

LATE TESTIMONY

TESTIMONY BY KALBERT K. YOUNG
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
STATE OF HAWAII
TO THE SENATE COMMITTEES ON JUDICIARY AND LABOR AND
WAYS AND MEANS
ON
SENATE BILL NO. 946

February 20, 2013

RELATING TO RESOLVING THE UNFUNDED LIABILITIES OF THE STATE AND THE COUNTIES

Senate Bill No. 946 establishes a statutory mechanism to pre-fund State and counties other post-employment benefits (OPEB) obligations as determined by an actuary retained by the Hawaii Employers-Union Health Benefits Trust Fund (EUTF) Board of Directors. For the counties, the bill amends Chapter 87A, HRS, by adding a new section to require that, beginning in FY 2018-19, each of the counties make annual required contributions for OPEB for its retirees and beneficiaries. The bill provides that if any portion of the required contribution is not paid by a county, the Director of Finance is to retain that amount from the county's share of the transient accommodations tax to make up the difference.

For the State, the bill amends Section 87A-42, HRS, by adding a new subsection to require that, beginning in FY 2018-19, the State make an annual required contribution for OPEB for its retirees and beneficiaries. The bill provides that if any portion of the required contribution is not paid by the State, general excise tax revenues shall be diverted and deposited to make up the difference of the State's required annual contribution.

The bill defines "annual required contribution" to mean a public employer's required contribution to that employers' EUTF trust fund that is sufficient to cover:

- 1) the normal cost, which is the OPEB cost attributable to the current year of

service; and 2) an amortization payment, which is a catch-up payment for past service costs to fund the unfunded actuarial accrued liability over the next 30 years.

Further, the bill (under Section 6) requires the State and the counties to begin phasing in making OPEB annual required contributions under the following formula:

- Twenty percent in FY 2014-15;
- Forty percent in FY 2015-16;
- Sixty percent in FY 2016-17;
- Eighty percent in FY 2017-18; and
- One hundred percent in FY 2018-19.

The bill also requires the Director of Finance to submit an implementation plan and any proposed legislation to the Legislature to execute the following:

- Joint use of any investment information, advice and services provided by fund managers retained by the Employees' Retirement System (ERS) for the purpose of investing moneys in the respective OPEB trust funds; and
- Procedures to accept and deposit employer contributions from county public employers.

The Department of Budget and Finance supports the intent of this bill to make a statutory commitment towards pre-funding the State's and counties' OPEB obligations. However, we are concerned that the specified contribution levels and timetable is not affordable at the present time without drastic reductions in other areas of the State's budget or significant measures to increase State general fund tax revenues.

For example, EUTF's July 1, 2012 actuarial valuation by Aon Hewitt determined that the State's annual required contribution for FY 2012-13 is \$994.9 million - \$474.5 million for normal cost plus interest and \$520.4 million for amortization of unfunded actuarial accrued liability. Using this amount as a benchmark for illustrative purposes, the State's annual required contribution under this bill could be at least:

- \$200 million in FY 2014-15 (20% of \$994.9);
- \$398 million in FY 2015-16 (40% of \$994.9);
- \$597 million in FY 2016-17 (60% of \$994.9);
- \$796 million in FY 2017-18 (80% of \$994.9); and
- \$995 million in FY 2018-19 (100% of \$994.9).

In comparison, the Governor's FB 2013-15 budget proposes to appropriate approximately \$100 million in each of the next fiscal years to get the State accustomed on the process towards contributing at least to amortizing the unfunded actuarial accrued liability of approximately \$500 million. Furthermore, the six-year financial plan does contemplate moving the State up to the \$500 million funding level in FY 2018 as State revenues build over that time. While we are all in agreement that the State does need to be pro-active in pre-funding its OPEB obligations, we are also mindful that the expense burden is a significant one. Considering the challenges the Legislature and the State face in revenue levels versus expenditure levels, we would suggest that the Legislature at least support the amount of annual required contribution specified in Senate Bill No. 946 to be reduced to no less than \$100 million annually through FY 2016-17, which is the amount that the Administration has proposed as the State's initial pre-funding payment level for the near term.

Regarding the requirement of joint use of any investment information, advice and services provided by ERS fund managers for the purpose of investing OPEB trust moneys, we recognize there are opportunities and synergies under such a joint investment structure. However, the ERS has raised a number of serious issues, such as the impact of a joint investment structure on ERS' tax exempt status and the overlapping fiduciary responsibilities of the ERS and EUTF Boards. We believe that these issues need to be investigated further before statutory implementation.

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SUBJECT: GENERAL EXCISE, TRANSIENT ACCOMMODATION; Disposition to the Hawaii Employer-Union Health Benefits Trust Fund (EUTF)

BILL NUMBER: SB 946

INTRODUCED BY: Ige and Baker

BRIEF SUMMARY: Amends HRS section 237-31 to provide that commencing with fiscal year 2018-2019, a sum of general excise tax revenues that represents the difference between the state public employer's annual required contribution for the separate trust fund and the amount of the state public employer's contributions into that trust fund shall be deposited to the credit of the state's annual required contribution into that trust fund in each fiscal year.

Amends HRS section 237D-6.5 to provide that commencing with fiscal year 2018-2019, a sum that represents the difference between a county public employer's annual required contribution for the separate trust fund and the amount of the county public employer's contributions into that trust fund shall be retained by the director of finance and deposited to the credit of the county public employer's annual required contribution into that trust fund in each fiscal year, if the respective county fails to remit the total amount of the county's required annual contributions.

Amends HRS section 87A-42 to provide that the board of trustees of the Hawaii employer-union health benefits trust fund (EUTF) establish a separate trust fund for public employer contributions with separate accounts for the **state** public employer and for each **county** public employer.

