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STATE OF HAWAII
EMPLOYEES' RETIREMENT SYSTEM

TESTIMONY BY THOMAS WILLIAMS
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STATE OF HAWAII

TO THE SENATE COMMITTEE ON WAYS AND MEANS
ON

SENATE BILL NO. 2346, S.D. 1

FEBRUARY 24, 2016, 1:15 P.M.

RELATING TO THE EMPLOYEES' RETIREMENT SYSTEM

Chair Tokuda, Vice Chair Dela Cruz and Members of the Committee,

S.B. 2346, S.D. 1, would allow the Board of Trustees of the Employees' Retirement System of the State of Hawaii (ERS), through its executive director, to appoint one or more investment professionals, investment specialists and investment support staff, who may be exempt from chapters 76 and 89, Hawaii Revised Statutes. In addition, S.B. 2346, S.D.1 would authorize the ERS to make direct payments to the spouse or former spouse of an ERS member or retiree when the spouse or former spouse has been awarded all or a portion of the member's or retiree's retirement benefits pursuant to a qualified domestic relations order (QDRO).

S.B. 2346, S.D. 1 is comprised of two unrelated sections of Chapter 88, Hawaii Revised Statutes (HRS). Part I would amend section 88-29.5 regarding investment personnel and Part II would add a new section to Part IIC of Chapter 88 to authorize the ERS to make direct payments to alternate payees under a QDRO.

- The ERS Board of Trustees supports part I of S.B. 2346, S.D.1 and believes it would be beneficial to the ERS and its members.



Employees' Retirement System
of the State of Hawaii

Successful investment of the funds of the Employees' Retirement System is one of the primary pathways to the stability and sustainability of the system. A member's retirement benefit is funded through a combination of employer and employee contributions and investment earnings. Seventy to eighty percent of benefits provided are attributable to investment earnings. The system currently has over fourteen billion dollars in domestic and international investments and decisions made by the Board of Trustees of the system concerning these investments are critical to the current and future funding of the system, which has an unfunded actuarial accrued liability of eight billion seven hundred million dollars and a funded ratio of 62.2% as of June 30, 2015.

Although the members of the Board of Trustees, as fiduciaries, are responsible for the general management of the system's assets and implementation of the system's investment policy, they rely heavily on internal and external investment experts for advice. The role of assisting and advising the board in managing the system's assets falls primarily with the system's investment staff consisting of a Chief Investment Officer, two strategy specific officers (liquid and illiquid investments), a risk officer and two Investment Specialists who are civil service employees.

The current staffing structure is not expected to meet our long term needs. Staffing will need to be augmented given the complexity of portfolios our size and the dynamics of modern financial markets. The investment portfolio has increased its allocations to equity products, covered calls, real return assets, and private equity. In addition, the ERS is transitioning its portfolio to a risk-based asset allocation program, the implementation of which will require additional attention, monitoring, review and rebalancing. This rebalancing will be outsourced initially at considerable expense, and we would like eventually to bring the function in-house.

Dedication to these investments requires experience and expertise of seasoned professionals. Investment office staff provides the Board with ongoing tactical and strategic insights into the risk-return trade-offs of multiple asset class investments. Establishing our Investment Specialists as true members of the team will help with retention and provide a career path for these talented staff members. Any associated costs will be derived solely from ERS monies.

- In order to implement Part II of S.B. 2346, S.D. 1 the ERS must have the adequate time, funding and resources for rule-making, member and public education, computer upgrades and testing, and the review of potential domestic relations orders. Alternate payees represent additional, separate benefit recipients of the System. The payments to alternate payees are not mere deductions from the ERS retiree's benefit. As specified by this bill, each alternate payee will be identified as a separate "pensioner" under the ERS with the alternate payee's own actuarially calculated benefit, post-retirement increases, tax withholding and reporting and entitlement to counseling. Modifications to the ERS's computer system will be necessary to properly administer QDROs. The ERS computer vendor estimated upwards of \$1 million for the modifications, changes,

processing, reporting and coding required by this draft legislation. Public pension systems similar to the ERS have indicated that legal and actuarial review and a dedicated professional benefits staff person would be necessary for the accurate and efficient processing of QDROs. The ERS staff estimates that, based on our active, vested and retired population, we could potentially receive 40 QDROs per month. The review and revision of prior court divorce decrees is likely to affect our administrative capabilities even more.

Without the funding and resource provisions appropriated by sections 6 and 7 of S.B. 2346, S.D. 1, the ERS will not be able to implement the requirements and additional payments stipulated by this proposal. The ERS board's support is subject to the provision of these additional resources.

A technical correction needs to be made to page 3, lines 17 and 18. "Hawaii domestic relations order" should be changed to "qualified domestic relations order" as it is a defined term under the Internal Revenue Code. One of the goals of the bill is to allow "Hawaii domestic relations orders" to be treated as "qualified domestic relations orders" for federal tax purposes.

Thank you for the opportunity to testify on these important measures.



HAWAII GOVERNMENT EMPLOYEES ASSOCIATION

AFSCME Local 152, AFL-CIO

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The Twenty-Eighth Legislature, State of Hawaii
The Senate
Committee on Ways and Means

Testimony by
Hawaii Government Employees Association

February 24, 2016

S.B. 2346, S.D. 1 – RELATING TO THE
EMPLOYEES' RETIREMENT SYSTEM

The Hawaii Government Employees Association, AFSCME Local 152, AFL-CIO strongly opposes Section 1 of S.B. 2346, S.D. 1, which excludes positions from collective bargaining and expands the exemption from civil service within the Employees' Retirement System (ERS), however we support the purpose and intent of Section 2 of S.B. 2346, S.D. 1, which authorizes and requires the ERS to make direct payments to a spouse or a former spouse pursuant to a Qualified domestic relations order.

As drafted, Section 1 of this legislation allows the ERS to exempt from civil service and exclude from collective bargaining investment professionals and support staff, which creates a government workplace of "at will" employment with minimal employee rights. Further, Section 1 grants the ERS Board of Trustees the authority and sole discretion to exempt and exclude – a power that we respectfully argue should remain vested with the Legislature. Collectively, the expansion of excluding and exempting positions in state government is in direct conflict with the Article XVI, Section 1 of the Hawaii State Constitution and Chapters 76 and 89, HRS, which establish a merit-based civil service system free from coercive political influences and collective bargaining.

Separately, we support the provisions of Section 2 of S.B. 2346. A Hawaii domestic relations order is a court ordered decree that recognizes an alternative payee's right to receive all or a portion of a benefits payable. Our members have raised concerns with the current process whereby an individual who is authorized by a domestic relations order to receive payments must rely on his or her former spouse to send the payment. In some cases, the former spouse does not send the full amount due, does not send payment in a timely manner, or does not send it at all, which causes unnecessary hardship to the individual. Passage of this legislation ensures that court orders are followed and that individuals receive regular, direct payment from the ERS instead of relying on a former spouse to send payment.

Thank you for the opportunity to testify in opposition of Section 1 and in support of Section 2 of S.B. 2346, S.D. 1.

Respectfully submitted,

Randy Perreira
Executive Director