HB 1182

RELATING TO THE EMPLOYEES' RETIREMENT SYSTEM.

LAB, FIN

HB1182 (?)

Submit Testimony

Measure Title:	RELATING TO THE EMPLOYEES' RETIREMENT SYSTEM.
Report Title:	ERS; Stress Test
Description:	Requires the ERS actuary to conduct annual stress tests of the system and the board to submit annual reports of the tests to the legislature.
Companion:	
Package:	None
Current Referral:	LAB, FIN
Introducer(s):	JOHANSON, HOLT, LUKE, SAIKI

Sort by Date		Status Text
1/24/2017	H	Pending introduction.
1/25/2017	H	Pass First Reading
1/30/2017	H	Referred to LAB, FIN, referral sheet 6
2/6/2017	H	Bill scheduled to be heard by LAB on Thursday, 02-09-17 8:30AM in House conference room 309.

S = Senate | **H** = House | **D** = Data Systems | **$** = Appropriation measure | **ConAm** = Constitutional Amendment

HOUSE OF REPRESENTATIVES
TWENTY-NINTH LEGISLATURE, 2017
STATE OF HAWAII

H.B. NO. 1182

A BILL FOR AN ACT

RELATING TO THE EMPLOYEES' RETIREMENT SYSTEM.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

SECTION 1. Chapter 88, part II, Hawaii Revised Statutes, is amended by adding a new section to subpart D to be appropriately designated and to read as follows:

"**§88- Stress test; annual report.** (a) The actuary shall conduct an annual stress test of the system.

(b) The board shall submit an annual report to the legislature, not later than twenty days prior to the convening of each regular session, on the results of the actuary's stress test.

(c) For the purposes of this section, a "stress test" shall address:

(1) Projections of assets, liabilities, pension debt, service costs, employee contributions, employer contributions, net amortization, benefit payments, payroll, and funded ratio for the employees' retirement system for each of the next thirty years

based upon the then-current actuarial assumptions, including the assumed rate of return;

(2) Projections for the items listed in paragraph (1), assuming that investment returns are two percentage points lower than the assumed rate of return and that the State makes employer contributions:

(A) Based upon the then-current funding policy for the employees' retirement system; and

(B) That are held constant at the levels calculated for paragraph (1);

(3) Estimates of the items listed in paragraph (1), if there is a one year loss on planned investments of twenty per cent followed by a twenty-year period of investment returns two percentage points below plan assumptions, with the following assumptions regarding contribution policy:

(A) Employer contributions are adjusted based upon current policy; and

(B) Employer contributions are held constant at the levels calculated for the baseline projections; and

(4) The estimated actuarially accrued liability, the total plan normal cost for all benefit tiers, and the employer normal cost for all benefit tiers, calculated using:

(A) A discount rate equal to the assumed rate of return; and

(B) The ten-year average of the yield of thirty-year treasury notes."

SECTION 2. New statutory material is underscored.

SECTION 3. This Act shall take effect upon its approval.

INTRODUCED BY: [signature]

JAN 24 2017

H.B. NO. 1182

Report Title:
ERS; Stress Test

Description:
Requires the ERS actuary to conduct annual stress tests of the system and the board to submit annual reports of the tests to the legislature.

The summary description of legislation appearing on this page is for informational purposes only and is not legislation or evidence of legislative intent.

DAVID Y. IGE
GOVERNOR

THOMAS WILLIAMS
EXECUTIVE DIRECTOR

KANOE MARGOL
DEPUTY EXECUTIVE DIRECTOR

STATE OF HAWAII
EMPLOYEES' RETIREMENT SYSTEM

TESTIMONY BY THOMAS WILLIAMS
EXECUTIVE DIRECTOR, EMPLOYEES' RETIREMENT SYSTEM
STATE OF HAWAII

TO THE HOUSE COMMITTEE ON LABOR AND PUBLIC EMPLOYMENT
ON

HOUSE BILL NO. 1182

FEBRUARY 9, 2017, 8:30 A.M.

