TESTIMONY BY WESLEY K. MACHIDA
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
STATE OF HAWAII
TO THE HOUSE COMMITTEE ON FINANCE
ON
HOUSE BILL NO. 1356

March 4, 2015

RELATING TO UNFUNDED LIABILITIES

House Bill No. 1356 establishes the Rate Stabilization Reserve Fund (RSRF) to stabilize the Hawaii Employer-Union Health Benefits Trust Fund (EUTF) when there is insufficient money to cover the costs of providing benefits to employee-beneficiaries and dependent-beneficiaries. The measure will also cap the employer contributions to the separate trust fund when the separate accounts for each public employer within the separate trust fund have a combined balance of at least $2 billion.

The Department of Budget and Finance strongly opposes this measure. Act 268, SLH 2013, mandated the establishment of the Other Post-Employment Benefits (OPEB) trust fund for the purpose of receiving employer contributions that will prefund OPEB costs for retirees and their beneficiaries. Act 268 required the EUTF Board of Trustees to "establish and maintain a separate account for each public employer within the separate trust fund to accept and account for each public employer's contributions. Employer contributions to the separate trust fund shall be irrevocable, all assets of the fund shall be dedicated exclusively to providing health and other benefits to retirees and their beneficiaries."

House Bill No. 1356 appears to conflict with the provisions of Act 268 by taking funds from the OPEB trust fund and depositing them into the RSRF to fund some of the very benefits that the OPEB trust fund will accomplish through pre-funding. It is akin to taking money from the Employees' Retirement System (ERS) to deposit into another revolving fund to make pension contribution payments to the ERS.

Further, the provisions of Act 268 provided for pre-funding of the State's Annual Required Contribution (ARC) for OPEB beginning with a 20% funding of the ARC in FY 15 and progressively increasing to 100% funding of the ARC in FY 19. The rating agencies, who review and rate the State's debt have stated that progression to 100% funding of the ARC is a substantial credit positive and will yield long-term benefits in reducing the State's unfunded OPEB liabilities. While it is recognized that fully funding the ARC results in substantial annual budget requirements, the pre-funding of the OPEB liability, similar to the annual contributions to the State's ERS, significantly addresses the State's unfunded OPEB liabilities. We are very concerned that termination of the 100% OPEB ARC funding would be viewed as a credit concern and may negatively impact the State's credit rating.

Finally, it is questionable whether the provisions of this measure will reduce the unfunded actuarial accrued liability of the EUTF or meet with the Governmental Accounting Standards Board's requirements for OPEB trusts.

DAVID Y. IGE
GOVERNOR

STATE OF HAWAII
HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
P.O. BOX 2121
HONOLULU, HAWAII 96805-2121
Oahu (808) 586-7390
Toll Free 1(800) 295-0089
www.eutf.hawaii.gov

ADMINISTRATOR
SANDRA L. YAHIRO

WRITTEN ONLY

TESTIMONY BY SANDRA YAHIRO
ADMINISTRATOR, HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
DEPARTMENT OF BUDGET AND FINANCE
STATE OF HAWAII
TO THE COMMITTEE ON FINANCE
ON
HOUSE BILL NO. 1356

March 4, 2015, 11:00 a.m.

RELATING TO UNFUNDED LIABILITIES

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

The Hawaii Employer-Union Health Benefits Trust Fund (EUTF) Board of Trustees has not taken a position on this bill as the EUTF Board has not been able to deliberate on this specific bill. At this time, I would like to point out the following fundamental flaws of this bill:

1. No solution is proposed in the bill to address the unfunded liability. The bill limits prefunding of the OPEB Trust to $2 billion and does not provide any measures to contain the rising active employee and retiree health benefit premium costs. The bill describes four solutions to addressing the unfunded liability but does not incorporate any of those solutions into a proposal nor does it address cost containment measures for the rising health benefit

premium costs. The EUTF board has actively taken measures to address the unfunded liability through the offering of a new Medicare Advantage plan effective January 1, 2015 with lower premiums for the employers and retirees and through the proposal of HB916 that would permit the EUTF to invest in asset classes currently not permitted under HRS 87A to maximize investment returns within prudent levels of risk.

2. Under the terms of the OPEB Trust and the Internal Revenue Code (IRC), the transfer of income in excess of $2 billion from the OPEB Trust to the rate stabilization reserve is not permitted. The terms of the OPEB Trust and the IRC stipulate that the OPEB funds must be used for the exclusive benefit of providing benefits to the retirees (the exclusive benefit rule). Therefore, transfer for amounts from the OPEB Trust to the rate stabilization reserve fund, which will be used for active employee premiums, is not permitted.

3. Stopping employer prefunding contributions to the OPEB Trust does not allow the State and counties the ability to reduce their unfunded liability for financial statement purposes and to maximize earnings within prudent levels of risk. Under Governmental Accounting Standards Board standards, state and counties are only able to reduce their other post-employment benefits liability, if their contributions are made to a qualified trust fund, which the OPEB Trust is. The rate stabilization reserve fund will not be a qualified trust fund. In addition, the long-term expected return of the OPEB Trust is 7% which is much greater than what the employers would earn on their own over a full investment cycle. Employers have chosen to prefund their OPEB

liability at different rates (e.g. as of July 1, 2013 the State's funded ratio was 0% while the Kauai Department of Water Supply and the Hawaii Department of Water Supply funded ratios were 30.6% and 29.7%, respectively). The employers other than the State should not be limited in the amount of prefunding because of the State's financial situation.

