

**TESTIMONY BY KALBERT K. YOUNG  
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE  
STATE OF HAWAII  
TO THE HOUSE COMMITTEE ON FINANCE  
ON  
SENATE BILL 1036**

**MARCH 27, 2013**

**RELATING TO EMPLOYEES' RETIREMENT SYSTEM PERSONNEL**

Senate Bill No. 1036 authorizes the Board of Trustees of the Employees' Retirement System (ERS), through its administrator, to appoint investment officers for the system and to change the title of the "Administrator" of the system to "Executive Director".

The Department of Budget and Finance strongly supports this Administration bill which is necessary to strengthen the ability of the ERS to continue to grow its corpus, which currently has in excess of \$12 billion dollars in domestic and international investments. Successful investments of these funds are critical to the current and future funding of the ERS, which has an unfunded actuarial accrued liability of \$8.4 billion as of June 30, 2012. The ERS' investment staff consists of a Chief Investments Officer and an Investment Specialist which is inadequate given the uncertainty and complexity of the modern financial markets and the need for the ERS Board to be provided with ongoing tactical and strategic insights into the risk-return trade-offs of multiple asset class investments. The ability of the ERS Board, through its administrator to appoint exempt, qualified and experienced investment officers is necessary to ensure that the ERS' investment portfolio is best positioned to meet its asset goals and reduce the ERS' unfunded liability. Further in-house knowledge and expertise can also serve to save up

to \$1 million in annual research, analytics, transition, monitoring, and other functions that ordinarily would be paid to consultants. Finally, the proposed title change of the “Administrator” of the ERS to “Executive Director” is necessary to be consistent with the title of the administrative head of other governmental agencies and other public pension funds.

TESTIMONY BY WESLEY K. MACHIDA  
ADMINISTRATOR, EMPLOYEES' RETIREMENT SYSTEM  
STATE OF HAWAII  
TO THE HOUSE COMMITTEE ON FINANCE  
ON  
SENATE BILL NO. 1036

MARCH 27, 2013

RELATING TO EMPLOYEES' RETIREMENT SYSTEM PERSONNEL

Chair Luke, Vice Chair Nishimoto, Vice Chair Johanson and  
Members of the Committee:

S. B. 1036 proposes a new section to chapter 88, Hawaii  
Revised Statutes, to allow the Employees' Retirement System  
(ERS) administrator to appoint one or more investment  
officers to the ERS investment office. In addition, this  
bill proposes to change the title of ERS' "Administrator"  
to "Executive Director."

Successful investment of the funds of the Employees'  
Retirement System is one of the foundations to the  
longevity and stability of the system. The system  
currently has over twelve billion dollars in domestic and  
international investments and decisions made by the Board  
of Trustees of the ERS concerning these investments are  
critical to the current and future funding of the System,  
which has an unfunded actuarial accrued liability of 8.4  
billion dollars as of June 30, 2012.

The role of assisting and advising the board with  
structuring the system's investment portfolio falls  
primarily with the system's investment staff which  
currently consists of a Chief Investment Officer and an  
investment specialist. The current staffing is not  
adequate given the uncertainty and complexity of modern  
financial markets. Furthermore, the current staffing  
structure is out of line with best practices of other  
similarly sized public pension plans.

See the attached table of similarly-sized public pension funds and the professional staff assisting their Chief Investment Officers:

<b>Public Pension Fund</b>	<b>Fund Size</b>	<b>Investment Staff</b>
<b>ERS State of Hawaii</b>	<b>\$12.2 B</b>	<b>1 Investment Professional</b>
LA City ERS	\$10.8 B	9 Investment Professionals
Kansas Public ERS	\$12.9 B	7 Investment Professionals
Kentucky Retirement System	\$12.8 B	10 Investment Professionals
Missouri State ERS	\$7.5 B	9 Investment Professionals
Utah Retirement System	\$20.9 B	11 Investment Professionals

The ERS investment portfolio has increased its allocations to equity products, covered calls, real return assets, and private equity. Dedication to these investments requires experience and expertise of seasoned professionals. The investment staff provides the Board with ongoing tactical and strategic insights into the risk-return trade-offs of multiple asset class investments. The ERS currently uses 2 investment consultants to assist with the monitoring of the program, including performing research and analysis on future strategies and products. They also assist with transitioning investment managers.

The individuals hired for these exempt investment officer positions will have the knowledge and experience to cover due diligence, monitor performance, negotiate fees, screen-out poor performers and to ensure a favorable outcome for the ERS. In order to maximize revenue and to secure a professional pool of applicants, the ERS anticipates that salaries for these exempt employees would be within the \$90,000 to \$100,000 range of compensation earned by investment professionals in comparable public pension funds. The ERS believes that offering investment officer salaries too far below the national average will make recruitment difficult. With this expertise, however, the ERS anticipates potential savings of \$98,000 to \$4,000,000

in any given year in both explicit and implicit costs related to research, analysis, transitions, monitoring, and other fees and opportunities that would ordinarily be accrued to external consultants and other service providers at the expense of the ERS.

In order to meet its asset goals and reduce the system's unfunded liability, the expanded and complex investment program requires an expanded professional staff to ensure that the investment portfolio is well-researched, monitored and evaluated. This proposal, therefore, allows the Board, through its Executive Director, to appoint exempt, qualified and experienced investment officers to the Employees' Retirement System investment office.

This bill also changes the title of the "Administrator" of the Employees' Retirement System to "Executive Director", to be consistent with the title of the administrative head of other government agencies and other public pension funds.

The ERS Board of Trustees strongly supports this bill.

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