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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 LABOR
ON
SENATE BILL NO. 2765

**January 30, 2018
2:45 P.M.
Conference Room 229**

RELATING TO INVESTMENT PERSONNEL OF THE EMPLOYEES' RETIREMENT SYSTEM

Chair Tokuda, Vice Chair English and Members of the Committee,

S.B. 2765 would allow the Board of Trustees of the Employees' Retirement System of the State of Hawaii (ERS), through its executive director, to offer ERS investment specialists the choice of being exempt from chapters 76 and 89, Hawaii Revised Statutes.

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. Over two-thirds of every dollar of benefits provided is attributable to investment earnings. The system currently has over seventeen billion dollars in domestic and international investments and decisions made by the Board of Trustees of the system, based on recommendations of our team of investment professionals, are critical to the current and future funding and sustainability of the system, which has an unfunded actuarial accrued liability of \$12.9 billion and a funded ratio of 54.9% as of June 30, 2017.



Employees' Retirement System
of the State of Hawaii

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 investing 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, each of whom is exempt from civil service classification, and two Investment Specialists who are civil service employees. With this legislation, the Investment Specialists would be given the choice of either converting to exempt employee status or remaining as civil service employees. Prospectively, the bill will provide that future appointments in these positions will be exempt from Chapters 76 and 89.

The current investment team staffing structure, consisting of exempt Investment Officers and non-exempt Investment Specialists, is not expected to meet our long term needs. Staffing will need to be both flexible and be augmented given the complexity of our portfolio, its size and the dynamics of modern financial markets. The investment portfolio has increased its allocations to domestic and international equity products, covered calls, real return assets, alternative investments, and private equity. In addition, the ERS is transitioning its portfolio to a risk-focused asset allocation program, the implementation of which will require additional attention, monitoring, review and rebalancing.

Effective management of our investments requires the 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. Allowing our two existing Investment Specialist to choose either civil service or exempt status while establishing our future Investment Specialists as exempt from civil service will permit us to recruit, compensate and retain these invaluable associates while providing a career path for these talented staff members. It is widely recognized that the greatest benefit and/or risk to public pension plan sustainability today resides in its capacity to recruit and retain the most qualified and capable team of investment professionals. Liabilities not offset by investment earnings result in increased employer and employee contributions. Any associated costs attributable to this conversion will be derived solely from ERS internally generated funds.

The Board of Trustees of the Employees' Retirement System supports this legislation.

Thank you for this opportunity to provide testimony on S.B. 2765.



The Senate Committee on Labor
Tuesday, January 30, 2018
2:45 PM, Conference Room 229

RE: **SB 2765, Relating to Investment Personnel of the Employees' Retirement System**

Attention: Chair Jill Tokua, Vice Chair J. Kalani English and members of the Committee

The University of Hawaii Professional Assembly (UHPA) urges the committee to **support passage of SB 2765, with amendments**. UHPA does support allowing the Board to expand its authority to appoint investment professionals reporting to the chief investment officer that are exempt from Chapters 76 and 89.

However, UHPA recommends an amendment to SB 2765 which amends Chapter 88-29.5 by removing "...through the executive director..." from line 4 of page 1 of the bill. The Board should be making these decisions with insight from the the subject matter expert, the chief investment officer, not the executive director.

UHPA had the opportunity to meet with the ERS Actuarial Consultant, Gabriel, Roeder, Smith & Company (GRS), to go over the most recent actuarial valuation report. Expanding the ERS investment team provides the appropriate resources to ensure that the investment returns are maximized when the financial markets are performing well, and helps protect against investment losses when the financial markets are struggling.

The investment team has performed exceptionally well over the past seven years helping stabilize the financial situation and decrease the timeline to full funding, despite actions by the Board that have dramatically increased the unfunded liability forcing a dramatic increase in employer contributions over the next three years.

UHPA supports the passage of SB 2765 with amendments.

Respectfully submitted,

Kristeen Hanselman
Executive Director