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GOVERNOR



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STATE OF HAWAII
EMPLOYEES' RETIREMENT SYSTEM

TESTIMONY BY THOMAS WILLIAMS
EXECUTIVE DIRECTOR, EMPLOYEES' RETIREMENT SYSTEM

STATE OF HAWAII
TO THE HOUSE COMMITTEE ON FINANCE
ON

SENATE BILL NO. 3070 H.D. 1

March 28, 2024

3:30 P.M.

Conference Room 308 and VIA Videoconference

RELATING TO THE EMPLOYEES' RETIREMENT SYSTEM FUNDING PERIOD.

Chair Yamashita, Vice Chair Kitagawa, and Members of the Committee,

S.B. 3070 H.D. 1, proposes to add a definition of the "maximum funding period" under Section 88-21 to decrease the maximum projected funding period limit in which to amortize the total unfunded actuarial accrued liability (UAAL) of the Employees' Retirement System (ERS) prescribed in Section 88-122(e) from thirty years to twenty years. The bill seeks to achieve this reduction by initially lowering the maximum funding period from thirty to twenty-five years for fiscal year end 2024, then lowering the limit by one year for each of the next five fiscal years, to end with a twenty-year funding period limit at fiscal year-end 2029 and thereafter. Exceeding the mandated funding limit would prompt an adjustment to the employer's normal cost and accrued liability contributions and/or a review of the plan's benefit structure.

The ERS Board of Trustees supports the bill and its intent to strengthen both the ERS' funding policy and the State's long term financial positions by providing a means for a more prudent and timely response to increases in the plan's UAAL.

Although the UAAL is not projected to breach the current 30-year funding period, should the system experience a continued adverse investment environment with returns of 5% instead of the assumed 7% benchmark or other unanticipated growth in liabilities, the



Employees' Retirement System
of the State of Hawaii

proposed lower maximum funding periods would initiate a more timely review of the plan's funding and benefit structure. The intent of which would be to address the growth of the UAAL by either modifying the plan's benefit structure or slowly increasing contribution rates by approximately 1.5% and potentially achieve 100% funding a decade earlier in this scenario. In comparison, the 30-year funding would never be breached to then address the growth in the UAAL.

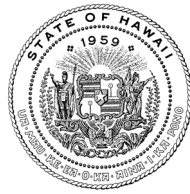
The proposed 20-year maximum funding period would be estimated to save more than \$50 billion in total contributions over the long term in comparison to the current 30-year period in the previous scenario, according to ERS' actuary, Gabriel, Roeder, Smith & Company. This fiscally judicious funding policy would save the State money over the long-term and align the Hawaii ERS with the majority of large pension plans nationally as well as with the EUTF, which utilizes a 20-year maximum funding period for its liabilities. The policy change would also be viewed very favorably by the State's bond rating agencies.

While 30-year funding periods were common in the past, industry best practices have moved in favor of more responsive and fiscally responsible shorter periods. Moving to the proposed 20-year maximum funding period would not only provide for a more rapid response to substantial adverse investment experience or other causes but would also avoid further growth of any initial unfunded liability, known as negative amortization. Savings result from avoiding the compounding cost of interest payments on the liability.

The bill proposes to have the year-over-year stepdown reduction in the maximum funding period mirror the forecasted continued annual reduction in the UAAL. The first year of the reduction of the proposed maximum funding period as of June 30, 2024 would be set at 25 years, while the ERS' funding period (currently 23 years) of the UAAL is projected to be 22 years on that date. Supposing all assumptions are met along with a continued commitment to current contribution levels, it is projected that the UAAL is unlikely to breach the proposed 20-year maximum funding periods and should not trigger the statutorily required review. The maximum funding period would lower to 20 years at FY end 2029 and remain there. The forecasted maximum funding period at that time is 17 years.

S.B. 3070 was passed by the Senate Committee on Labor and Technology on February 9, 2024 (See S.S.C.R. No. 2431) and the Senate Committee on Ways and Means on February 28, 2024 (See S.S.C.R. No. 2913). The Senate passed S.B. 3070 on third reading on March 5, 2024. The House Committee on Finance passed S.B. 3070 H.D. 1 with amendments on March 14, 2024. (See H.S.C.R. No. 1167-24).

