuesday, February 14, 2012 **TIME:** 9:30 a.m.

**LOCATION:** State Capitol, Room 309

**TESTIFIER(S):** David M. Louie, Attorney General, or  
Diane S. Kishimoto, Deputy Attorney General

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Chair Rhoads and Members of the Committee:

The Department of the Attorney General supports this bill.

This bill 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," i.e., late career spikes in the employee's compensation attributable to non-base pay compensation such as overtime. The bill also 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. The exclusion applies to employees who become members of the Employees' Retirement System after June 30, 2012. The exclusion of spiked compensation also applies, effective July 1, 2015, to employees who became members of the Employees' Retirement System prior to July 1, 2012. Section 4 of the bill, on page 10, provides that the application of the exclusion to current members is subject to the provisos that:

(1) A member's average final compensation shall not be less than what the employee's average final compensation would have been if the member had retired on June 30, 2015; and

(2) Compensation, pay, or salary earned before July 1, 2015, is not subject to the limits imposed by the bill.

We believe that the foregoing provisos provide a defense to a potential legal challenge to the bill under article XVI, section 2, of the State Constitution, which provides that:

"Membership in any employees' retirement system of the State or any political subdivision

thereof shall be a contractual relationship, the accrued benefits of which shall not be diminished or impaired."

In Kaho'ohanohano v. State, 114 Hawai'i 302, 342, 162 P.3d 696, 736 (2007), the Hawai'i Supreme Court recognized that, although article XVI, section 2 prohibits the reduction of benefits attributable to past services: "the intent of article XVI, section 2 was in part to provide the legislature with the flexibility to 'reduce benefits as to . . . persons already in the system in[ ]so[ ]far as their *future services* were concerned.'" (Emphasis and brackets in original.) For current members, this bill applies only to benefits as to future services. The benefits attributable to past services, i.e., the average final compensation based on past services and inclusion of the full amount of compensation for past services in the calculation of average final compensation, are protected by the provisos included in this bill.

This bill does not impair or diminish accrued benefits. The bill protects the retirement benefits that will be accrued as of its July 1, 2015, effective date for current members.

We respectfully request that the Committee pass this bill.

TESTIMONY BY KALBERT K. YOUNG  
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE  
STATE OF HAWAII  
TO THE HOUSE COMMITTEE ON LABOR AND PUBLIC EMPLOYMENT  
ON  
HOUSE BILL NO. 2488

February 14, 2012

RELATING TO THE EMPLOYEES' RETIREMENT SYSTEM

House Bill No. 2488 proposes to revise the allowability of certain employee compensation for the calculation of retirement pension if the overall compensation in the final years of service are determined to have been enhanced through means of "spiking." The bill provides definitions for determining that spiking has occurred and establishes the threshold limitations for calculating the effect on an employee's final compensation. In preventing spiking of pension benefits, this bill will also address some of the impact on the unfunded actuarial accrued liability of the Employees' Retirement System (ERS) by limiting the amount of compensation included in "average final compensation" and requires employers to pay the additional costs resulting from spiking.

The Department of Budget and Finance strongly supports this Administration bill which will allow the ERS to minimize the effect of spiking. The ERS has an unfunded actuarial accrued liability of \$8.164 billion (as of June 30, 2011). The strategy of spiking is not the only contributing factor for the unfunded liability, but there is no doubt that individuals whose retirement pension is bolstered as a result of spiking, have contributed to the overall systems' 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. 2488 limits the amount an employee's salary can contribute to determining their annual pension amount, but it 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, that employees' pension benefit is 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. 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 House Committee on Labor and Public Employment to support House Bill No. 2488.

TESTIMONY BY WESLEY K. MACHIDA  
ADMINISTRATOR, EMPLOYEES' RETIREMENT SYSTEM  
STATE OF HAWAII  
TO THE HOUSE COMMITTEE ON LABOR AND PUBLIC EMPLOYMENT  
ON  
HOUSE BILL NO. 2488

FEBRUARY 14, 2012

RELATING TO THE EMPLOYEES' RETIREMENT SYSTEM

Chair Rhoads and Members of the Committee,

The provisions of H.B. 2488 address "pension spiking" and represent one way in which public pension funds across the nation have been dealing with their growing pension and unfunded liabilities.

