Photo: Panoramic view of Haleakala Crater on Maui

2017 Employees' Retirement System Legislative Proposals

The 29th Legislature opened its 2017 session on Wednesday, January 18, 2017. By January 25th, the cut-off date for bill introduction, there were almost 3,000 House and Senate Bills proposed. Five ERS-related proposals were submitted through Governor Ige's administrative proposals package and are summarized below:

HB 1061 and SB 927 - Relating to the Employees' Retirement System and Employer Contribution Rates

This proposal provides for increased rates for employer contributions to the ERS beginning with fiscal year 2017-2018. The employer contributions that State and county agencies are required to make to the ERS to meet obligations for retirement benefits are based on a percentage of payroll. Section 88-122, Hawaii Revised Statutes, provides that the contribution rates are subject to adjustment if the period required to amortize the unfunded accrued liability of the system exceeds thirty years. Based on a five-year actuarial experience review performed as of June 30, 2016, the ERS actuary recommended changes to the actuarial assumptions used for the actuarial valuation of the system. Those assumptions, which include longer member life expectancy and lower assumed investment returns, resulted in an unfunded liability amortization period in excess of thirty years. Providing that no benefit changes are made, the actuary recommended and the ERS Board approved, a four-year phased-in increase in the employer contribution rate from 25 percent to 41 percent for police officers, firefighters, and corrections officers, and a four-year phased-in increase in the employer contribution rate from 17 percent to 25 percent for all other employees. These increases are expected to begin in the 2017-2018 fiscal year and continue through the 2020-2021 fiscal year and remain at the final increased rates therafter.

HB 1063 and SB 929 - Relating to the Employees' Retirement System and Unclaimed Property

The ERS is required to return member contributions and to commence the payment of benefits to members, former members, beneficiaries, or other persons or entities at certain required distribution dates. Despite our best efforts, the ERS sometimes cannot locate the member, former member, beneficiary, person or entity to be paid. This bill would preserve the ERS's use and control of unclaimed member contributions and benefit payments by suspending and forfeiting them to the ERS prior to the time that they would be required to be paid to the State's Unclaimed Property Program or escheated to another state. In addition, the bill preserves the ability of the member, former member, beneficiary, or other person or entity to recover the forfeited contributions or benefit payments by providing a means for those persons or entities to apply to the ERS for recovery of those forfeited contributions and benefit payments.

HB 1065 and SB 931 - Relating to the Actuarial Costs of Separation of Public Employees from Service

The purpose of this bill is to ensure that an employer who separates a significant number of employees from public service bears the economic responsibility to the ERS for the consequences of such action. The ERS is a cost-sharing plan in which all employers contribute and from which all

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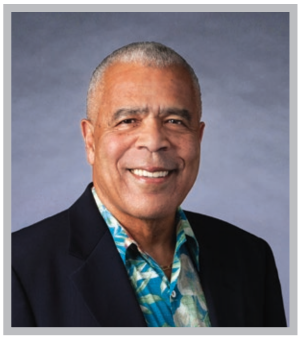
Message From The Executive Director

Actual Cost of Benefits Unaffected by Assumptions



The ERS Board's decision in December to adopt new, more conservative investment and mortality assumptions, with the goal of maintaining the plan's current funding trajectory, is improperly viewed by some as increasing the plan's longer-term costs.

Over time, the true cost of benefits is not affected by actuarial assumptions. The true cost of benefits is borne out in the plan's actual member experience (termination, retirement, and longevity), the plan's benefit provisions and its actual investment returns. At the end of the day, contributions and investment earnings must equal benefits plus expenses (C+I = B+E). Assumptions don't affect the plan's ultimate costs, they merely dictate the timing of the contributions required in order to pay the promised benefits, i.e. the cost of the plan. A lower investment return assumption serves to pull required contributions forward, generally resulting in higher near-term contributions and lower long-term costs. Higher investment return assumptions tend to lower current contribution requirements and potentially understate the plan's overall liabilities while deferring payment into the future. The Board's challenge is to employ the best available information as to past experience and future expectations in order to achieve the optimum balance between paying now and paying later. Of course, paying later is almost always more expensive.