RELATING TO THE EMPLOYEES' RETIREMENT SYSTEM

Chair Johanson, Vice Chair Holt and Members of the Committee,

H.B. 1182 proposes that the actuary of the Employees' Retirement System (ERS) conduct an annual stress test of the System with regards to actuarial projections of the funded status for the ERS for each of the next thirty years based on "then-current" actuarial assumptions, including the assumed rate of return and projected lower rates of return. In addition, H.B. 1182 would require that the actuary provide estimates of their actuarial projections with assumptions including extreme decreased investment returns and liabilities and costs based on the assumed discount rate and thirty-year treasury notes. The results of the stress test would be submitted as an annual report to the legislature twenty days prior to the convening of each regular session.

The ERS Board has not had an opportunity to review H.B. 1182, and therefore, has not declared a position on this proposal; however, ERS Staff has the following comments:

1. Most of the projections listed under §88-___(c)(1) regarding projections of assets, pension debt, net amortization and funded ratio over a thirty year time-frame is already included in the annual Report to the Board of Trustees on the actuarial valuation of the ERS. This report is typically presented to the Board in January based on data review as of June 30 of the previous year and is made publically available immediately following adoption by the board to the legislature and all interested parties. The 91st annual

Employees' Retirement System
of the State of Hawaii

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valuation was presented and adopted by the board on January 9, 2017, for the year ending June 30, 2016. It was posted to the ERS website (at ers.ehawaii.gov) immediately following board acceptance ad was discussed with key House members during a briefing session on January 10, 2017. Table 9c of the valuation provides the 30-year projections of assets, liabilities and funded ratio proposed in H.B. 1182 from 2016 through 2045. That table is attached for your reference as attachment 1. The proposed bill's second requirement is that we provide projections "assuming that investment returns are two percentage point lower than the assumed rate of return." Attachment 2, to this testimony, extracted from the current valuation, is responsive to that request.

2. ERS management, staff and actuaries annually hold briefing sessions for the Senate and House at the beginning of the legislative session to review the valuation results, plan experience, projections and funding issues. During these sessions, the actuaries provide various "stress test" scenarios as noted in §88-___(c)(2) which illustrate varying investment returns and their effect on ERS funding policy recommendations. We can easily incorporate required additional illustrations into that briefing.

3. As to projections of a twenty-year period of investment returns 2% below the assumed rate under §88-___(3) or that we project liabilities and assets based on the "ten-year average of the yield of thirty-year treasury notes," the ERS actuaries would be able to model results on any of these scenarios and such other scenarios as are deemed relevant.

4. As a final note regarding the reporting of this information to legislature 20 days prior to each session, as the ERS actuaries do not typically publish valuation information prior to the Board's review and acceptance, any results produced in December or earlier would have to be based on data available from the previous fiscal year, which would differ from that reflected in the valuation presented in January.