The ERS Board of Trustees strongly supports this bill as it will help to strengthen the integrity and sustainability of the ERS through proper funding, assist in addressing the growing pension liabilities, and eliminate benefit inequities.

The 2011 Legislature took an important step in addressing the growing pension liabilities when it passed the benefit changes for new hires starting after June 30, 2012. Although the changes enacted are significant, they affect the long-term future liabilities of the ERS. The solutions proposed in this bill will address unanticipated increases currently occurring in the ERS Unfunded Liability (reported at \$8.164 billion as of June 30, 2011) and help to ensure ERS' future sustainability.

The continued volatility and uncertainty of the investment markets, increasing longevity of ERS members, payroll declines (employer contributions are based on total payroll), and others have a significant impact on the increasing unfunded liability. In FY2011, employee and employer contributions were \$715 million and almost \$1 billion in benefit payouts were made. This means that approximately \$300 million was liquidated from the investment portfolio to pay benefits. So far in FY2012, contributions of \$425 million were received and \$600 million in benefit payouts were made with \$175 million being liquidated to cover the payouts. If these trends continue without significant increases to the investment portfolio, more solutions will be needed to prevent the investment corpus from being depleted.

As a solution, some states have converted from a defined benefit structure to a defined contribution structure. To do so would

be detrimental to the ERS members and costly to employers and taxpayers over the next 15 years given the ERS' large unfunded liability. Rather than changing the structure, the restrictions to pension spiking being proposed in this bill is another appropriate step toward ERS' sustainability.

This bill addresses the unexpected increases in benefits of members of the Employees' Retirement System (ERS) 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 3 years) and by requiring employers of current members to pay the costs attributable to additional benefits resulting from "pension spiking."

"Pension spiking" is the 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 than they otherwise would be entitled to receive.

Public employers and ERS members provide contributions that fund a member's retirement benefits over the member's anticipated employment period, so that there will be sufficient money to pay the member's retirement benefit. For the career government employee, this could entail a span of between 25 or 30 years of service. If an employee's pay suddenly 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 the increase. This, in turn, increases the unfunded actuarial accrued liability of the ERS.

The impact of pension spiking is described and illustrated below. Assume that a member's average final compensation for the first 25-27 years of employment totaled \$50,000. Without spiking and with "normal" salary increases, the last three years of pay would compute to an average final compensation of \$56,243 and an annual maximum allowance of \$33,746. However, if this member's average salary during the last three years increased to \$200,000 due to overtime or other non-base pay, the member's pension would be spiked to an annual maximum allowance of \$120,000. The additional contributions on the spiked pay received by the ERS would cover less than 2 years of the additional \$86,254 in benefits that would need to be paid.

As indicated below, the ERS' unfunded liability based on this one example is increased by \$1,134,720.

Description	Service Years	Average Final Compensation (Highest 3 years)	Annual Pension (Maximum Allowance)	Actuarial Accrued Liability (unfunded liability) at Retirement
Without Spiking	25 -27; 28 -30	\$50,000; \$56,243	\$33,746	\$443,946
With Spiking	25 - 27; 28 - 30	\$50,000; \$200,000	\$120,000	\$1,578,666
<b>Difference</b>		<b>\$143,757</b>	<b>\$86,254</b>	<b>\$(1,134,720)</b>

If this sample case was multiplied several times as noted, for instance, in the December 2011 report by the City Auditor regarding excessive overtime pay of 10 EMS employees, the estimated impact/increase of the ERS' Unfunded Liability would be approximately \$4 million (determined by the ERS Actuary - with certain assumptions).

As the ERS is a cost sharing, multi-employer plan, if the employers of ERS members with "spiked" benefits do not pay the additional cost resulting from spiking, the costs would be borne by all employers as part of the increase in the unfunded accrued liability of the Employees' Retirement System.