The largest factor affecting the level and timing of contributions is investment earnings followed closely by member longevity. While we can make assumptions about each, in the end each is subject to a reality which we can't fully control. ERS's realized investment returns of 5.8% over the ten-year period ending September 30, 2016, can be viewed as annually illustrative of two points. First, although our plan's long-term investment performance compares favorably to the median public fund (5.8%), it nonetheless has fallen below our long-term assumed rate. Next, it reflects an overall but steady decline in capital market returns. Economists, investment managers and academics are near consensus in forecasting diminished future capital market returns and inflation expectations relative to the last 10 or 20 years.

Will we earn more or less than forecast? No one can know for sure but we are taking steps to position our portfolio and our investment staff to take optimum advantage of the opportunities presented. Enhancing our program's investment capabilities and expertise represents perhaps the greatest opportunity available to lower employer contributions to the plan relative to its long-term costs.

The second most impactful factor impacting the plan's benefit obligations and cost is mortality, or in other words, how long our membership lives after retirement. The people of the State of Hawaii, and the ERS membership in particular, enjoy the longest life expectancy of any state population in the nation. This requires that we pay a stated level of benefits for what is relatively a longer period of time. While this poses a challenge, it's one we're apt not to complain about.

Properly funding public pension funds is a vital and complex business. The ERS's experienced and dedicated board, supported by professional staff and expert consultants, is unquestionably best suited to make those decisions which assure that the plan is run professionally and with the best interest of its members and beneficiaries in mind. That solemn responsibility, accompanied by the best available information, guides our every decision.

Thom Williams

Ua ʻIke Anei ʻOukou? (Did you know?)

The ERS website has frequently-requested forms for active members, retirees and employers. Just go to the "Resources" menu at http://ers.ehawaii.gov and refer to "All Forms."

Report from Vijoy Chattergy, Chief Investment Officer

Aloha Kãkou,

In the previous *Holomua* article, I articulated the case for why the ERS investment portfolio has increased in complexity compared to 25 years ago. I invoked the notion that things should be as simple as possible, but no simpler. This is a good rule of thumb to live by and construct investment portfolios, but it offers no insight as to why the portfolio is no simpler today. We need to consider how our understanding of investment management has evolved.

Let's focus on the notions of return and risk, and how the combination of these two ideas reshaped how different assets are combined optimally to achieve better investment results. The topic is appropriate now because the new ERS portfolio design is predicated on risk-taking driving expected returns.

To get started, we will again draw an analogy from physics and Professor Einstein. Before Einstein's theory of special relativity, space and time operated much as we all experience it. In space, we can move up-down, left-right, and forward-backward. In time, we move linearly from the past to the present and into the future. Everything is as it appears, and reality is experienced the same for everyone.

After Einstein's theory we have the insight into something called the space-time continuum, where the experience of space and time can be different for agents in the world moving around at different speeds. This is hardly intuitive or natural to how any of us experiences reality. And yet, this insight helps to explain a great many natural phenomena.

Returning to investment management, prior to 1952 when Harry Markowitz proposed Modern Portfolio Theory ("MPT"), the idea that returns should be optimized based on a given level of risk was not formally recognized. At best, the trade-off between return and risk was linear. At worst, investors did not even consider risk, and simply evaluated investment acumen based on how much the portfolio grew. The naive asset owner would just demand that her/his portfolio just make money, or that an X% return was good or bad without an appreciation for what risks were taken to achieve the outcome.

After Professor Markowitz's insight, investors understood that portfolio construction is an exercise in maximizing expected returns for a given level of market risk. It is no longer satisfactory to look at a single number and declare investment performance adequate. Instead of looking at return measures like percentage or dollar value in isolation from risk metrics like standard deviation or variance, the two numbers need to be combined into risk-adjusted ratios such as the Sharpe and Sortino ratios which present a more thorough and precise illustration of what those results really mean.