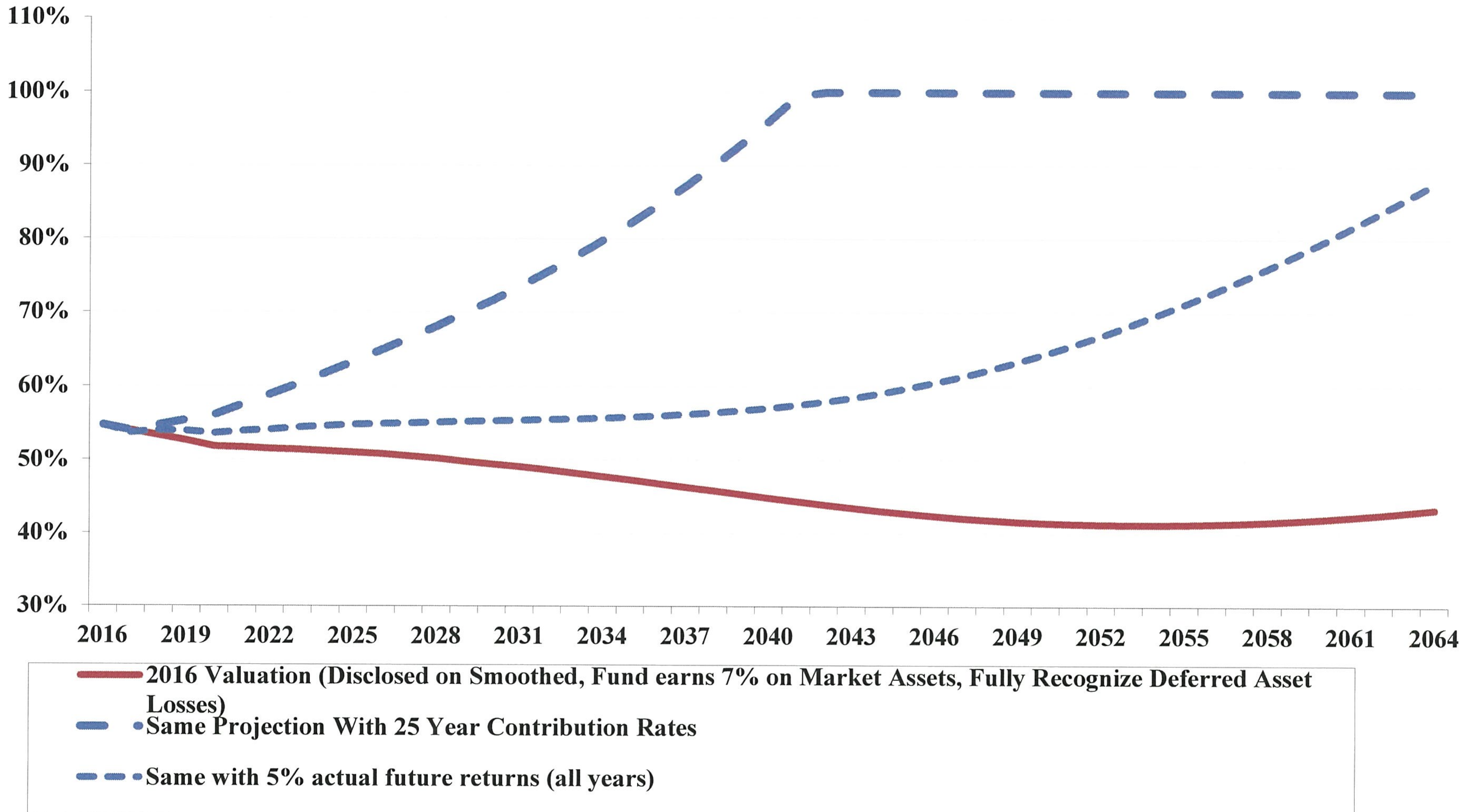
In summary, staff believes that this information being requested is largely already made available for the Legislature's consideration and that any additional report needed may be incorporated into our annual actuarial report. On behalf of the Board of Trustees and staff of ERS we wish to thank you for the opportunity to testify.

