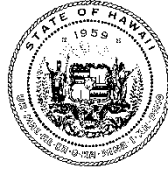


DAVID Y. IGE
GOVERNOR



RODERICK K. BECKER
Comptroller
AUDREY HIDANO
Deputy Comptroller

**STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL
SERVICES**

P.O. BOX 119, HONOLULU, HAWAII 96810-0119

TESTIMONY OF
RODERICK K. BECKER, COMPTROLLER
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
TO THE
HOUSE COMMITTEE ON FINANCE
ON
TUESDAY, FEBRUARY 27, 2018
11:00 A.M.
CONFERENCE ROOM 308

H.B. 2603, H.D. 1

RELATING TO STATE SELF-INSURANCE AGAINST PROPERTY AND CASUALTY RISKS.

Chair Luke, Vice Chair Cullen, and Members of the Committee, thank you for the opportunity to provide testimony on H.B. 2603 H.D.1

The Department of Accounting and General Services (DAGS) has serious concerns over the measure and offers the following comments for the Committee's consideration.

The Risk Management Office (RMO) is primarily responsible for the Statewide Risk Management Program pursuant to Chapter 41D, Hawaii Revised Statutes (HRS). RMO's mission is to protect the State against catastrophic losses and to minimize the total cost of insuring risk, and one of its responsibilities is to purchase property, excess liability, cyber liability and crime insurance policies. The FY 18 annual premiums for these policies are \$11.8 million of which \$8.7 million represents annual premiums for the Property insurance policy. This policy serves to provide coverage to state buildings and assets against fire, theft, vandalism, hurricane, tsunami, flood, earthquake and other perils providing \$200 million in aggregate.

Named windstorms (e.g., hurricanes) have a per occurrence limit of \$200 million with no aggregate limit.

The proposed measure, 1) establishes a special fund for the State to self-insure against property and casualty risks, 2) authorizes the Governor to transfer \$19 million in general funds to the special fund on an annual basis to address payment of any losses for State of Hawaii property and casualty risks, 3) provides for the Comptroller to establish deductibles for the State agencies for certain perils or classes of property or casualty risks, and 4) provides for the Comptroller to request that the Governor authorize an advance to the special fund of sufficient sums of money from other funds in the State when the fund balance is insufficient to keep the special fund actuarially sound and pay claims; advance to be repaid within ten years with interest, including the option to assess State agencies for the repayment as needed.

Although we support the general intent to save the State the costs of its annual insurance premiums by establishing and administering self-insurance coverage, we would like to highlight some areas of concern:

- The most current property actuarial study obtained by the RMO forecasted losses of about \$161 million based on a 100-year windstorm event. A property policy with \$200 million limits was accordingly purchased. The proposed annual general fund transfers of \$19 million would take about 10 loss-free years before obtaining the capital equivalent to the current insurance policy at the \$200 million level.
- As this is a non-discretionary expense, in the event of fund depletion due to catastrophic losses, this measure would require the State to have sufficient and available funds to replenish and keep the special fund actuarially sound which requires large sums of capital to address catastrophic losses and be able to continue to pay on going claims and operational costs.

In addition to keeping this fund at acceptable levels, the State will be faced with funding other uninsurable losses, all of which will compete with and strain State financing resources.

- The requirement for the proposed special fund to repay the moneys advanced for insufficiencies may not be attainable because the only potential revenue source for the special fund will come from State agency assessments. State agencies will be required to budget for amounts that are difficult to plan for since the timing and amounts of the insufficiencies are unpredictable.

- The proposed bill in its current form deletes the option of purchasing property and casualty insurance from Section 41D-2, HRS, thereby eliminating any flexibility for the State to exercise its choices in managing risks.

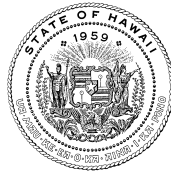
The proposed approach to manage and finance State risks would not be recommended by the RMO, especially for property and cyber losses, without an exacting assessment of the State's capacity to absorb uncertainty and take on 100% of the risk. A more conservative approach to expend smaller premium payments to transfer risks to insurers for larger insurance policy protection would be a more prudent and feasible way to manage the State of Hawaii's risk. It would be a huge financial/fiscal risk to slowly try to build a large fund while funding losses along the way, losses that are unpredictable and could be substantial.

In keeping with RMO's mission to minimize the total cost of insuring risk, legislation was sought and Act 62 was enacted in the 2017 legislative session, which allowed the RMO to procure insurance broker services on a fixed fee basis. This approach was pursued to allow the State of Hawaii to potentially obtain savings, projected at \$500,000 annually, from its insurance expenditures. The fixed fee would replace any commissions as historically earned by insurance brokers. With the passage of Act 62, the RMO posted a solicitation on January 8, 2018 for a

fixed fee contract with a three (3) year fixed period and two (2) optional twelve (12) month extensions. The projected award date is scheduled to be done before May 2018. Currently, this measure would conflict the operations scheduled for the RMO.