As in science with the space-time continuum, in investment management the risk-return space helps to provide a more robust and comprehensive understanding of how the world works. All that comes with risk-return space, such as portfolio diversification and factor driven returns, are at the core of the ERS's functional risk allocation portfolio construction design. The policies governing the new approach are available online, but more importantly as we move into 2017, the implementation of the portfolio is nearing completion.

The journey to this point is one that the Board of Trustees has boldly undertaken with expert advice from external consultants and professional staff. The Board has built a modern portfolio with innovative ideas from academia and industry. As with good science, good investment management is conducted when the professionals are true to their principles and standards. That spirit was captured by the 17th century philosopher/scientist Galileo Galilei who, after having to recant his correct theory that the earth moves around the sun, is said to have whispered, *"E pur si muove"* ("and yet it moves"). Let's not restrict the professionals from practicing science or finance, but hold them accountable to rigorously tested theories and results.

Continued from cover

employees receive benefits. The elimination of State and county employee positions, through privatization or closure of State or county facilities or through workforce restructuring, can have an adverse impact on the funded status and sustainability of the ERS. If an employer reduces the employer's payroll by eliminating employee positions, the employer's contributions to the system are reduced, including payments towards the accrued pension liability. This bill will require that the employer shall compensate the ERS for the actuarial loss incurred by the separation of these employees.

HB 1067 and SB 933 - Relating to Investment Personnel of the Employees' Retirement System

Successful investment of the funds of the ERS is one of the primary foundations to the stability and sustainability of the system. ERS's investment staff assists and advises the Board with structuring the System's investment portfolio and currently consists of a Chief Investment Officer and five investment professionals, two of whom are civil service employees. Management of the complexity and diversity of the ERS's investment portfolio requires the experience and expertise of seasoned professionals. The purpose of the bill is to allow the ERS Board of Trustees, through its executive director, to appoint one or more investment specialists who will be exempt from civil service limitations.

HB 1070 and SB 936 - Relating to the Employees' Retirement System – "Housekeeping" Amendments

This bill proposes several "housekeeping" measures:

(1) To correct the anomaly of the finalized retirement adjustment period for December 31 retirees to be consistent with the full six month finalized adjustment period of members retiring on the first of the month and to adjust the interest rate on underpayments if benefits are not finalized within six months from the date of retirement.

(2) To address employer concerns regarding the amount of time between when the employers are billed for additional retirement contributions due to their employees retiring with significant non-base pay increases and the due date of the payment.

(3) To improve service provided to members and beneficiaries applying for disability retirement and accidental death benefits by reducing the direct involvement of the Board of Trustees of the ERS and allowing ERS staff to play a greater role in the process. Also allows the Board of Trustees to have medical reviews of disability retirement and accidental death claims performed by a designated entity in addition to the ERS medical board.

These bills and other legislation may be reviewed on the Hawaii State Legislature website at http://www.capitol.hawaii.gov.

2017 Neighbor Island Retirement Workshops

We're pleased to announce that our 2017 neighbor island retirement workshop schedules have now been posted to the ERS website at http://ers.ehawaii.gov under Members->Retirement Planning. The schedules include dates, times, locations and registration instructions for each island. The ERS neighbor island office staff on Hawaii Island, Maui, and Kauai sponsor and conduct these workshops for active members of the State and county on their island. Workshops include pre-retirement and informational sessions covering ERS benefits.

For our neighbor island membership, please register directly with each neighbor island office. You'll find registration forms printed on the schedules. Registering early is recommended, as the number of attendees for each session is limited.