The ERS Board of Trustees reviewed several options recommended by the ERS Actuary to remedy pension spiking and looked at the impact of overtime and other non-base pay on the unfunded liability. Furthermore, the Board discovered that there were at least 10 systems that excluded or restricted overtime in their pension calculations and there were 15 states that have anti-spiking provisions in their laws (as reported by the National Association of State Retirement Administrators). It was also reported that many of these states implemented a more strict criteria than that included in this bill. After reviewing the recommendations from the ERS Actuary and the pension spiking

laws enacted by other states, the ERS Board took a moderate and balanced approach in its recommendation of the pension spiking criteria included in this bill. This criteria is summarized as follows:

- **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.

Based on a sample group of about 5,000 members who retired from 2008 to 2010, the ERS Actuary calculated that more than 670 (or about 13%) of those retirees would meet the pension spiking criteria in this bill. The resulting impact/increase on the ERS' Unfunded Liability was over \$39 million.

The ERS Board of Trustees believes that this proposed legislation is needed to help with the ERS' unfunded liability and to mitigate inequities. 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.



**AMENDED**

DEPARTMENT OF BUDGET & FISCAL SERVICES

**CITY AND COUNTY OF HONOLULU**

530 SOUTH KING STREET 2<sup>nd</sup> FLOOR • HONOLULU, HAWAII 96813  
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PETER B. CARLISLE  
MAYOR



MICHAEL R. HANSEN  
DIRECTOR

February 14, 2011 2012

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

Dear Chair Rhoads and Members:

Subject: House Bill 2488  
Relating to the Employee's Retirement System

The City and County of Honolulu supports the intent of House Bill 2488 to address the effects of spiking on the unfunded liability of the Employees' Retirement System; however, we have a number of questions on the method being used to determine "spiking" and the resultant impact to the employee and the employer. Accordingly, we suggest a cautious approach to the bill.

We recognize that some extreme situations involving City employees have come to light recently that may have played a part in creating an urgency to address spiking. We want to assure you that to the extent we are able, within the bounds of the collective bargaining agreements we are subject to and without affecting public safety, we are taking steps to address the situation. That being said, this is a complex issue and we have only recently become aware of the approach being endorsed by the ERS Board.

While we value the efforts of the Board, we have not had an opportunity to review in-depth the formula and its effects, nor have we had a chance to question the actuaries regarding the method that will be used to assess the employer. We believe that a thorough review and understanding is essential to ensuring the fair and equitable resolution (from both the employer's and employees' perspectives) that we understand the Board is seeking. Below are just three examples of situations we wish to explore further:

The Honorable Karl Rhoads, Chair  
and Members of the Committee on Labor and  
Public Employment  
The House of Representative  
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- To what extent are recurring differentials, paid for virtually all hours the employee is at work, resulting in a "spiking" determination—for example, the 25% hazard pay differential paid to solo bike officers?
- To what extent has "spiking" been considered in the setting of the new employer contribution rates—which for police and fire go from 19.7% this year to 25% on July 1, 2015?
- The bill currently requires the last employer of the employee who retired in the previous year to pay the costs associated with that employee's spiking. However, the spiking may have occurred prior to the period during which the employee worked for that last employer. If the bill's intent is to charge the employer for the costs of their employees' spiking, this provision should be revised.

The City is committed to efforts to address the ERS unfunded liability. Last year we fully supported the measure that will increase substantially our employer contributions to the ERS. We also have supported, and will continue to support measures—such as HB1751 which is on the agenda today—to add a county representative to the ERS Board so that we may have input on, and a comprehensive understanding of, measures such as these. At this point, we do not believe we have the understanding necessary to support all the provisions in this measure.

Thank you for the opportunity to testify on House Bill 2488.