Thank you for the opportunity to submit testimony on this measure.

DAVID Y. IGE
GOVERNOR



LAUREL A. JOHNSTON
DIRECTOR

KEN N. KITAMURA
ACTING DEPUTY DIRECTOR

EMPLOYEES' RETIREMENT SYSTEM
HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
OFFICE OF THE PUBLIC DEFENDER

**STATE OF HAWAII
DEPARTMENT OF BUDGET AND FINANCE**

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ADMINISTRATIVE AND RESEARCH OFFICE
BUDGET, PROGRAM PLANNING AND
MANAGEMENT DIVISION
FINANCIAL ADMINISTRATION DIVISION
OFFICE OF FEDERAL AWARDS MANAGEMENT (OFAM)

WRITTEN ONLY

TESTIMONY BY LAUREL A. JOHNSTON
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
TO THE HOUSE COMMITTEE ON FINANCE
ON
HOUSE BILL NO. 2603, H.D. 1

**February 27, 2018
11:00 a.m.
Room 308**

**RELATING TO STATE SELF-INSURANCE AGAINST PROPERTY AND CASUALTY
RISKS**

House Bill No. 2603, H.D. 1, establishes a special fund to provide the State with self-insurance against the State's property and casualty risks, and appropriates general funds in FY 19 for deposit into the special fund. The measure states that in order to ensure the special fund is operated on an actuarially sound basis, the Governor shall authorize the annual transfer of \$19,000,000 in general funds to the special fund. The expending agency for the appropriation is the Department of Accounting and General Services.

The Department of Budget and Finance offers the following comments on this measure. First, the reserve will take years to build up to the desired target level. During the initial years building up the reserve, the State will bear a significant degree of potential risks. Second, after the target level is reached, there is no assurance in the bill that will limit or restrict these funds from being used for other fiscal needs.

Thank you for your consideration of our comments.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: MISCELLANEOUS, State Self-Insurance Against Property and Casualty Risks

BILL NUMBER: HB 2603, HD-1

INTRODUCED BY: House Committee on Intrastate Commerce

EXECUTIVE SUMMARY: Establishes a special fund to provide the State with self-insurance against the State's property and casualty risks. This method appears to be fraught with danger because the State tends not to leave large pots of money untouched at the slightest sign of financial difficulty.

SYNOPSIS: Adds a new section to chapter 41D, HRS, to establish the state self-insurance against property and casualty risks special fund. Requires an annual transfer of \$19 million from the general fund to it.

Makes conforming amendments to section 41D-2, and 41D-4, HRS.

EFFECTIVE DATE: July 1, 3000.

STAFF COMMENTS: The bill recites, and we have no reason to doubt, that the State buys property and casualty insurance at retail, and pays more than \$19 million in premiums annually.

The solution proposed by the bill is to create a special fund that would pay property and casualty claims.

This might be a good solution if State lawmakers left the fund alone to pay only its contemplated expenses, namely property and casualty claims. However, State lawmakers have a history of looking for alone and unprotected pots of money and raiding them when times were tough (or perhaps even not so tough).

In a recent speech on Maui, for example, Employees' Retirement System head Thom Williams described that in 1995 the ERS was more than 95% funded, but the Legislature continually raided the fund whenever its investments brought in more than the 8% rate of return on which its actuarial assumptions were based, to the tune of \$1.7 billion over a 32-year period. As a result, a *Forbes* article dated August 30, 2017, stated that as of 2015, the state's unfunded pension liability was \$12.4 billion. That number is expected to grow, and of course it does not include the EUTF, which is also underfunded.

The ERS is not an isolated case either. The Hawaii Supreme Court case *Hawaii Insurers Council v. Lingle*, 120 Haw. 51, 201 P.3d 564 (2008), describes a legislative raid on the Department of Commerce and Consumer Affairs' Compliance Resolution Fund. The Hawaii Supreme Court ultimately found the raid illegal and ordered the State to pay back the money.

Rather than rely on the Legislature's ability to keep its fingers out of the fund, the State should take its own advice and establish a captive insurance company.

In recent years, Hawaii's DCCA has developed a fair amount of expertise in regulating captive insurance companies, such that Hawaii is now the third most popular place in the United States, based on total premium, for organizing a captive according to a fact sheet recently released by the Governor's office. (<http://governor.hawaii.gov/newsroom/latest-news/release-successful-2017-for-hawaiis-captive-insurance-industry/>)

A captive insurer is an insurance company that then buys insurance against catastrophic risk in the wholesale market, leading to substantial savings over retail insurance premiums. The State authorized the counties to have captive insurance companies to cover their own risks in HRS section 46-1.5(36), and now should seriously consider establishing one for itself. If the captive insurance company is then required to be capitalized with a substantial fund, one can be established, but the danger of raiding the fund would be substantially lessened because of regulatory restrictions or covenants the State would be required to make with its wholesale insurance providers.

Digested 2/25/2018