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**TESTIMONY TO THE  
SENATE COMMITTEE ON WAYS AND MEANS**

For Hearing on Tuesday, March 30, 2021 at 9:00 a.m.  
Conference Room 211 and via video teleconference

By

RYKER WADA  
DIRECTOR

**Senate Concurrent Resolution 211, Senate Draft 1:  
URGING THE DEPARTMENT OF HUMAN RESOURCES DEVELOPMENT AND  
DEPARTMENT OF EDUCATION TO ESTABLISH AND OFFER A QUALIFIED ROTH  
CONTRIBUTION PROGRAM TO THEIR RETIREMENT PLAN PARTICIPANTS**

(WRITTEN TESTIMONY ONLY)

CHAIR DELA CRUZ, VICE CHAIR KEITH-AGARAN AND MEMBERS OF THE COMMITTEE:

Thank you for the opportunity to provide these **COMMENTS** on SCR 211, Senate Draft 1, which urges the Department of Human Resources Development (DHRD) and the Department of Education (DOE) to establish and offer a qualified Roth contribution program to their retirement plan participants by July 1, 2022.

We defer to the DOE to address whether a Roth contribution program can be established and offered through their tax-sheltered annuity plan governed by section 403(b) of the IRC, as that program is outside of DHRDs purview. We are limiting our comments to the Island Savings Plan, which is a voluntary deferred compensation plan under section 457(b) of the IRC and the deferred compensation plan for part-time, temporary, and seasonal/casual employee (PTS Plan) governed under section 457(b) and section 3121 of the IRC.

While there is enabling language under Hawaii Revised Statutes, chapter 88E, governing the regular deferred compensation plan (aka the Island Savings Plan) the Administrative Rules for the Plan will need to be amended prior to permitting after-tax Roth deferrals into the Plan. We wish to inform you that the Board's staff is currently working with legal counsel and the Plan's

consultant to amend the rules, which will not only include language for the Roth option, but other housekeeping amendments from earlier federal regulation mandates and the most recent federal regulation mandates as a result of the COVID-19 pandemic (e.g., SECURES Act, CARES Act, etc.). Once the draft amendments are completed, it will need to go through Board review, consultation with stakeholders, the rule-making and public hearing process and development of the administrative process to accept the deferred funds, prior to offering the Roth option to the participants. These steps are both time and labor intensive, and therefore, we would likely not meet or come close to a July 1, 2022 implementation date.

With regards to the PTS Deferred Compensation Plan, the Plan is an eligible deferred compensation plan under section 457 and 3121 of the Internal Revenue Code (Code) for part-time, temporary, and seasonal/casual employees. Participation is mandatory and the pre-tax contribution amounts to be deferred by participants to the Plan are in lieu of social security contributions. A designated Roth contribution is a type of elective deferral that is a post-tax contribution that is included in gross income. The Plan's consultant advises a conservative approach by not allowing Roth contributions because it is not clear within current regulations whether mandatory contributions for FICA alternative purposes could include Roth contributions. If Roth contributions were to be allowed and later determined that it does not meet the requirements under a 3121 plan, there would be tax implications and would be a mess to correct.

Thank you for allowing us the opportunity to provide this testimony.

My name is Brandon Lee and I am testifying in strong support of SCR 211 SD 1 / SR 174 SD 1 with amendments, which urges the Department of Human Resources Development and Department of Education to offer Roth programs.

### Recommended Amendments

- Delete all references to the Employees Retirement System and its pension plan as their deferred compensation plan is not able to be structured as a Roth program
  - Delete all of page 2 lines 1 - 5
  - Delete "401(k)" on page 2, line 34
- Add UH as they along with DOE offer 403(b) plans
  - Add "UH" on page 3, line 25
  - Add "University of Hawaii" on page 3, line 39

### Retirement Needs

Retirement is one of the largest financial burdens that an individual will need to save for. According to Investopedia, your retirement income needs to be about 80% of your final pre-retirement salary.<sup>1</sup> This means for someone making \$100,000 annually at the end of their career, they will need \$80,000 per year in retirement income. One easy-to-use formula is to divide your desired annual retirement income by 4%, which is known as the 4% rule. Therefore, to generate \$80,000 per year, you would need a nest egg of \$2 million ( $\$80,000 / 0.04$ ), something very few employees have. There is lot of discussion about the cost of housing, food, health care, and other immediate expenses, but retirement savings on a numbers basis might be the largest expenditure while simultaneously drawing far less attention. There is also less safety net programs for retirees who run out of money in retirement, a growing problem as employers have switched to defined contribution retirement plans over the past few decades.