Projection Results Based on June 30, 2016 Actuarial Valuation

Valuation as of June 30,	Employer Contribution Rate for Fiscal Year Following Valuation Date	Compensation (in Millions)	Employer Contributions (in Millions)	Actuarial Accrued Liability (AAL, in Millions)	Actuarial Value of Assets (AVA, in Millions)	Unfunded Actuarial Accrued Liability (UAAL, in Millions)	Funded Ratio
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
2016	17.91%	$ 4,258.9	$ 763	$ 27,439	$ 14,997	$ 12,443	54.7%
2017	17.91%	4,348.5	779	28,504	15,626	12,878	54.8%
2018	17.91%	4,449.4	797	29,643	16,318	13,325	55.0%
2019	17.91%	4,557.6	816	30,785	17,002	13,783	55.2%
2020	17.90%	4,672.8	837	31,929	17,676	14,252	55.4%
2021	17.90%	4,793.9	858	33,074	18,341	14,733	55.5%
2022	17.90%	4,920.0	881	34,220	18,995	15,224	55.5%
2023	17.90%	5,052.4	904	35,365	19,639	15,726	55.5%
2024	17.89%	5,190.1	929	36,510	20,271	16,239	55.5%
2025	17.89%	5,333.8	954	37,651	20,889	16,763	55.5%
2026	17.88%	5,484.6	981	38,788	21,492	17,296	55.4%
2027	17.88%	5,642.6	1,009	39,921	22,081	17,840	55.3%
2028	17.87%	5,807.9	1,038	41,051	22,658	18,393	55.2%
2029	17.87%	5,981.2	1,069	42,179	23,223	18,956	55.1%
2030	17.87%	6,162.1	1,101	43,307	23,779	19,528	54.9%
2031	17.86%	6,351.0	1,134	44,436	24,328	20,108	54.7%
2032	17.86%	6,547.3	1,169	45,565	24,869	20,696	54.6%
2033	17.86%	6,750.8	1,205	46,694	25,404	21,290	54.4%
2034	17.85%	6,963.1	1,243	47,827	25,935	21,891	54.2%
2035	17.85%	7,184.2	1,282	48,964	26,466	22,498	54.1%
2036	17.85%	7,414.0	1,323	50,108	26,999	23,109	53.9%
2037	17.85%	7,653.7	1,366	51,261	27,538	23,723	53.7%
2038	17.85%	7,904.3	1,411	52,429	28,088	24,340	53.6%
2039	17.85%	8,165.8	1,458	53,614	28,656	24,959	53.4%
2040	17.85%	8,438.4	1,506	54,823	29,246	25,577	53.3%
2041	17.85%	8,722.4	1,557	56,060	29,866	26,194	53.3%
2042	17.86%	9,017.3	1,610	57,331	30,523	26,808	53.2%
2043	17.86%	9,324.0	1,665	58,642	31,225	27,417	53.2%
2044	17.86%	9,643.1	1,722	59,998	31,977	28,021	53.3%
2045	17.86%	9,974.2	1,781	61,406	32,790	28,616	53.4%

Projection assumes all assumptoins exactly met, including a 7.00% annual return on the current actuarial value of assets.

Impact of Higher Contribution Rates and Perpetual Low Investment Returns



Assumes employer contribution rates of 42.5% for Police and Fire and 24.75% for All Other Employees beginning in FY2018 and for all years thereafter until 100% funded

Assumes all assumptions met, including assumed rate of return each year on the current *market* value of assets

GRS

The House Committee on Labor & Public Employment
Thursday, February 9, 2017
8:30 am, Room 309

RE: **HB 1182, Relating to Employees' Retirement System**

Attention: Chair Aaron Ling Johanson, Vice Chair Daniel Holt and Members of the Committee

The University of Hawaii Professional Assembly (UHPA) urges the committee to **support passage of HB 1182,** requiring the Employeees' Retirement System (ERS) actuary to perform annual stress tests of the system and the ERS Board to submit annual reports of the tests to the legislature.

The recent decision by the ERS Board to reduce the assumed rate of return from 7.5% to 7.0% all at once immediately increased the unfunded liability by $1.7 Billion, and has forced the legislature to review the required contributions. Requiring the ERS actuary to perform an annual stress test and report its findings to the legislature will provide a level of transparency that is currently not in place and ensure that the decisions of the ERS Board are not made in a vacuum since the decision to reduce the assumed rate has statewide implications.

UHPA supports passage of HB 1182.

Respectfully submitted,

Kristeen Hanselman
Executive Director

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HB 1182

Late testimony

LATE

LATE

LATE

Testimony in Support of HB 1182

Relating to the Employees' Retirement System

Presented to the House Committee on Labor and Public Employment

for the Public Hearing

8:30 a.m. Thursday, February 9, 2017

in Conference Room 309

Chair Johanson, Vice Chair Holt and members of the committee:

I'm David Rolf, a long time resident in the state of Hawaii, and occasionally a commenter on matters relating to state revenues.

The underfunded Employee Retirement System issue is key part of what some call "sophisticated state failure." Business leaders have offered some solutions. The use of new technology to modernize government processes has application to this issue.

"Sophisticated state failure," is the phrase coined by Jan Techau of Carnegie Europe.