Further, makes non-tax amendments to require the annual public employer contribution to be equal to the annual required public employer contribution, to be determined by an actuary commencing with FY 2018-2019. Also establishes a schedule to phase-in the annual required state public employer contribution requirement. Directs the director of finance to report to the legislature on an implementation plan and proposed legislation to the 2014 legislature.

The amendments made to section HRS section 237D-6.5 shall not be repealed when HRS section 237D-6.5 is repealed and reenacted on June 30, 2015 pursuant to Act 61, SLH 2009, as amended by Act 103, SLH 2011.

EFFECTIVE DATE: July 1, 2013

STAFF COMMENTS: This measure would earmark: (1) general excise tax revenues for any shortfall of the state's required contribution to EUTF; and (2) transient accommodation tax (TAT) revenues from each respective county for any shortfall in their required EUTF contribution to address the growing unfunded liability of the EUTF.

If this measure were adopted, it would prioritize the funding of the EUTF ahead of all other purposes and will result in less general funds and TAT revenues available for their respective programs and/or services. In addition, the danger in adopting this measure is that it may spawn additional requests for other “creative” accounting through the earmarking of tax revenues. In addition, the automatic funding mechanism proposed in this measure would set aside general excise tax and TAT revenues without going through the appropriation process and, most importantly, without legislative scrutiny or intervention.

While this measure also provides that this earmarking shall not prevent the legislature from appropriating additional funds to amortize the unfunded actuarial accrued liability of the trust fund, once the earmarking takes effect and automatically deposits the money into the EUTF, this earmarking may be “forgotten” and only the additional amount appropriated would be “visible” and subject to legislative approval.

More importantly, because the general excise tax revenues and TAT are earmarked for this purpose, the funds will go directly to the EUTF and not to the general fund where it would otherwise be counted against the general fund expenditure ceiling. Thus, the scheme proposed is an outright attempt to circumvent the constitutional mandate. Further, because the amount is designated for this purpose, will the taxpaying public know that this contribution is coming at the expense of all other programs or will it prompt a call for an increase in taxes so that both the unfunded liabilities and all other programs can be funded? And will lawmakers have the courage to cut programs financed with general fund dollars or will this situation lead lawmakers to raise the general excise or TAT based on the need to fund the EUTF and maintain all other existing programs?

Lawmakers should admit that funds that should have been going toward paying down the unfunded liabilities of both the EUTF and the state pension system were instead used to fund new programs in the past or expand existing programs. Now that the day of judgment has arrived, will lawmakers merely “kick the can down the road” refusing to cut existing programs while attempting to pay down the unfunded liabilities of both the pension and health fund? Earmarking tax receipts, as this bill does, is an abdication of responsibility that, no doubt, will lead to pressure to raise additional revenues by raising taxes or enacting new revenue enhancements.

How soon lawmakers have forgotten how earmarking general fund revenues can get the state into trouble. It was only 1989 when lawmakers approved earmarking \$90 million for educational facilities as the “commitment” to education and only three years later they took back the earmarking because general fund revenues started to dwindle. Further, rather than spurring on construction of classrooms, the earmarking merely created apathy as school officials knew they would receive \$90 million off the top and they didn’t have to justify a request for funding. Lawmakers should go back and read a little of their own history and learn from their mistakes.

While this proposal may be viewed as “the right thing to do” in order to insure the integrity of the EUTF, it makes no effort to curtail benefits for future beneficiaries nor does it address how the shortfall of resources created by this siphoning off of general excise tax and TAT revenues will be dealt with while other general fund programs and TAT funded programs still demand funding. Is this just another back door way to create a demand for higher taxes? Will this bill merely punish future taxpayers for the mistakes made by the legislatures in the past?

TESTIMONY BY WESLEY K. MACHIDA
ADMINISTRATOR, EMPLOYEES' RETIREMENT SYSTEM
STATE OF HAWAII
TO THE SENATE COMMITTEE ON JUDICIARY AND LABOR
AND
THE SENATE COMMITTEE ON WAYS AND MEANS
ON
SENATE BILL NO. 946

FEBRUARY 20, 2013

RELATING TO RESOLVING THE UNFUNDED LIABILITIES OF THE STATE AND
COUNTIES

Chair Hee, Chair Ige and Members of the Committees:

S.B. No. 946 requires the Employer Union Health Benefits Trust Fund (EUTF) to establish a separate trust fund for public employer contributions with separate accounts for the state and county public employers. In addition, it requires the director of finance to report to the legislature on an implementation plan to have both the EUTF and the Employees' Retirement System (ERS) jointly share investment information and services for the benefit of the trust fund.

The ERS Board of Trustees supports the intent of this bill and recognizes that there is a definite need to manage the unfunded liability of the EUTF. The Board and the ERS administration are willing to work with the EUTF and the Director of Finance for the benefit of the trust fund.

However, the proposal's involvement of the ERS' investment program and services brings up many unanswered questions for the Board particularly in areas that may affect the ERS' tax-qualified status. They are concerned about increased diligence required on the part of the ERS, possible tax code issues which may jeopardize the tax-qualification of the ERS, and the cost to the ERS for the additional investment services required. In addition, they are concerned about the short time frame proposed for the implementation of this bill and note the question of board authority -- as the EUTF's board has its own investment committee. Their main concern, however, is the possible disruption of their primary fiduciary responsibility to the ERS.

The Board requests that the Committees consider implementing a feasibility study on the specifics, and possible consequences, of the sharing of investment information and services between

the two agencies. The ERS Board and administration will be pleased to work with the EUTF and Director of Finance to help support the proposal's goals while addressing ERS' concerns.

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