

DAVID Y. IGE
GOVERNOR



CRAIG K. HIRAI
DIRECTOR

GLORIA CHANG
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**

P.O. BOX 150
HONOLULU, HAWAII 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. 2240, H.D. 1

**FEBRUARY 23, 2022
2:00 P.M.
Via Videoconference**

RELATING TO OTHER POST-EMPLOYMENT BENEFITS.

The Department of Budget and Finance (the "Department") supports the intent of House Bill No. 2240, H.D. 1, which authorizes the director of finance to issue an unspecified amount of general obligations (G.O.) bonds and makes an appropriation of the same to pay or prepay the State's other post-employment benefits (OPEB) liability. Unencumbered appropriation would lapse on June 30, 2024. The measure allows the director of finance to issue the bonds provided that: 1) to determine the annual required contribution, a preliminary annual required contribution be developed that treats the outstanding bond balance as part of the plan's unfunded actuarial accrued liability and that the net cash contribution required to be contributed to the plan shall equal the preliminary annual required contribution minus the bond repayment for the respective year; 2) the all-in true interest cost of the bonds must be at least three hundred basis points less than the assumed rate of return of the respective system; 3) the general obligation bonds shall not be issued as a means for addressing budget shortfalls related

to contributions required by law; and 4) the general obligation bonds may only be issued as a means to produce long-term savings.

The Department appreciates the strong support of the legislature in addressing the State's unfunded pension and OPEB liabilities. The State's OPEB funding requirement is now among the strongest, if not the strongest, in the nation.

Nonetheless, the State's OPEB unfunded actuarial accrued liability as of July 1, 2021, stood at \$8.125 billion, projected to be paid down through the year 2044.

State and local jurisdictions generally issue pension bonds or OPEB bonds because they expect to achieve greater returns on investments than the cost of the bonds over the long-term, providing arbitrage, and thus value for the taxpayer. However, there is risk that the investments can earn less than the cost of the bonds or even lose value, especially over the short-term. The intent of this measure is to address the additional risks involved by recognizing the savings from the targeted arbitrage as they happen, which increases the probability of achieving savings, reduces the risk of loss, and maintains consistent funding progress.

The requirement to consider OPEB bond debt in the calculation of the annual required contribution is intended to ensure continued strength of the OPEB funding policy and mitigate additional investment risk. Also, while in the long-term, pension and OPEB system investment programs are already highly likely to outperform bonds, requiring that the all-in true interest cost of OPEB bonds be a full 300 basis points, or three percent, less than the expected return the systems further increases the prospects for arbitrage and reduces long-term risk of loss, should conditions permit the issuance of the bonds.

The long-term expected return for EUTF investments has been determined, with the expertise of the plan's investment advisors and actuary, to be 7%. All-in true interest costs on the State's recent G.O. bond sales have been under 3%. This measure would currently permit the issuance of OPEB bonds if the all-in true interest cost on the bonds is 4% or less. Arbitrage earned through this approach could reduce future funding requirements and corresponding burden on taxpayers.

We would like to point out that should OPEB bonds be issued, the method of calculating the ARC as contemplated by this measure may cause the amount of the required contribution to be less than it would have been under the current approach to calculating the ARC. The committee may want to consider requiring the contribution amount to be the greater of the existing method of calculation or the calculation defined under this measure.

We are available to work with the Committee and the Employer-Union Health Benefits Trust Fund (EUTF) on this measure.

Thank you for considering our testimony.



HAWAII GOVERNMENT EMPLOYEES ASSOCIATION

AFSCME Local 152, AFL-CIO

RANDY PERREIRA, Executive Director • Tel: 808.543.0011 • Fax: 808.528.0922

The Thirty-First Legislature, State of Hawaii
House of Representatives
Committee on Finance

Testimony by
Hawaii Government Employees Association

February 23, 2022

H.B. 2240, H.D. 1 – RELATING TO
OTHER POST-EMPLOYMENT BENEFITS

The Hawaii Government Employees Association, AFSCME Local 152, AFL-CIO supports the purpose and intent of H.B. 2240, H.D. 1 which authorizes general obligation bonds for the payment of other post-employment benefits liability.

We view this proposed legislation as a novel approach and viable option to ensure the state meets its financial obligations for other post-employment benefits payments. We respectfully defer to the Department of Budget and Finance to suggest an appropriate amount of GO bonds that would comport with the state's financial plan.

Thank you for the opportunity to provide testimony in support of H.B. 2240, H.D. 1.

Respectfully submitted,

Randy Perreira
Executive Director

House Committee on Finance
Written Testimony By Wesley K. Machida on HB2240 HD1
February 23, 2022

Chair Luke, Vice Chair Yamashita, and Members of the House Committee on Finance:

I am in support of HB2240 HD1, as it provides a viable financing option (with appropriate safeguards) to be considered for addressing and managing the increasing employer contributions and unfunded actuarial accrued liability (UAAL) of the Hawaii Employer-Union Health Benefits Trust Fund (EUTF).

The State's annual general fund employer contribution requirement to the EUTF is projected to increase to over a billion dollars in the near future, with over \$8 billion in UAAL to the State and a total UAAL of over \$10 billion that includes the counties and their appropriate water supply agencies. As taxpayer monies are used to pay for these contributions and to pay down the liability, it may be appropriate to consider financing options that can help to reduce the future financial strain on the State, counties, and taxpayers.

There are financial risks with any financing opportunities; however, provisions in this proposal seeks to minimize risk such as requiring that the issuance be permissible if the all-in true interest cost of the bonds is at least three hundred basis points (3%) less than the assumed rate of return of the system, which currently stands at 7%. Furthermore, these bonds shall not be issued to address budget shortfalls, but as a means to produce long-term savings. For reference, the EUTF over the last 10 years has averaged about 9% in investment returns (which includes the impact of the pandemic) and over 8.4% since the inception of the EUTF, and could have derived savings over these time periods. In the July 1, 2021 Retiree Health Care Valuation (OPEB), the State's assets grew by \$580 million of which \$390 million was additional contributions. This additional contributions, along with favorable investment returns and claims experience, is expected to reduce the 2024 required contributions by \$48 million and further reduce required contributions in the future years. The financing option in this proposal, with its appropriate safeguards, can produce similar favorable results for the EUTF, its members and beneficiaries, employers, and taxpayers.

Thank you for the opportunity to provide my testimony and for your consideration of this important proposal. I will be happy to clarify any of the above or provide any additional information that the committee needs.