Techau presages the crackup of the Western model of governance because retirement systems, premised on workforces growing faster than retired populations, are helpless to adjust when the opposite is true.

By my calculations, the really bad news is predicted to come to Hawaii at 10 a.m. March 15, 2023—a short 7 years from now.   ZERO HOUR.

The Honolulu Star-Advertiser's front page recently sounded the warning.

The page headline: "Nest Egg Shortfall Tops $12 Billion."

EMPLOYEES' RETIREMENT SYSTEM

NEST EGG SHORTFALL TOPS $12 BILLION

ILLUSTRATION BY BRYANT FUKUTOMI / BFUKUTOMI@STARADVERTISER.COM

The pension plan will seek $385 million more annually to make up the difference

By Dave Segal
dsegal@staradvertiser.com

The shortfall in Hawaii's public employees pension fund mushroomed to $12.44 billion in fiscal 2016, setting the stage for more finger-pointing in the Legislature and dealing a financial blow to taxpayers who will have to dig deep to pay for it.

A report released Monday by an independent actuary showed the deficit in the state Employees' Retirement System pension fund widened substantially from last year's $8.77 billion, and the pension plan is only 54.7 percent funded compared with 62.2 percent funded a year ago.

The pension plan now needs an additional $385 million a year from taxpayers to make up for the shortfall, according to ERS Executive Director Thom Williams, who took over his position in November 2015. With that additional revenue, taxpayers would be paying $1.14 billion a year to help fund the pension plan, which provides retirement, disability and survivor benefits to more than 120,000 active, retired and inactive state and county employees.

"This is going to be a big pill to swallow," ERS board member Colbert Matsumoto said Monday.

Please see ERS, *A5*

TIGERS ROAR

Clemson claws back to topple No. 1 Alabama, 35-31

SPORTS / C1

INSIDE

2 protests against Trump policies staged in Honolulu

LOCAL / B1

City officials propose $2 zoo admission increase for nonresident visitors

LOCAL / B1

Extra security sought as medical pot taxes are expected in cash

By Kevin Dayton
kdayton@staradvertiser.com

The state tax department needs extra security guards, armored car services and new surveillance equipment to prepare for a surge in cash payments to cover the taxes paid to the state for medical marijuana sales.

Hawaii's medical marijuana dispensaries are expected to pay about $400,000 a month to cover their state taxes, and those payments likely will be in cash because the dispensaries generally are unable to use banks for their financial transactions.

Marijuana is still illegal under federal law, and Hawaii banks have been reluctant to accept dispensaries as customers.

Mallory Fujitani, spokeswoman for the state Department of Taxation, said the cash tax payments from dispensaries might include both excise taxes and payments for items such as payroll withholdings.

"We don't know if they're paying their employees in cash and they're just having them deposit