Thank you for the opportunity to provide testimony on S.B. 3070 H.D. 1.



JOSH GREEN, M.D.
GOVERNOR

SYLVIA LUKE
LIEUTENANT GOVERNOR

LUIS P. SALAVERIA
DIRECTOR

SABRINA NASIR
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EMPLOYEES' RETIREMENT SYSTEM
HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
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FINANCIAL ADMINISTRATION DIVISION
OFFICE OF FEDERAL AWARDS MANAGEMENT

TESTIMONY BY LUIS P. SALAVERIA
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
TO THE HOUSE COMMITTEE ON FINANCE
ON
SENATE BILL NO. 3070, H.D. 1

March 28, 2024
3:30 p.m.
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RELATING TO THE EMPLOYEES' RETIREMENT SYSTEM FUNDING PERIOD

The Department of Budget and Finance (B&F) supports this Administration bill.

Senate Bill No. 3070, H.D. 1, amends Chapter 88, HRS, to: 1) add a new definition for "maximum funding period" to reduce the amortization period cap of the Employees' Retirement System's (ERS) unfunded accrued actuarial liability (UAAL) from 30 years to 25 years as of June 30, 2024, then reduce it further by an additional year every subsequent year until it reaches 20 years as of June 30, 2029; and 2) make other amendments for consistency.

B&F strongly supports this bill that would align the maximum funding period for the ERS' UAAL with current actuarial industry guidance in a phased-in manner. This is not anticipated to affect the pension accumulation contribution rates and annual costs for public employers since the funding period as of June 30, 2023, has already reached 23 years, and is expected to continue to decline annually. Furthermore, the reduction of the maximum funding period is expected to have a positive impact on the State's credit ratings and long-term borrowing costs.

Thank you for your consideration of our comments.

TAX FOUNDATION OF HAWAII

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SUBJECT: MISCELLANEOUS, Lower Funding Period in Employees' Retirement System

BILL NUMBER: SB 3070 HD 1

INTRODUCED BY: House Committee on Labor & Government Operations

EXECUTIVE SUMMARY: Lowers the Employees' Retirement System's funding period from 30 years to 20 years to amortize the System's total unfunded accrued liability.

SYNOPSIS: Amends section 88-21, HRS, to add a new definition of “maximum funding period” as a period over which the amortization of the unfunded accrued liability shall not exceed twenty-five years as determined by the actuarial valuation as of June 30, 2024, twenty-four years as determined by the actuarial valuation as of June 30, 2025, twenty-three years as determined by the actuarial valuation as of June 30, 2026, twenty-two years as determined by the actuarial valuation as of June 30, 2027, twenty-one years as determined by the actuarial valuation as of June 30, 2028, and twenty years as determined by the actuarial valuation as of June 30, 2029, and thereafter.

Amends section 88-122(e), HRS, to replace “thirty years” with the new defined term.

EFFECTIVE DATE: July 1, 3000.

STAFF COMMENTS: This is an Administration measure sponsored by the Department of Budget & Finance and designated BUF-10 (24). Both Senate committees to which it was referred passed the measure as is.

The change proposed by this bill can be thought of as similar to refinancing a 30-year mortgage and replacing it with a 20-year mortgage. The good news is that the total carrying costs, primarily interest, will be greatly reduced over the term of the loan. The bad news is that the monthly payment will be significantly higher.

The debt that we are talking about with this bill is huge. The Unfunded Actuarial Accrued Liability (UAAL) of the ERS, as of fiscal year 2021-22, was \$14.6 billion. This amount is the difference between the present value of what ERS expects to pay out and the present value of the assets it has. By comparison, the amount appropriated to run all of our state government for one year, in this case fiscal year 2022-23, was \$17.2 billion.

We have not seen figures showing the difference in annual required contributions that each of the governmental employers are going to have to make under the plan as amended versus the present plan. We anticipate that the number will be quite large. If the adoption of the plan will require loads of additional taxes from an already overtaxed citizenry, we question whether the change will be worth the social cost.

Digested: 3/26/2024