Yours truly,

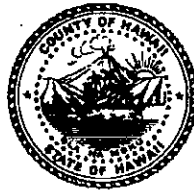


Michael R. Hansen, Director  
Department of Budget & Fiscal Services



Noel T. Ono, Director  
Department of Human Resources

William P. Kenoi  
*Mayor*



Nancy E. Crawford  
*Director*

Deanna S. Sako  
*Deputy Director*

## County of Hawai'i

### Finance Department

25 Aupuni Street, Suite 2103 • Hilo, Hawaii 96720  
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February 13, 2012

The Honorable Karl Rhoads, Chair  
and Members of the House Committee on Labor & Public Employment  
Hawai'i State Capitol  
415 South Beretania Street  
Honolulu, Hawai'i 96813

RE: Testimony for House Bill No. 2488  
Hearing Tuesday, February 14, 2012, at 9:30 a.m., Conference Room 309

Honorable Chair Rhoads and Members of the Committee:

Hawai'i County supports the intent of H.B. 2488, to address the effects of spiking on the unfunded liability of the Employees' Retirement System, however, we have a number of concerns with the bill. Last year the rates that the employers pay to ERS were increased substantially, so we are unclear if the spiking component was already taken into account at that time. Also, the system described in the bill to determine spiking and then to repay ERS for the spiking seems very confusing – I am not sure how the employers will ever be able to determine if we are paying the correct amount or even if we owe at all. Requiring the last employer to pay seems to go against the intent of the bill, since the spiking could have happened prior to the employee's position with their last employer. It seems the payment related to spiking should be made by the employer where the spiking occurred. In general with the significant increase in rates paid to ERS, we will have a difficult time paying any additional amounts to ERS.

Thank you for your attention to our concerns.

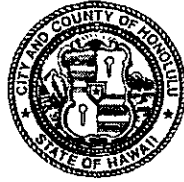
Sincerely,

A handwritten signature in black ink that reads "Nancy E. Crawford".

Nancy Crawford  
Director of Finance

POLICE DEPARTMENT  
CITY AND COUNTY OF HONOLULU

801 SOUTH BERETANIA STREET · HONOLULU, HAWAII 96813  
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PETER B. CARLISLE  
MAYOR

LOUIS M. KEALOHA  
CHIEF

DAVE M. KAJIHIRO  
MARIE A. McCAULEY  
DEPUTY CHIEFS

OUR REFERENCE JC-VYH

February 14, 2012

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

Dear Chair Rhoads and Members:

Subject: House Bill No. 2488, Relating to the Employees' Retirement System

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

The HPD supports the intent of House Bill No. 2488 but has several concerns about the possible impact it may have on the department.

We realize that "Spiking" will have detrimental consequences on the retirement system that will affect us all. Changes involving better management of overtime are needed to correct the problem. Beginning in 2008, the HPD required managers to play a strong role in the strict management of overtime with the Fair Labor Standards Act lawsuit. Since that time, officers have been required to work under strict overtime controls. This resulted in a drastic reduction in overtime as seen in the results posted by Mayor Peter Carlisle for the recent Asia-Pacific Economic Cooperation summit held in Honolulu.

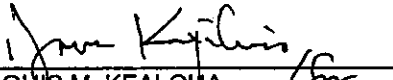
The HPD was not involved in any of the previous discussions regarding this bill. Therefore, we do not understand how the calculations were derived to determine what was considered as "Spiking." This lack of understanding has led to some confusion that we believe needs to be clarified before more drastic steps are taken to make changes.

Because of this lack of clarity, we request the opportunity to meet with representatives from the Employees' Retirement System and other city agencies to create a system that is sustainable for the future before further repercussions occur.

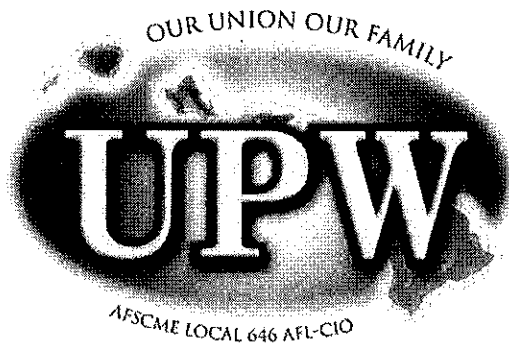
Thank you for this opportunity to testify.