4. The bill proposes to use the rate stabilization reserve "to prevent frequent increases in premium contributions required from active employees and the employers of the State…" Using the reserve to reduce or buy down the premium does not resolve the problem of increasing health benefits premiums. Having the reserve continue to buy down a portion or all of the increase in premiums is not sustainable and will eventually result in depletion of the reserve. This is one of the reasons the EUTF Board, which has the ability to, has not used available reserves to buy down the premiums.

Thank you for the opportunity to testify.

The Uniformed Service Member's Voice in Government
NATIONAL ASSOCIATION FOR UNIFORMED SERVICES
Hawaii Chapter (HI-1)

March 02, 2015

TESTIMONY IN SUPPORT OF HOUSE BILL 1356

RELATING TO FILIPINOVETERANS

HOUSE COMMITTEE ON FINANCE

HEARING ON WEDNESDAY MARCH 4 TH AT 11:00AM, IN CONFERENCE ROOM 308

Aloha Chair Luke and Vice Chair Nishimoto: Thank you, for providing this opportunity to testify in support of House Bill 13569. On Capitol Hill the National Association for Uniformed Services (NAUS) is "The Service Member's Voice in Government." Here, in the great State of Hawaii, NAUS Hawaii Chapter (HI-1) serves at the will and pleasure of our nation's largest per-capita uniformed service community.

NAUS Hawaii Chapter (HI-1) members are or were all federal employees: We understand the issue HB 1356 addresses, well, and sincerely applaud your efforts to bring stability and sustainability to Hawaii's public sector employee benefit programs, by amending Hawaii Revised Statutes, Chapter 87A, without increasing the cost to our taxpayers.

NAUS Hawaii Chapter (HI-1) respectfully urges your committee to pass House Bill 1356, as currently published.

Thank you for being here for us,

D EggE

Dennis Egge; Chapter President

1298 Kukila Street, Honolulu, Hawaii 96818
Naushawaii1@yahoo.com; 808-382-5833

From: mailinglist@capitol.hawaii.gov
Sent: Tuesday, March 03, 2015 11:48 AM
To: FINTestimony
Cc: clskwock@gmail.com
Subject: Submitted testimony for HB1356 on Mar 4, 2015 11:00AM

HB1356
Submitted on: 3/3/2015
Testimony for FIN on Mar 4, 2015 11:00AM in Conference Room 308

Submitted By	Organization	Testifier Position	Present at Hearing
CHU LAN SHUBERT-KWOCK	CHINATOWN BUSINESS & COMMUNUTY ASSOCIATION	Support	No

Comments: We support this common sense approach to unfunded health benefits for our State and County retirees by capping the amount which would earn interest returns to sustain the fund without further taxing the public time and again.

Please note that testimony submitted less than 24 hours prior to the hearing, improperly identified, or directed to the incorrect office, may not be posted online or distributed to the committee prior to the convening of the public hearing.

From: mailinglist@capitol.hawaii.gov
Sent: Tuesday, March 03, 2015 2:04 PM
To: FINTestimony
Cc: carl.campagna@kamakagreen.com
Subject: Submitted testimony for HB1356 on Mar 4, 2015 11:00AM

HB1356
Submitted on: 3/3/2015
Testimony for FIN on Mar 4, 2015 11:00AM in Conference Room 308

Submitted By	Organization	Testifier Position	Present at Hearing
Carl Campagna	Individual	Support	No

Comments: Aloha Legislators, Thank you for your time and consideration for this bill, HB1356. I am in support. We have come to understand that the State Unfunded Liability is estimated to reach $18B by 2016 and that Act 268 from 2013 mandated that the State and Counties contribute to pre-fund both the Other Post-Employment Benefits (OPEB) as well as the Monthly Premiums on an increasing schedule from $100M to $500M by 2019 and then for 30 years thereafter. This is too heavy of a burden to pass along to our children. This bill creatively addresses the Health Unfunded Liability Without: o Increasing the State GE tax & County Real Property Tax o Laying off current employees o Reducing already promised benefits o Or Combination of the above Continuously paying $500M for 30 years beginning in 2019 is not sustainable for the State, therefore this bill proposes that the health benefits funding mechanism established in the Act is the next best alternative to establishing a self-insured health benefits program for public employers and employees. Therefore I urge all members to pass this bill.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304 Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: MISCELLANEOUS, Rate Stabilization Reserve Fund for OPEB

BILL NUMBER: HB 1356

LATE

INTRODUCED BY: Cachola, Evans, Luke, Mizuno, Rhoads, Saiki, Souki

EXECUTIVE SUMMARY: The problem the bill deals with is other post-employment benefits for state workers – think ERS and EUTF. Act 268, SLH 2013, established a mechanism to pay down the unfunded liabilities over time. This bill proposes to toss that away, instead adopting a pay-as-you-go mentality.