Please see SECURITY, *A5*

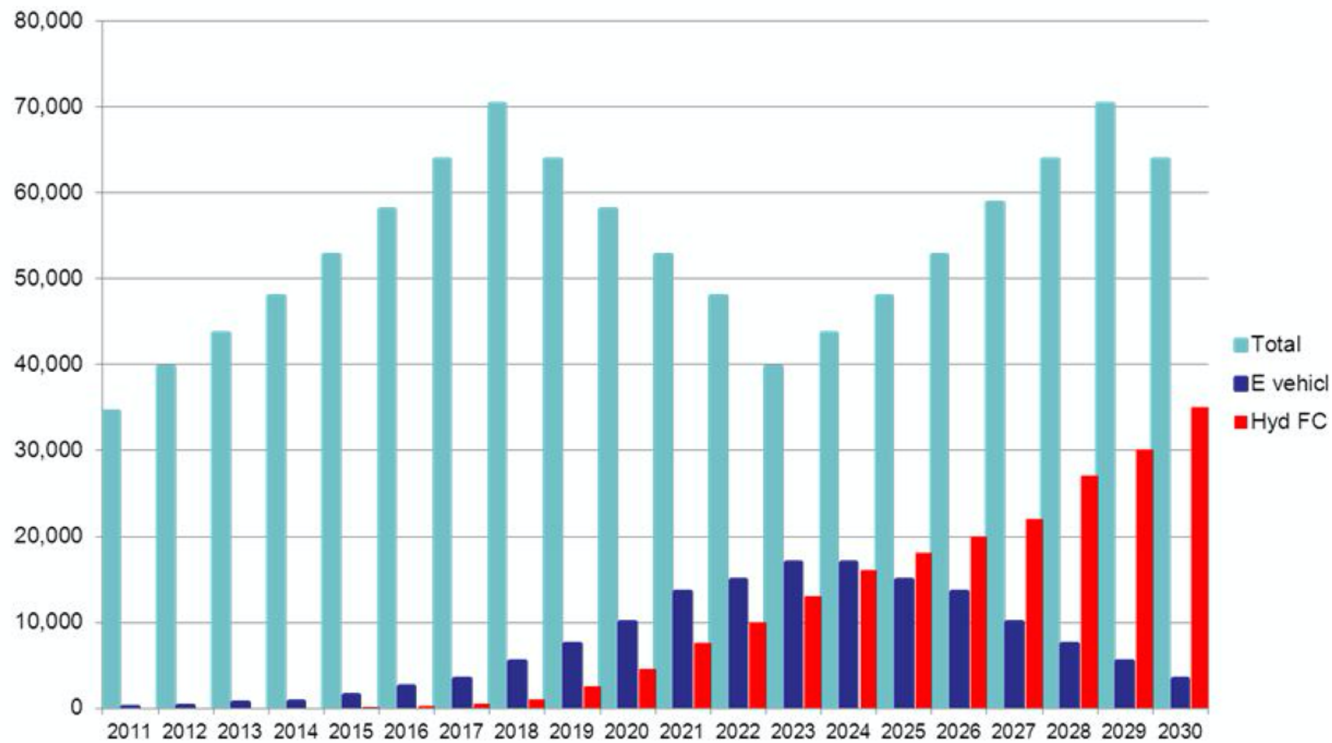
The Holman Jenkin's Jr. quote from the Wall Street Journal, shown in this testimony's fourth paragraph, continues on to provide a succinct and startling insight that "governments are powerless to change the situation."

Many good people in Hawaii, however, believe that if we face ZERO HOUR we can change the situation.

In Hawaii, it's like a Pacific version of the ancient pharaoh's dream. The fat years are followed by the lean ones.

New car sales projections provide a good look at what likely will be future state economic performance.

New car sales (registrations) have, since records have been kept, followed a pattern in Hawaii that resembles San Francisco's Golden Gate Bridge.



The predictive graphic, which was produced in 2008 and has proven to be surprisingly accurate. Note: the red and blue bars are not applicable to this testimony, however. They show the adoption rate of renewable fuel vehicles needed to meet the goals of the Hawaii Clean Energy Initiative.

Since new car sales mirror the performance of the state's economy the graphic has proven a useful tool for planning.

I overlaid Mr. Jenkins' column's statement about the failure of retirement systems on the Hawaii graph and saw the pending notification of the collapse of the state employee retirement system happening here in 2023.

