THE CIVIL BEAT
LAW CENTER FOR THE PUBLIC INTEREST

700 Bishop Street, Suite 1701
Honolulu, HI 96813

Office: (808) 531-4000
Fax: (808) 380-3580
info@civilbeatlawcenter.org

Senate Committee on Labor, Culture and the Arts
Honorable Brian T. Taniguchi, Chair
Honorable Les Ihara, Jr., Vice Chair

RE: Testimony Opposing S.B. 1084, Relating to Employees' Retirement System Investments
Hearing: February 12, 2021 at 3:20 p.m.

Dear Chair and Members of the Committee:

My name is Brian Black. I am the Executive Director of the Civil Beat Law Center for the Public Interest, a nonprofit organization whose primary mission concerns solutions that promote governmental transparency. Thank you for the opportunity to submit testimony **opposing the language in subsection (e) of the proposed amendment in S.B. 1084.**

I attended the August 28, 2020 meeting of the Legislative Committee of the Board of Trustees of the Employees' Retirement System. At that meeting, ERS informed the committee that it proposed the language in this bill so that ERS is "exempt from FOIA." ERS should not be exempt from our public records law.

The Law Center does not have a position concerning the exemption for specific documents concerning specific investments in subsection (d). Subsection (e), however, is far more broadly worded and could be read by ERS—in light of its desire to be "exempt from FOIA"—to justify withholding documents that currently are public.

To focus this bill on specific records and to avoid unintended consequences, the Law Center requests that the Committee **remove subsection (e)**. It is unnecessary. Neither OIP nor the courts have ever held that the specificity of a confidentiality statute means that an agency cannot rely on normal record exceptions. To the contrary, after determining that a record is not covered by a confidentiality statute, OIP consistently turns next to the determine whether the record may be withheld under the normal exceptions.

In the alternative, please amend subsection (e) to simply read:

> The foregoing categorical exemptions from chapter 92F are in addition to any other records otherwise exempt from disclosure pursuant to chapter 92F or other law.

Thank you again for the opportunity to testify.

DAVID Y. IGE
GOVERNOR

THOMAS WILLIAMS
EXECUTIVE DIRECTOR

KANOE MARGOL
DEPUTY EXECUTIVE DIRECTOR

STATE OF HAWAII
EMPLOYEES' RETIREMENT SYSTEM

TESTIMONY BY THOMAS WILLIAMS
EXECUTIVE DIRECTOR, EMPLOYEES' RETIREMENT SYSTEM
STATE OF HAWAII

TO THE SENATE COMMITTEE LABOR, CULTURE AND THE ARTS
ON

SENATE BILL NO. 1084

February 12, 2021
3:00 P.M.
Conference Room 225

RELATING TO THE EMPLOYEES' RETIREMENT SYSTEM INVESTMENTS

Chair Taniguchi, Vice Chair Ihara and Members of the Committees,

S.B. 1084 identifies certain specific types of alternative investment fund information, the disclosure of which would likely put the Employees' Retirement System ("ERS") at a competitive disadvantage, and therefore exempts such categories of information from disclosure under chapter 92F, Hawaii Revised Statutes (HRS), consistent with market best practices. With ERS' $14.6 billion unfunded liability and its 55.3% funded ratio, it is essential that ERS' assets be protected and its ability to be competitive in alternative private markets not be impaired. The ERS Board of Trustees strongly supports this legislation.

This bill amends section 88-103 to exempt certain specific types of alternative investment fund information from disclosure under chapter 92F. This is in order to enable the ERS to efficiently maintain the confidentiality of information relating to alternative investments such as investments in private equity, private credit and private real estate funds, consistent with competitive investment market best practices. S.B. 1084 also addresses concerns raised by S.B. 2869 during the 2020 session by further limiting the documents which may be exempt from disclosure requirements of chapter 92F, HRS, while still ensuring that the system will not be disadvantaged as a competitive investor.