For Active Members

ERS Brown Bag Sessions

As a reminder, here is our schedule for the remaining Brown Bag sessions for the first half of 2017:

Date	Retirement Plan	Time	Location
April 5	Noncontributory	11:30 pm to 12:30 pm	City Financial Tower-ERS 201 Merchant Street, Suite 1400
April 19	Hybrid		

To register, please call our office at 586-1735 at least one week prior to the scheduled workshop. Each session is limited to thirty-five (35) members. On the day of the session, please report to the 14th floor in our building and staff will accompany you to the conference room. Feel free to bring your lunch. Please note that limited parking is available in our building.

Our fall Brown Bag sessions schedule will be published in the next issue of the *Holomua*.

Addressing the ERS Unfunded Liability

The ERS actuary reported that as of June 30, 2016, the ERS is approximately 54.7% funded with a $12.4 billion unfunded liability. Actuaries review and "diagnose" the funded health of a pension plan, project a "prognosis" of its durability and suggest current changes to ensure its future health. The ERS's unfunded actuarial accrued liability (UAAL) indicates that the ERS does not currently have all the money needed to pay future benefits. Similar to a mortgage, the unfunded liability is generally "amortized" or funded over not more than 30 years. The period for the ERS to become fully funded, according to the report of the actuary presented in January 2017, is estimated to be 66 years.

Managing this unfunded liability is the responsibility of the ERS through its investments, its employer and employee contributions and by monitoring its benefits. To this end, the ERS depends on the legislature to adjust contributions (which are mandated by statute) and to help curb retirement benefit enhancements (also statutorily mandated) to ensure that the fund becomes and stays fully funded.

Investment earnings provide the largest source of income for the ERS. The investment office of the ERS supports the overall goals and objectives of the ERS, particularly through investment portfolio design and management and by applying investment skills on behalf of the ERS Board of Trustees. The investment office analyzes and recommends financial investment opportunities for the sole benefit of the ERS members and beneficiaries.

All of the benefit changes in 2011 which created a new tier of employees after June 30, 2012, including the 2011 moratorium on retirement benefits and the 2012 exclusion of overtime for new employees, will help the ERS to draw down the plan's unfunded liability and, once 100% funded, to ensure that it remains solvent for the future.

For Retirees

Tax information follow-up

If you received benefits from the ERS during 2016, your 2016 Form 1099-R was mailed to your home address by January 31, 2017. For foreign persons who received benefits from ERS during 2016, your 2016 Form 1042-S was mailed to your home address by February 28, 2017. If you haven't received your form, please call our office to request a reprint. Please allow at least one week for mail delivery to a US address and two weeks for delivery to a foreign address. If your address has changed, please provide us with your new address when requesting a duplicate form.

For those who received benefits from ERS during 2016 due to either a service-connected (work related) disability or death, an Annual Nonreportable Benefit Notice was mailed to your home address by February 1, 2017, for the portion of your pension benefits that are considered payments in the nature of workers' compensation and, therefore, excludable from gross income under Internal Revenue Code (IRC) Section 104(a)(1). If a portion of your benefits is taxable, you should have received a 2016 Form 1099-R by January 31, 2017.

For more information you may want to review:

- the Retiree FAQ section of the ERS website http://ers.ehawaii.gov (Retirees/Retirees FAQs) or
- information on the IRS website (http://www.irs.gov) such as IRS Publication 575, Pension and Annuity Income, the instructions for IRS Form 1040 U.S. Individual Income Tax Return

To change the amount of taxes withheld for 2017, please complete Form W-4P, Withholding Certificate for Pension or Annuity Payments. Form W-4P is available under the Retirees>>Pension Forms section of our website or you may call our office to have the tax withholding form mailed to you. Form W-4P may also be obtained from the IRS or downloaded from the IRS website.