In addition, retirees without retirement savings will need to have their needs taken care somehow and ultimately that responsibility is likely to fall on government, further stressing the expenditure side of the State budget. Therefore, any program that can incentivize government workers to save for their own retirement is a very beneficial thing for both the worker and long term state budgets.

### Traditional vs. Roth Retirement Plans

There are traditional and Roth retirement plans. Currently, State of Hawaii retirement plans such as the 457 or 403b plans, etc. only allow for traditional retirement plans, instead of Roth versions. Opening up Roth options provide choice based upon the employee's financial circumstances, thereby creating economic efficiency within the marketplace.

Traditional plans deduct payments pre-tax thereby reducing taxable income and one's tax federal and state tax burden for that current year. However, the traditional plans will also count all future distribution (principal plus any gains over the years) as taxable income at the time of withdrawal. Meanwhile, Roth plans count contributions as taxable in the current year, but do not count tax any qualified distributions as taxable. Especially for contributors such as younger workers whose distributions won't occur decades into the future, the gains are often worth more than the contributions

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<sup>1</sup> How much do I need to Retire?, <https://www.investopedia.com/retirement/how-much-you-should-have-saved-age/>

due to compounding growth. Therefore, for many government workers, it would be more beneficial to have the option of contributing to Roth vehicles as opposed to traditional vehicles.

Attached are visual examples that highlight different people with different life scenarios:



**Jeff (Age 45):**  
Wants current tax break

Jeff considers himself in his "peak" earning years. He knows he won't be making this money forever, but wants to enjoy it while he can.

- Doesn't think he can afford to lose another tax deduction at this point
- Doesn't really like change anyway
- Expects to be in a lower tax bracket when he retires



**Linda (Age 25):**  
Wants long-term tax-free growth potential

Linda just got out of grad school and is embarking on her new career. She feels good about the fact she's already starting to build up her savings.

- Isn't worried about the tax deduction now
- Confident her salary will increase over the years to come
- Expects to be in a higher tax bracket when she retires

**Comparing Jeff's options:**

	Traditional Pre-tax 457(b)	Roth After-tax 457(b)
Gross income:	\$75,000	\$75,000
Annual salary available to save:	\$10,000	\$10,000
<b>Less taxes at 25%<sup>1</sup>:</b>	-\$0	-\$2,500
Net yearly contribution (totals over 20 years:	\$10,000 \$200,000	\$7,500 \$150,000)
Value at retirement (assumes 20 years of contributions at 6%)	\$378,572	\$283,929
<b>Less taxes at 15%<sup>2</sup>:</b>	-\$56,786	-\$0
<b>After-tax value:</b>	<b>\$321,786</b>	\$283,929

Considering

**Traditional 457(b)**

**Comparing Linda's options:**

	Traditional Pre-tax 457(b)	Roth After-tax 457(b)
Gross income:	\$35,000	\$35,000
Annual salary available to save:	\$3,000	\$3,000
<b>Less taxes at 15%<sup>1</sup>:</b>	-\$0	-\$450
Net yearly contribution (totals over 40 years:	\$3,000 \$120,000	\$2,550 \$102,000)
Value at retirement (assumes 40 years of contributions at 6%)	\$477,811	\$406,140
<b>Less taxes at 33%<sup>2</sup>:</b>	-\$157,678	-\$0
<b>After-tax value:</b>	\$320,134	<b>\$406,140</b>

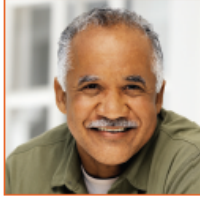
Considering

**Roth 457(b)**

<sup>1</sup> Based on current federal tax rates as of 2016.

<sup>2</sup> Assumed rates designed to illustrate impact of lower and higher tax rates in retirement.

Note: These are hypothetical illustrations for demonstration purposes only. They are not guaranteed and not intended to (1) serve as financial advice or as a primary basis for investment decisions and (2) imply the performance of any specific security. Contributions are subject to Internal Revenue Code limits. Systematic investing does not ensure a profit nor guarantee against loss. Investors should consider their ability to invest consistently in up as well as down markets. This example does not represent any specific product, nor does it reflect sales charges or other expenses that may be required for some investments. After tax value of traditional 457(b) assumes a one time lump sum distribution. Your actual results may vary.