In order to address the system's unfunded liability and other financial needs, the system, as a prudent investor, engages in diversified investment, including high-yield private alternative investment funds. Due diligence into such investments requires that the system invest time and money for detailed proprietary and confidential information regarding the projected performance of each fund. If the system is required to disclose such confidential information, the system is disadvantaged as a competitive investor. Competing investors would be able to acquire, at no cost, the system's investment intelligence, resulting in oversubscription of the system's best investments, reducing the system's access. Further, if the system is required to disclose confidential information which the investment funds require to be kept confidential, some high-performing funds will be deterred from allowing the system to invest with them. In order to manage such risks, the system currently expends significant resources and efforts in responding to requests for such confidential information.

This S.B. 1084 identifies certain, specifically listed categories of alternative investment fund information the disclosure of which would likely put the system at a competitive disadvantage, and therefore categorically exempts such categories of information from disclosure under chapter 92F, consistent with market best practices. A byproduct is that investment staff will be allowed to focus its attention on ERS high value investment activities as opposed to information gathering and disclosure to commercial entities.

The ERS Board of Trustees is in strong support of S.B. 1084.

Thank you for this opportunity to testify.

OFFICE OF INFORMATION PRACTICES

STATE OF HAWAII
NO. 1 CAPITOL DISTRICT BUILDING
250 SOUTH HOTEL STREET, SUITE 107
HONOLULU, HAWAII 96813
TELEPHONE: 808-586-1400 FAX: 808-586-1412
EMAIL: oip@hawaii.gov

To: Senate Committee on Labor, Culture and the Arts

From: Cheryl Kakazu Park, Director

Date: February 12, 2021, 3:20 p.m.
Via Videoconference

Re: Testimony on S.B. No. 1084
Relating to Employees' Retirement System Investments

Thank you for the opportunity to submit testimony on this bill, which would exempt certain specific types of alternative investment fund information from disclosure under chapter 92F, the Uniform Information Practices Act (Modified) (UIPA). The Office of Information Practices (OIP) offers comments explaining its lack of objection to this bill.

A version of this bill introduced last year drew concern that the language of its UIPA exemption was written loosely enough for the Employees' Retirement System (ERS) to assert in the future that the exemption did not apply only to the listed specific categories of protected alternative investment fund information, but also could be used to withhold any records related to managing and investing ERS funds. Although OIP had not testified to that concern, OIP understands how the looseness of the language in last year's version of this bill gave rise to it.

The exemption language in the bill as introduced this year has been tightened up, and OIP believes it makes clear that the only documents being statutorily exempted from the UIPA are the specifically listed categories of documents relating to alternative investments, and does not allow room for an

interpretation that the exemption might apply to records related to managing and investing ERS funds generally. After setting out a list of categories of records that are statutorily exempted from the UIPA, the bill goes on to specify that the categorical exemption for those records is in addition to any other UIPA exceptions that may apply to ERS records. OIP believes this makes clear that ERS records not falling into one of the listed categories of exempt records may be withheld to the extent they fall under one of the UIPA's generally applicable exceptions to disclosure, but are not automatically exempted from disclosure.

OIP finds the listed categories of records relating to alternative investments that would be statutorily exempted by this bill reasonably limited and specific, and based on the explanation in the bill's purpose clause, consistent with the UIPA's generally applicable exceptions to disclosure. The records to be protected would likely fall under the UIPA's frustration exception to disclosure in any case, so this bill would not restrict public access to a type of records that have historically been public under the UIPA, and OIP recognizes that having a specific statutory exemption will give confidence to alternative investments that ERS will not be required to publicly release their confidential information.

Thank you for considering OIP's comments.

UNITE HERE! LOCAL 5 HAWAII

Eric W. Gill, Financial Secretary-Treasurer Gemma G. Weinstein, President Godfrey Maeshiro, Senior Vice President

February 11, 2021

Committee on Labor, Culture and the Arts
Senator Brian Taniguchi, Chair
Senator Les Ihara, Jr., Vice Chair

Testimony in strong opposition to SB 1084

Chair Taniguchi, Vice Chair Ihara and Members of the Committee:

UNITE HERE Local 5 is **strongly opposed to SB 1084**. The Employees Retirement System fund is working people's money. Beneficiaries have struggled long and hard to ensure that they and their families can have the ability to retire with dignity. They have sacrificed other things they could have potentially negotiated in order to ensure that the retirement fund would be built. ERS is funded through public money, for the public benefit. Working people deserve to be able to see what their money is being invested in, whether those investments are suitable to their needs and concerns, and whether those investments are sound. This is not a pot of money for private equity firms to play around with.