Active Employee News

Open Enrollment

The Open Enrollment period for all EUTF Active Employee Health and Life Insurance plans, including HSTA VB plans, will be from April 3, 2017 through April 28, 2017. Now is the time when you should stop and think about health coverage for yourself and your family and determine which plan will best meet your needs for the new plan year (July 1, 2017 through June 30, 2018). Open Enrollment is your only opportunity to make changes without a qualifying event during the plan year such as needing to enroll a new dependent due to marriage or birth. EC-1/EC-1H (for employees enrolled in HSTA VB plans) forms must be submitted to your employer's Open Enrollment designee by April 28, 2017.

Here are some important dates to remember:

• Open Enrollment election period:	April 3, 2017 through April 28, 2017
• Rate changes effective:	July 1, 2017
• New premiums deducted from paycheck:	July 15, 2017 through June 30, 2018 (County Employees) July 20, 2017 through July 5, 2018 (State Employees)
• Plan period:	July 1, 2017 through June 30, 2018

Active employees should pay special attention to the premium rates listed in the 2017 Reference Guide which can be found at eutf.hawaii.gov: Look under: News > New-Active Open Enrollment 2017. Please note that the premium rates that are included in the reference guide are the continuation of the July 1, 2016 to June 30, 2017 employer contributions, limited to the actual premium, until a collective bargaining agreement is reached.

Visit EUTF's website at eutf.hawaii.gov to review the 2017 Reference Guide which includes the changes to the plan benefits and a schedule of Open Enrollment Informational Sessions. At these Informational Sessions, the EUTF and the insurance carriers will provide information on changes to the plans as well as tips on what to consider in selecting the right plan for you and your family and how to better utilize your EUTF health benefits.

Thinking of Retiring?

New in 2017, EUTF is conducting Pre-Retirement Lunch N' Learn Workshops! Employees can bring their lunch and join us for a 45-minute workshop on applying for EUTF retiree health benefits. Sessions will be held on the following dates at the EUTF office at: 201 Merchant Street, Suite 1700, Honolulu, HI 96813

May 5, 2017 at 11:30 AM and 12:30 PM · May 17, 2017 at 11:30 AM and 12:30 PM
June 1, 2017 at 11:30 AM and 12:30 PM · June 23, 2017 at 11:30 AM and 12:30 PM

Please email eutf.outreach@hawaii.gov or call 586-7390 ext. 75537 to reserve your spot. Attendance is limited and on a first come, first served basis.

PCP Enrollment (For State Employees Only):

The Premium Conversion Plan (PCP) is a voluntary benefit plan, administered by the State Department of Human Resources Development (DHRD) that allows employees to pay their health benefit plan premiums on a pretax basis and is being offered pursuant to Section 125 of the Internal Revenue Code. For more information, go to the DHRD website at http://dhrd.hawaii.gov.

By electing to participate in PCP, please note that:

1. Your authorization will automatically continue year-to-year for the duration of the plan until you change or cancel your participation in PCP during the Open Enrollment period or as provided under number 2 below.
2. If you have an allowable change in status event (e.g., marriage, birth or adoption of children, divorce, etc.), you must complete/file all the required PCP forms within 90 days of the event, to change or cancel your reduction in pay (otherwise, changes can be made only during the Open Enrollment period). Please note that you must notify the EUTF within 30 days of the event in order to make the change in coverage.

***Important:** The EUTF is a separate organization from the ERS. If you have any questions about information in these articles, please contact the EUTF directly. Contact information: 586-7390, 1-800-295-0089 toll free; Email: eutf@hawaii.gov*

3. Allowable changes/cancellations shall become effective as soon as administratively possible, on a **prospective** basis, after you file your forms (e.g. the beginning of the pay period following receipt of your form). To avoid the risk of losing money, you need to file the forms as soon as possible. Changes in pre-tax payroll deductions are always done after receipt of the PCP-2 forms, never retroactively.