**Brian (Age 50):**  
Wants to maximize contributions and tax-free income

Brian is established in his career and makes a great salary. He

thinks he'll be able to live on less when he retires, yet is eager to maximize his retirement income.

- Unable to contribute to a Roth IRA (his income exceeds the Roth IRA limits)
- Likes the idea of tax-free retirement income, previously unavailable for the highly compensated



**Wanda (Age 55):**  
Wants tax flexibility now and in retirement

Wanda likes the idea of tax-free retirement income, but also likes her current tax deduction. And she

doesn't have a clue where taxes are headed in the future!

- Is getting close to retiring, but not that close
- Wants the flexibility to optimize her tax strategy year-to-year as she withdraws retirement income

**Comparing Brian's options:**

	Traditional Pre-tax 457(b)	Roth After-tax 457(b)
Gross income:	\$120,000	\$120,000
Annual salary available to save:	\$18,000	\$26,866
Less taxes at 33% <sup>1</sup> :	-\$0	-\$8,866
Net yearly contribution (totals over 15 years:	\$18,000 \$270,000	\$18,000 \$270,000)
Value at retirement (assumes 15 years of contributions at 6%)	\$431,173	\$431,173
Less taxes at 33% <sup>2</sup> :	-\$142,287	-\$0
<b>After-tax value:</b>	\$288,886	<b>\$431,173</b>

Considering

**Roth 457(b)**

**Comparing Wanda's options:**

	Traditional Pre-tax 457(b)	Roth After-tax 457(b)
Gross income:	\$60,000	\$60,000
Annual salary available to save:	\$6,000	\$6,000
Less taxes at 25% <sup>1</sup> :	-\$0	-\$1,500
Net yearly contribution (totals over 10 years:	\$6,000 \$60,000	\$4,500 \$45,000)
Value at retirement (assumes 10 years of contributions at 6%)	\$81,389	\$61,041
Less taxes at 25% <sup>2</sup> :	-\$20,347	-\$0
<b>After-tax value:</b>	<b>\$61,041</b>	<b>\$61,041</b>

Considering

**Combination of Traditional 457(b) and Roth 457(b)**

<sup>1</sup> Based on current federal tax rates as of 2016.

<sup>2</sup> Assumed rates designed to illustrate impact of lower and higher tax rates in retirement.

This illustration assumes a weekly pay period, with contributions made at the beginning of each pay period.

This illustration is hypothetical, not guaranteed and does not depict the performance of any particular security and is not intended to predict or project future investment results. The illustration does not reflect any charges, expenses, or fees that may be associated with your Plan. Systematic Investing does not ensure a profit nor guarantee against loss. Investors should consider their ability to invest consistently in up as well as down markets. This example does not represent any specific product, nor does it reflect sales charges or other expenses that may be required for some investments. After tax value of traditional 457(b) assumes a one time lump sum distribution. Your actual results may vary.

As one can see from the analysis above, retirement planning can be complicated for a lot of people and yet it is fundamental for one's economic future. Yet, one heavily under discussed benefit of Roth retirement plans is they provide greater fiscal certainty for the employee. In the traditional plans, the amount of money you actually receive in retirement is heavily based on what the tax rate is in your retirement years, which can be decades into the future. This uncertainty leads to making retirement planning even more challenging for knowledgeable retirement planners and rookies alike. With the

Roth option, you know exactly how much money you have for retirement at all times, further leading to better economic planning and decision making in the lead up to and during one's retirement years.

### Roth Programs are not new

Roth programs are not a new concept. First, established in 1998, Individual Retirement Accounts (IRA) were allowed to have a Roth option. Currently, in 2021 anyone with modified adjusted gross income can put up to \$6,000 into a traditional or Roth IRA with diminishing limits up to \$139,000. Therefore, American citizens have experience with Roth options.

The Small Business Jobs Act of 2010 (<https://www.congress.gov/bill/111th-congress/house-bill/5297/text>) which took effect on January 1, 2011 specifically carves out a Roth option for 457 plans (deferred compensation - Island Savings plan). Furthermore, IRS guidance ([https://www.irs.gov/publications/p571#en\\_US\\_202101\\_publink1000239672](https://www.irs.gov/publications/p571#en_US_202101_publink1000239672)), specifically allows 403b contribution plans to have a Roth option. However, Hawaii has not yet made a Roth option available for any participant.