Furthermore, private equity firms in particular need to be closely monitored by the public. While all PE firms may not have engaged in the all of misdeeds listed below, the prevalence of these issues by some PE firms makes transparency/ public disclosure critical.

A 2016 report by the Center for Economic and Policy Research states:

> Private equity general partners (GPs) have misallocated PE firm expenses and inappropriately charged them to investors; have failed to share income from portfolio company monitoring fees with their investors, as stipulated; have waived their fiduciary responsibility to pension funds and other LPs; have manipulated the value of companies in their fund's portfolio; and have collected transaction fees from portfolio companies without registering as broker-dealers as required by law. In some cases, these activities violate the specific terms and conditions of the Limited Partnership Agreements (LPAs) between GPs and their limited partner investors(LPs), while in others vague and misleading wording allows PE firms to take advantage of their asymmetric position of power vis-à-vis investors and the lack of transparency in their activities. In addition, some of these practices violate the U.S. tax code. Monitoring fees are a tax deductible expense for the portfolio companies owned by PE funds and greatly reduce the taxes these companies pay. In many cases, however, no monitoring services are actually provided and the payments are actually dividends, which are taxable, that are paid to the private equity firm.[i]

Further on, the report elaborates on fiduciary responsibility:

> Some Limited Partnership Agreements specifically state that private equity firms may waive their fiduciary responsibility towards their limited partners. This means that the general partner may make decisions that increase the fund's profits (and the GP's share of those profits —so-called carried interest) even if those decisions negatively affect the LP investors. This waiver has serious implications for investors, such as pension funds and insurance companies, which have fiduciary responsibilities to their members and clients. These entities violate their own fiduciary responsibilities if they sign agreements that allow the PE firm to put its interests above those of its members and clients.[ii]

Concerns about private equity have not disappeared since 2016. In fact, on June 23, 2020, the SEC Office of Compliance Inspections and Examinations ("OCIE") issued a risk alert about several common practices in private equity. In the report's introduction, the OCIE notes:

> Many of the deficiencies discussed below may have caused investors in private funds ("investors") to pay more in fees and expenses than they should have or resulted in investors not being informed of relevant conflicts of interest concerning the private fund adviser and the fund.[iii]

Here are a few excerpts of the OCIE's report:

> "The [OCIE] staff observed private fund advisers that preferentially allocated limited investment opportunities to new clients, higher fee-paying clients, or proprietary accounts or proprietary-controlled clients, **thereby depriving certain investors of limited investment opportunities without adequate disclosure.**"[iv] [emphasis added]

> "The staff observed private fund advisers that allocated securities at different prices or in apparently inequitable amounts among clients (1) without providing adequate disclosure about the allocation process or (2) in a manner inconsistent with the allocation process disclosed to investors, **thereby causing certain investors to pay more for investments or not to receive their equitable allocation of such investments.**" [v] [emphasis added]

> "Advisers charged private fund clients for expenses that were not permitted by the relevant fund operating agreements, such as adviser-related expenses like salaries of adviser personnel, compliance, regulatory filings, and office expenses, **thereby causing investors to overpay expenses.**" [vi]

> "Advisers failed to comply with contractual limits on certain expenses that could be charged to investors, such as legal fees or placement agent fees, **thereby causing investors to overpay expenses.**" [vii]

> "**Advisers failed to follow their own travel and entertainment expense policies, potentially resulting in investors overpaying for such expenses.**" [viii]

> "*Valuation.* The staff observed private fund advisers that did not value client assets in accordance with their valuation processes or in accordance with disclosures to clients (such as that the assets would be valued in accordance with GAAP). In some cases, the staff observed that this failure to value a private fund's holdings in accordance with the disclosed valuation process **led to overcharging management fees and carried interest** because such fees were based on inappropriately overvalued holdings." [ix]

Nor is this report the first time the OCIE has discussed issues within private equity. In a speech by then-director of the OCIE Andrew Bowden on May 6, 2014, he discussed the results of examinations the OCIE had been conducting on private equity advisers. Among other things, he stated:

