DAVID Y. IGE
GOVERNOR

CURT T. OTAGURO
COMPTROLLER

AUDREY HIDANO
DEPUTY COMPTROLLER

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
P.O. BOX 119, HONOLULU, HAWAII 96810-0119

WRITTEN TESTIMONY
OF
CURT T. OTAGURO, COMPTROLLER
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
TO THE

COMMITTEE ON FINANCE

H.B. 1830, H.D. 1

FEBRUARY 24, 2022, 11:00AM
VIA TELECONFERENCE, STATE CAPITOL

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

Chair Luke, Vice Chair Yamashita and Members of the Committee, thank you for the opportunity to testify on H.B. 1830, H.D. 1.

The Department of Accounting and General Services ("Department") appreciates the intent of the measure and provides the following comments.

The proposed measure 1) adds a new section to chapter 41D, Hawaii Revised Statutes ("HRS"), to establish a special fund for the State to self-insure against property and casualty risks, 2) authorizes the governor to transfer an undetermined amount of 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.

The Department appreciates the general intent to save the State the cost of its annual insurance premiums by establishing and administering self-insurance coverage, but would like to highlight the following areas of concern with the measure:

- The amending of Section 41D-2, HRS, eliminates the comptroller's discretion to purchase property and casualty insurance for the State. The current language within Section 41D-2, HRS, states that the comptroller, through the risk manager, shall have discretion to purchase casualty and property insurance. Without this discretion, the State will be left with only one option, that of total self-insurance. The current statute allows for both insurance purchases and self-insurance as options, depending on insurance market conditions. It would be prudent to have options in protecting the State against catastrophic losses and to minimize the total cost of insuring risk. As such, amendments to Section 41D-2, HRS, would not be recommended.

- There are insurance requirements and other risk management considerations. Procurement/financing agreements may be affected, e.g., financiers involved in the State's option to pursue Public-Private Partnerships (P3) for future projects may require certain levels of insurance to satisfy their requirements. FEMA may also require certain levels of insurance due to past funding provided to the State of Hawaii. If the State received FEMA funding from past flood damages, there is a requirement to have flood insurance in place. If insurance coverage is not maintained, the State risks FEMA funding being withheld should another flood loss occur to the same area. Additionally, limiting the ability of the State to buy insurance could raise questions with credit rating agencies and affect the analysis they conduct on governance practices.

- The requirement for the proposed special fund to repay the monies advanced for insufficiencies may not be feasible 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 time and amounts of the insufficiencies are unpredictable.

- The Department annually reviews and analyzes the insurance program for its effectiveness to ensure it manages the cost of the State's insurable risks. During the 2017 legislative session, Act 62 was enacted which allowed the risk management office to procure insurance policies on a flat fee basis instead of the traditional commission fee basis. This approach has saved over $8.4 million over 4 fiscal years for an average of $2.1 million per year. The proposed measure will eliminate the purpose and intent of Act 62. The Department, thus, recommends that the risk management office continue its efforts in evaluating options to manage the costs of its insurance premiums while effectively managing risk and minimizing the State's loss exposure.

The Department would like for the Committee to consider the following options and costs associated with total or partial self-insurance.

- A significant infusion of funds is needed for the proposed self-insurance special fund to be funded on an actuarially sound basis. To date, the following policies and coverage limits are in effect:

Property	$200,000,000
Terrorism	$100,000,000
Excess Liability	$7,500,000
Crime	$10,000,000
Cyber	$5,000,000
Total	**$322,500,000**

  In essence, the minimum amount of an up-front appropriation for total self-insurance would be $322,500,000 which would be equivalent to removing all insurance policies. This self-insurance fund would require a long-term financial commitment to remain actuarially sound as monies must be maintained and made available to address any unforeseen events like a hurricane or cyber-attack.

  Incremental infusions into a self-insurance fund in order to reach the desired target level cannot be considered as it will represent a great financial risk to the State of Hawaii. At the current general fund appropriation level, it would take more than 30 loss-free years to optimally fund a self-insurance fund and provide the capital equivalent to the coverage at current levels. If a severe loss should occur during the interim, the self-insurance fund could be depleted. The State's capacity to absorb uncertainty and take on 100% of the risk while capitalizing the fund would be a huge financial/fiscal risk. Hence, the need to maintain the comptroller's discretion to purchase insurance will still be needed to eventually reach a total self-insured level if incremental infusions are deemed a feasible option.