BRIEF SUMMARY: Adds a new section to HRS chapter 87A that establishes a rate stabilization reserve fund. The fund is to provide reserve funding to stabilize the fund when there is insufficient money in the fund to cover the costs of providing health and other benefit plans for employee-beneficiaries and dependent-beneficiaries. Unless otherwise specified by law, the rate stabilization reserve fund shall not be subject to appropriation for any purpose and shall not be subject to claims by creditors of the employers.

Provides that any balance in the employee benefits trust fund under section 87A-31 will be transferred to the new rate stabilization reserve fund.

Deletes the language providing that a public employer's required contribution to the employee benefits trust fund includes an amortization payment that is designed to fund the unfunded actuarial accrued liability over the next thirty years. Adds language stating that no public employer contribution shall be require dif the separate accounts for each public employer within the employee benefits trust fund have a combined balance of at least $2 billion.

STAFF COMMENTS: The state long ago agreed to pay post-employment benefits to its workers. ERS, or Employees' Retirement System, represents the retirement benefits. EUTF, the Employer-Union Health Benefits Trust Fund, represents the medical benefits. At June 30, 2013, ERS had an "unfunded actuarial accrued liability" of about $8.4 billion. For EUTF, the number was about $18.2 billion. Those numbers represent the present value of what we taxpayers owe for these future benefits. In comparison, the total annual state general fund budget is $5.5 billion.

Faced with these staggering numbers, Act 268, SLH 2013, was enacted. Act 268 required public employers to pay actuarially determined annual required contributions to fund the present cost of the benefits and to eat away at the unfunded balance over thirty years' time. If the public employers did not pay their required contribution, the general excise tax would be sequestered to pay it if the delinquent employer was the State; if the delinquent employer was one of the counties, that county's share of the transient accommodations tax would be sequestered. Again, the idea was to pay down the unfunded liability over a period of several years.

The bill proposes to deal with the issue by establishing a new fund to "stabilize" the system when there is insufficient money. The first issue, of course, is figuring out how to fund this fund.

To accomplish this trick, the bill basically proposes to do away with the amortization built into Act 268. "The State and counties cannot afford to pay for both the increasing cost of healthcare premiums as well as the prefunding of the liability," the bill's preamble states, and it goes on to observe that "most state governments, including Hawaii, currently follow a pay-as-you-go approach, paying an amount each year about equal to the benefits distributed or claimed in that year." In other words, the bill proposes to deal with the unfunded liabilities problem by denying that it's a problem. "Don't worry," it's telling everyone. "We can pay the current year's costs of the post-employment benefit programs we created. There won't be any rainy day. So just go about your business."

This might be fine if there is in fact no rainy day, and the economy chugs along giving us enough money to pay these obligations. But if bad things happen – we've recently had to face crippling economic recessions as well as natural disasters – then we might deeply regret ever having gone into pay-as-you-go mode.

In addition, one of the central premises behind the proposed stabilization fund is that it won't be raided, ever. The reality, however, is that nice, fat stabilization funds make for very tempting raid targets. However well-intentioned this legislature is, however, it normally can't bind a future legislature.

Digested 3/3/2015

LATE

I am Testifying in Strong Support of HB-1356

First of all, I want to thank House and Senate Leadership, the Administration and some segments of the private sector for encouraging policy makers to think outside the box to find a solution to the States health unfunded liability, which is currently estimated to be $18B. I introduced HB1356 based on this encouragement.

To fully understand HB-1356, I encourage everyone to read Section 1 or purpose section of the bill. One key thing to keep in mind is that the new OPEB standards, under GASB statements #43 and #45, do not mandate the funding of OPEB benefits, in other words, we are not required to set aside assets in advance to pay benefits in the future.

Paying $500M per year over 30 years for Government employee health benefits as mandated by law is not sustainable and places a heavy burden on future generations. **My inspiration and motivation for coming up with this bill begins with my grandchildren by asking this question, "What will their future be with this heavy burden?"**

HB1356 is an innovative way to address the Health Unfunded Liability **<u>Without</u>**:

- Increasing the State GE tax & County Real Property Tax
- Laying off current employees
- Reducing already promised employee benefits
- Or Combination of the above

Please note that if you are a resident of Hawaii and a home owner you can be hit twice with tax increases. An increase in GET by the State and Increase on property tax by the county in order to meet their share of the mandated contribution under Act 268. If you are a renter, you will also be hit twice, both from GET and from the landlord who passes the property tax increase along into the rent payment.

Passing this policy as set in HB1356 will result in long term cost savings for the State, the Counties, the members of Employer-Union Trust Fund (EUTF) and most importantly, our constituents, many of whom are a paycheck away from becoming homeless. The efficiencies set under this policy will save tax payer money and provide State and Counties financial flexibilities to fund other needed programs and services.

Since the financial viability and future of Hawaii, the Counties and our constituents is at stake, I urge all members to vote in support of HB1356.

Romy M. Cachola
House of Representatives
District 30