Currently, I use a Roth IRA for my personally created IRA retirement fund and then am forced to use a traditional plan for my workplace retirement account, further complicating my retirement planning and leading to greater long-term fiscal uncertainty.

As mentioned in the resolution's text, at least 13 other states including and numerous municipalities offer Roth options for their government workplace retirement plans.

- Alaska: <http://doa.alaska.gov/drb/headlines/roth457billFAQs.html>
- Connecticut:  
<https://ingcustom.voya.com/einfo/pdfs/forms/ingcustomct/ct403bpu/Roth457.pdf>
- Idaho: [https://www.idahodc.com/iApp/tcm/idahodc/learning/library/roth\\_457\\_accounts.jsp](https://www.idahodc.com/iApp/tcm/idahodc/learning/library/roth_457_accounts.jsp);  
[https://www.idahodc.com/tcm/idahodc/static/Plan\\_Comparison\\_Chart.pdf](https://www.idahodc.com/tcm/idahodc/static/Plan_Comparison_Chart.pdf)
- Iowa: [https://das.iowa.gov/sites/default/files/hr/ric/457/documents/Roth\\_sum\\_PSE.pdf](https://das.iowa.gov/sites/default/files/hr/ric/457/documents/Roth_sum_PSE.pdf);  
[https://das.iowa.gov/sites/default/files/hr/ric/403b/documents/Roth\\_sum\\_ERE.pdf](https://das.iowa.gov/sites/default/files/hr/ric/403b/documents/Roth_sum_ERE.pdf)
- Maryland:  
[https://www.marylanddc.com/iApp/tcm/marylanddc/learning/library/roth\\_457\\_accounts.jsp](https://www.marylanddc.com/iApp/tcm/marylanddc/learning/library/roth_457_accounts.jsp);  
<http://msrp.maryland.gov/rothflyer2014.pdf>
- Massachusetts:  
<https://www.umass.edu/humres/sites/default/files/457%20Roth%20Plan%20Information.pdf>
- Michigan: <https://stateofmi.voya.com/einfo/pdfs/forms/michigan/640001/roth.pdf>;  
<https://www.mersofmich.com/participant/programs/457-program/roth-or-pre-tax-457/>;  
<https://hr.umich.edu/benefits-wellness/financial/retirement-savings-plans/roth-options>
- Minnesota: <https://www.msrs.state.mn.us/pretax-aftertax-mndcp>;
- Nevada: [https://defcomp.nv.gov/Resources/FAQ-Roth\\_457/](https://defcomp.nv.gov/Resources/FAQ-Roth_457/);  
<https://ingcustom.voya.com/einfo/pdfs/forms/ingnv/nvdcppu/3020983.G.P-3.FNL.pdf>;  
<https://defcomp.nv.gov/Resources/ROTH/>
- New Jersey: <https://uhr.rutgers.edu/benefits/nj-state-employees-deferred-compensation-plan-njsedcp>

- New Hampshire: <https://das.nh.gov/hr/documents/2020-Roth-Overview.pdf>;  
[https://das.nh.gov/documents/NH\\_457\\_Plan\\_Features\\_and\\_Highlights.pdf](https://das.nh.gov/documents/NH_457_Plan_Features_and_Highlights.pdf)
- New York: [https://www.nysdcp.com/iApp/tcm/nysdcp/learning/library/roth\\_457\\_accounts.jsp](https://www.nysdcp.com/iApp/tcm/nysdcp/learning/library/roth_457_accounts.jsp);  
[https://www.nysdcp.com/tcm/nysdcp/static/faqs\\_roth\\_457\\_contributions.pdf?r=1](https://www.nysdcp.com/tcm/nysdcp/static/faqs_roth_457_contributions.pdf?r=1)
- Ohio: <https://www.ohio457.org/resources>; <https://www.ohio457.org/assets/help-pdfs/Roth%20Brochure.pdf>

### Public and Private Sector

The State of Hawaii requires a qualified workforce. However, public sector pay has not kept up with more financially lucrative private sector pay, leading to top talent moving out of the public sector. This resolution would strengthen retirement programs - one of the few advantages the public sector has over its private sector counterparts. Yet, because the public sector is a such a large employer who also has the goal of ensuring economic prosperity for all of its citizens, by establishing Roth options in government, private sector companies will also slowly over time need to re-evaluate to see if Roth options are necessary to retain competitive advantage for employees. Either way, this is a net benefit for the State and its mission.

I urge this committee to pass these resolutions for the betterment of the people of Hawaii.