- Currently, the Department is open to considering self-insurance for certain coverages such as the liability, crime and cyber coverage; exclusive of property coverage as articulated above. This is based on the current insurance market conditions, whereby, government entities are able to purchase only a limited amount of coverage at an increasing cost. Self-insurance for liability, crime and cyber coverage would require a minimal up-front infusion of $22,500,000 to attain current coverage levels. Additional funding may be required if funds are expended in excess of general fund appropriations and State agency assessments. However, it would be prudent to retain a property coverage policy based on the higher coverage and the availability of additional coverage unlike the liability, crime, and cyber coverages.

In summary, the Department appreciates the intent of this bill for total self-insurance as a cost-saving measure but has concerns regarding certain risks and costs associated with it. Preserving the Department's flexibility to exercise its discretion on how to manage its cost of risk is **vitally** important. Therefore, it is highly recommended that the current statute be preserved and not amended. If implemented, the option to be fully self-insured will require at least $322,500,000 and the option to be partially self-insured for only liability, crime and cyber exposures will require at least $22,500,000.

Thank you for the opportunity to testify on this matter.

DAVID Y. IGE
GOVERNOR

CRAIG K. HIRAI
DIRECTOR

GLORIA CHANG
DEPUTY DIRECTOR

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

STATE OF HAWAIʻI
DEPARTMENT OF BUDGET AND FINANCE
P.O. BOX 150
HONOLULU, HAWAIʻI 96810-0150

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

WRITTEN ONLY
TESTIMONY BY CRAIG K. HIRAI
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
TO THE HOUSE COMMITTEE ON FINANCE
ON
HOUSE BILL NO. 1830, H.D. 1

February 24, 2022
11:00 a.m.
Room 308 and Videoconference

RELATING TO STATE SELF-INSURANCE AGAINST PROPERTY AND CASUALTY RISKS

The Department of Budget and Finance (B&F) offers comments on House Bill (H.B.) No. 1830, H.D. 1.

H.B. No. 1830, H.D. 1, establishes the State Self-Insurance Against Property and Casualty Risks Special Fund (SIAPCRSF) to be administered by the Comptroller, through the Risk Manager, to provide the State with self-insurance against the State's property and casualty risks. The bill appropriates unspecified general funds in FY 23 to the Department of Accounting and General Services to be deposited into this newly established special fund and appropriates out of this special fund unspecified funds in FY 23 for the purposes of this measure. Also, to ensure that the special fund is operated on an actuarially sound basis, the measure states that the Governor shall authorize the annual transfer of unspecified general funds to the SIAPCRSF.

B&F strongly recommends that a study first be completed to assess whether having the State self-insure against property and casualty risks is both viable and cost effective. Additionally, B&F needs to point out that the Legislature must appropriate annually general funds to support the SIAPCRSF because the State Constitution does not permit standing appropriations.

B&F also notes that, with respect to the general fund appropriation in this bill, the federal Coronavirus Response and Relief Supplemental Appropriations Act requires that states receiving Elementary and Secondary School Emergency Relief (ESSER) II funds and Governor's Emergency Education Relief II funds must maintain state support for:

- Elementary and secondary education in FY 22 at least at the proportional level of the state's support for elementary and secondary education relative to the state's overall spending, averaged over FYs 17, 18 and 19; and
- Higher education in FY 22 at least at the proportional level of the state's support for higher education relative to the state's overall spending, averaged over FYs 17, 18 and 19.

Further, the federal American Rescue Plan (ARP) Act requires that states receiving ARP ESSER funds must maintain state support for:

- Elementary and secondary education in FY 22 and FY 23 at least at the proportional level of the state's support for elementary and secondary education relative to the state's overall spending, averaged over FYs 17, 18 and 19; and
- Higher education in FY 22 and FY 23 at least at the proportional level of the state's support for higher education relative to the state's overall spending, averaged over FYs 17, 18 and 19.

The U.S. Department of Education has issued rules governing how these maintenance of effort (MOE) requirements are to be administered. B&F will be working with the money committees of the Legislature to ensure that the State of Hawai'i complies with these ESSER MOE requirements.

Finally, regarding the establishment of the SIAPCRSF, as a matter of general policy, B&F does not support the creation of special funds which do not meet the requirements of Section 37-52.3, HRS. Special funds should: 1) serve a need as demonstrated by the purpose, scope of work and an explanation why the program cannot be implemented successfully under the general fund appropriation process; 2) reflect a clear nexus between the benefits sought and charges made upon the users or beneficiaries or a clear link between the program and the sources of revenue; 3) provide an appropriate means of financing for the program or activity; and 4) demonstrate the capacity to be financially self-sustaining. In regard to H.B. No. 1830, H.D. 1, the special fund will not be self-sufficient.

Thank you for your consideration of our comments.