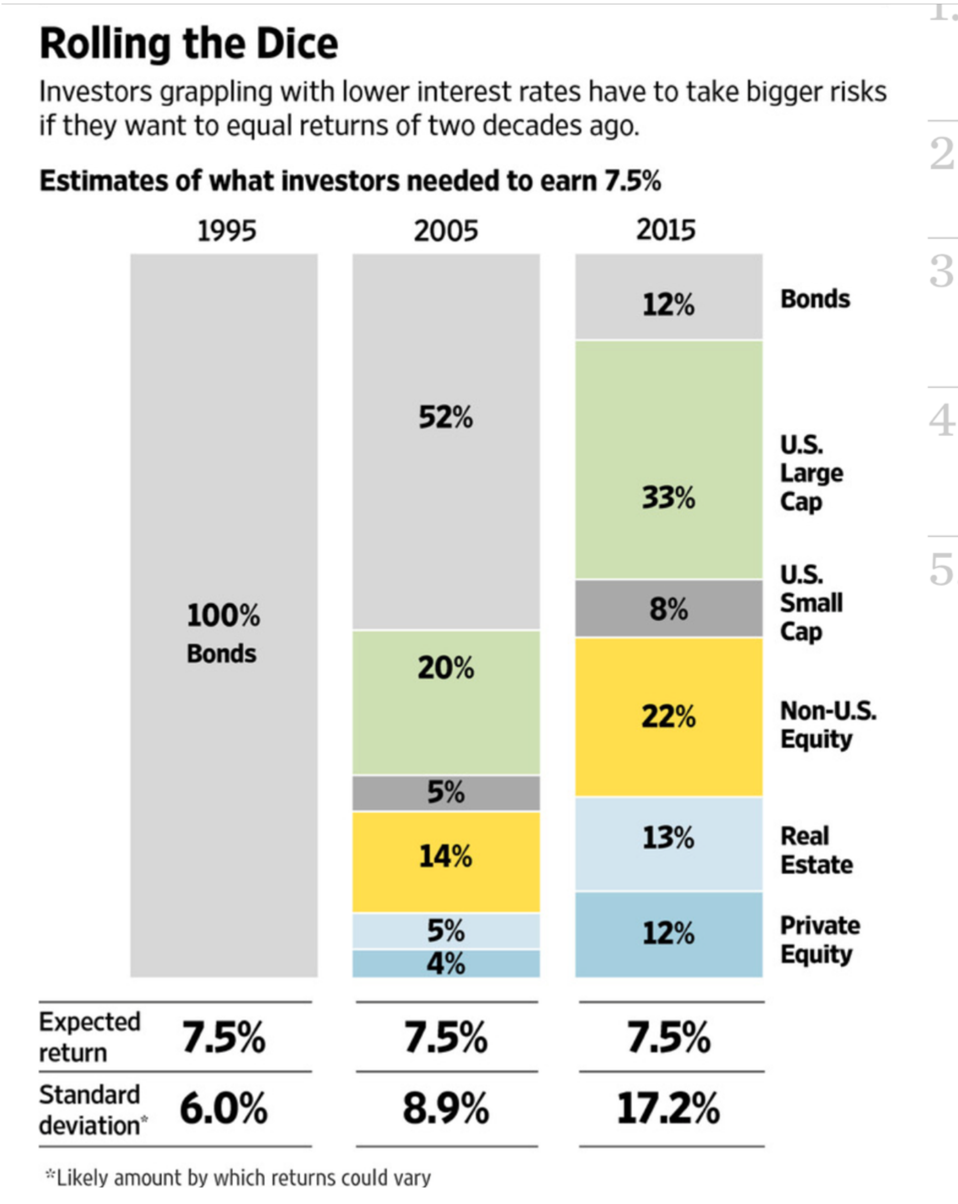
The retirement payment outlays will eventually exceed the income on a continuing basis.

This perfect storm now appears on the radar. I might as well use the graph to call the day, March 15, when it will all become apparent--The Ides of March, 2023.

Another graphic is helpful.

Some states retirement fund managers have barely been able to achieve 1% returns this past year and don't see any path to 7.5% without unauthorized levels of risk.

What does this mean for a state like Hawaii, which has covered less than 60% of its employee retirement fund's future needs?



Hawaii is in some kind of straitjacket.

Hawaii's governor David Ige, is being pragmatic, however. He is proposing to tuck away some of Hawaii's $6.5 billion state tax revenue in the coming years to head the problem off at the pass. It will be hard.

Since U.S. states cannot declare bankruptcy, our state taxes would have to go up dramatically to meet the retirement system obligations, and Hawaii's taxes are already some of the highest in the nation.

The bottom of the economy would fall out like a wet sack of garbage being taken to the curb.

Thanks for the warning Mr. Jenkins.

Solutions, through efficiencies are available.

Government leaders, business leaders, and others have proposed several good solutions.

Respectfully submitted,

David H. Rolf

Mililani