APPROVED:

Sincerely,

  
LOUIS M. KEALOHA  
Chief of Police

  
MARK M. NAKAGAWA, Assistant Chief  
Administrative Bureau



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

COMMITTEE ON LABOR & PUBLIC EMPLOYMENT

The Honorable Sen. Karl Rhoads, Chair  
The Honorable Sen. Kyle T. Yamashita, Vice Chair

DATE OF HEARING: Tuesday, February 14, 2012  
TIME OF HEARING: 9:30 a.m.  
PLACE OF HEARING: Conference Room 309

**TESTIMONY ON HB 2488 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 01 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.

The UPW opposes HB 2488, which addresses "spiking" by public employees who intentionally increase their high three in an effort to grow their retirement benefits.

Our members are hard working citizens that provide critical services to the State of Hawaii. Historically, UPW 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. Overtime is approved and scheduled by management.

While we acknowledge the unfunded liability and other problems facing the ERS, this bill is not the answer. Instead, we suggest the respective parties come together and discuss viable solutions to address this situation.

Thank you for the opportunity to testify on this measure.



HAWAII GOVERNMENT EMPLOYEES ASSOCIATION  
AFSCME Local 152, AFL-CIO

RANDY PERREIRA, Executive Director • Tel: 808.543.0011 • Fax: 808.528.0922

The Twenty-Sixth Legislature, State of Hawaii  
House of Representatives  
Committee on Labor and Public Employment

**LATE**

Testimony by  
Hawaii Government Employees Association  
February 14, 2012

H.B. 2488 – RELATING TO THE  
EMPLOYEES' RETIREMENT SYSTEM

The Hawaii Government Employees Association, AFSCME Local 152, AFL-CIO strongly opposes the purpose and intent of H.B. 2488, which attempts to prevent unexpected increases in pension benefits and the unfunded actuarial accrued liability of the Employees' Retirement System (ERS) by defining and limiting the amount of compensation included in the average final compensation calculation.

First and foremost, overtime, and therefore by default any definition of "spiking," is strictly an Employer issue, whereby the Employer has direct oversight and control of whom, how much and when overtime is granted to. If the Employer perceives a situation in which an Employee is intentionally attempting to boost their average final compensation, then the Employer has the purview to cease authorizing the overtime. Within the Personal Rights and Representation article in our mutually agreed upon Collective Bargaining Agreements is language that states "the Employee shall have the right to refuse for good cause as determined by the Employer to work overtime" [emphasis added]. Per contract, it is the Employer's prerogative, not the Employee's, to determine if the refusal is for good cause. In some cases, our members are not afforded the option to refuse overtime, and are required to work half-shifts prior to or after their regular shift. In other cases, Employees are required to work back-to-back double shifts due to staff shortages, health and safety compliance, or to staff a 24/7 facility. Our members provide critical services to the community and should be adequately compensated; both immediately in compensatory time off or overtime pay, and also in retirement benefit calculations that accurately reflect the Employee's work. We find it incongruous to force an individual to work overtime and not count the overtime hours toward their final retirement calculation.

However, understanding that the ERS is a singular entity that collects contributions from each Employer and furnishes the retirement benefits to all beneficiaries, we support the provision that the specific Employer who authorizes increased overtime also increase their contribution accordingly, in an effort to curb the unfunded liability. If the Employer authorizes the overtime, it is incumbent upon them to pay all additional costs. It is our

Committee on Labor and Public Employment  
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utmost desire that the fund remain solvent and structurally in tact for all current and future beneficiaries.

Finally, while we realize and understand the need to address the Employees' Retirement System's unfunded liability, we respectfully request the Committee to consider the percentage of the unfunded actuarial accrued liability that is directly attributed to "spiking" and whether or not the Employer could implement cost-containment measures independent of the Legislature statutorily intervening. If it becomes law, H.B. 2488, in concert with the omnibus changes provided in Act 163, Session Laws of Hawaii 2011 will leave your government workforce with two separate and distinct tiers of employee benefits.

We respectfully urge the committee to defer this measure. Thank you for the opportunity to testify in strong opposition of H.B. 2488.

Respectfully submitted,



Randy Perreira  
Executive Director