> By far, the most common observation our examiners have made when examining private equity firms has to do with the adviser's collection of fees and allocation of expenses. When we have examined how fees and expenses are handled by advisers to private equity funds, we have identified what we believe are **violations of law or material weaknesses in controls over 50% of the time**.[x]

And

> So … when we think about the private equity business model as a whole, without regard to any specific registrant, we see **unique and inherent temptations and risks** that arise

> from the ability to control portfolio companies, **which are not generally mitigated, and may be exacerbated, by broadly worded disclosures and poor transparency.**[xi]

Beyond these issues related to the treatment of investors are issues about what private equity funds are invested in and how the funds make profits. For example, a November 2020 report issued by the Institute for Policy Studies discusses twelve examples of companies and billionaires whose wealth increased during the pandemic, including five private equity firms:

> In recent years, private equity firms and their billionaire backers have moved into sectors of the economy such as health care, grocery provision, and pet supply. **With their singular focus on aggressive cost cutting and profit extraction, these private firms are not oriented toward protecting their essential workers during a pandemic.** Among the "Delinquent Dozen" are several private equity firms that own or have large ownership stakes in multiple companies with essential workers. They could use their significant power and wealth to direct corporate managers to protect essential workers, but they have fallen short.[xii]

The people deserve the right to information about private equity investments. Please reject SB 1084.

Thank you.

---

[i] "Fees, Fees and More Fees:How Private Equity Abuses Its Limited Partners and U.S. Taxpayers," Center for Economic and Policy Research, May 2016, pg. 1. https://cepr.net/images/stories/reports/private-equity-fees-2016-05.pdf

[ii] "Fees, Fees and More Fees:How Private Equity Abuses Its Limited Partners and U.S. Taxpayers," Center for Economic and Policy Research, May 2016, pg. 3. https://cepr.net/images/stories/reports/private-equity-fees-2016-05.pdf

[iii] Risk Alert, SEC Office of Compliance Inspections and Examinations, June 23, 2020, pg. 1. https://www.sec.gov/files/Private%20Fund%20Risk%20Alert_0.pdf

[iv] Risk Alert, SEC Office of Compliance Inspections and Examinations, June 23, 2020, pg. 2. https://www.sec.gov/files/Private%20Fund%20Risk%20Alert_0.pdf

[v] Risk Alert, SEC Office of Compliance Inspections and Examinations, June 23, 2020, pg. 2. https://www.sec.gov/files/Private%20Fund%20Risk%20Alert_0.pdf

[vi] Risk Alert, SEC Office of Compliance Inspections and Examinations, June 23, 2020, pg. 5. https://www.sec.gov/files/Private%20Fund%20Risk%20Alert_0.pdf

[vii] Risk Alert, SEC Office of Compliance Inspections and Examinations, June 23, 2020, pg. 5. https://www.sec.gov/files/Private%20Fund%20Risk%20Alert_0.pdf

[viii] Risk Alert, SEC Office of Compliance Inspections and Examinations, June 23, 2020, pg. 5. https://www.sec.gov/files/Private%20Fund%20Risk%20Alert_0.pdf

[ix] Risk Alert, SEC Office of Compliance Inspections and Examinations, June 23, 2020, pg. 5. https://www.sec.gov/files/Private%20Fund%20Risk%20Alert_0.pdf

[x] "Spreading Sunshine in Private Equity," speech by Andrew J. Bowden, Director, Office of Compliance Inspections and Examinations, at the Private Equity International (PEI), Private Fund Compliance Forum, May 6, 2014. https://www.sec.gov/news/speech/2014--spch05062014ab.html

[xi] "Spreading Sunshine in Private Equity," speech by Andrew J. Bowden, Director, Office of Compliance Inspections and Examinations, at the Private Equity International (PEI), Private Fund Compliance Forum, May 6, 2014. https://www.sec.gov/news/speech/2014--spch05062014ab.html

[xii] "Billionaire Wealth vs. Community Health: Protecting Essential Workers from Pandemic Profiteers," by the Institute for Policy Studies, Bargaining for the Common Good and United for Respect, November 2020, pg. 5.