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# TESTIMONY BY LUIS P. SALAVERIA
# DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
# TO THE SENATE COMMITTEE ON LABOR AND TECHNOLOGY
# ON
# SENATE BILL NO. 3070

**February 9, 2024**
**3:15 p.m.**
**Room 224 and Videoconference**

RELATING TO THE EMPLOYEES' RETIREMENT SYSTEM FUNDING PERIOD

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

Senate Bill No. 3070 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.

JOSH GREEN, M.D.
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 ON LABOR AND TECHNOLOGY

ON

SENATE BILL NO. 3070

**February 9, 2024**

**3:15 P.M.**

**Conference Room 224 and VIA Videoconference**

RELATING TO THE EMPLOYEES' RETIREMENT SYSTEM FUNDING PERIOD.

Chair Aquino, Vice Chair Moriwaki, and Members of the Committee,

S.B. 3070, 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.

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 proposed lower maximum funding periods would initiate a quicker review of the plan's funding. The intent of which would be to address the growth of the UAAL by slowly increasing contribution rates by about 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. Additionally, it would also be viewed 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 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 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 maximum funding periods and should not trigger the statutorily required contribution review for adjustment. 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.

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

LEGISLATIVE TAX BILL SERVICE

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 305 Honolulu, Hawaii 96813 Tel. 536-4587

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

BILL NUMBER: HB 2381, SB 3070

INTRODUCED BY: HB by SAIKI; SB by KOUCHI (Governor's Package)

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: Upon approval.

STAFF COMMENTS: The change proposed by this bill can be thought of as similar to refinancing a 30-year mortgage and replacing it with a 15-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 your 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: 2/4/2024