   Example #1:
   - Employee acquires health coverage through spouse's plan effective July 1, 2017.
   - Employee has 30 days to submit Enrollment Change form to terminate coverage.
   - Employee submits and Enrollment Change form to their Human Resources Officer (HRO) on July 7, 2017.
   - EUTF terminates coverage effective June 30, 2017.
   - PCP allows payroll deduction change to become effective July 16, 2017, prospective (next pay period) from the date the HRO receives the Enrollment Change form.
   - Employee suffers one pay period forfeiture (July 1 through 15, 2017).
   - If employee had submitted their Enrollment Change form to the HRO on or before June 30, 2017, there would be no forfeiture.

4. If you change/cancel your health insurance plan coverage, but your PCP change/cancellation is not allowable (e.g. Enrollment Change form is submitted more than 90 days after the event date), your PCP payroll deduction will not be changed through the end of the plan year and your payments will be forfeited until PCP change/cancellation forms are filed and approved during the next Open Enrollment period.

   Example #2:
   - Employee has a divorce effective July 3, 2017 that changes coverage from 2-party to self.
   - Employee submits Enrollment Change and PCP forms to their personnel office on November 2, 2017 (more than 90 days after the event).
   - EUTF terminates coverage for the ex-spouse effective July 15, 2017. The employee will be responsible for his/her ex-spouse's claims after July 15, 2017.
   - PCP does not allow any change to the payroll deduction since forms were turned in 90 days after the event. Therefore, for the entire plan year, July 1, 2017 through June 30, 2018, the employee's payroll deductions will be based on 2-party coverage. There will be no refund of the difference between the 2-party and self coverage payroll deduction amounts.

Active Employee and Retiree News from the EUTF

Get Healthy With Coaching

Did you know that HMSA and Kaiser Permanente offer telephonic health coaching at no charge? Coaches can help you reduce stress, manage your weight, eat better, get more active and manage chronic conditions. To learn more about this program or to schedule a convenient telephone session with your personal coach call your health plan today. HMSA members call 1-855-329-5461 toll-free Monday – Friday 8:00 a.m.– 7:00 p.m. and Saturday 8:00 a.m.– 5:00 p.m. Kaiser Permanente members call 808-432-2262 or 808-432-2260 Monday – Friday 8:00 a.m.–4:00 p.m.

Common Qualifying Events and Submission of Supporting Documents

You must complete an EC-1/EC-1H (for employees enrolled in HSTA VB plans) form within 30 days (180 days for newborns) from the effective date of the qualifying event and submit supporting documentation to the EUTF within 60 days of the qualifying event (60 days of enrollment for newborns). Failure to submit proof of documents to the EUTF by the deadline, will result in the reversal of the enrollment change retroactive to the event date.

For a complete listing of qualifying events, visit the EUTF website at eutf.hawaii.gov.

Employees' Retirement System
of the State of Hawaii
201 Merchant Street, Suite 1400
Honolulu, HI 96813-2980

How to Contact ERS-Pension

Monday-Friday 7:45 a.m. - 4:30 p.m.
(Except State holidays)
For pension related questions, please contact ERS at:

O'ahu Office, (808) 586-1735
Kaua'i Office, (808) 274-3010
Hawai'i Office, (808) 974-4077
Maui Office, (808) 984-8181

Moloka'i and Lana'i, (Toll free to Maui): 1-800-468-4644, ext. 48181

Continental U.S. toll free to O'ahu: 1-888-659-0708

http://ers.ehawaii.gov

How to Contact EUTF-Medical Coverage

Monday-Friday 7:45 a.m. - 4:30 p.m.
(Except State holidays)
For medical coverage and Medicare reimbursements, please contact EUTF at:

(808) 586-7390
toll-free at 1-800-295-0089 or
email at eutf@hawaii.gov

Ask ERS

Answers to some frequently asked questions:

Q: Why is the ERS identified as a "Trust Fund"?

A: ERS funds are held in trust and must be used for the exclusive benefit of its members. ERS is also a "defined benefit" plan which means that it needs to have enough assets to pay benefits to current retirees and surviving beneficiaries as well as future benefits being earned by active employees. As a "prefunded" system, investment earnings and employee and employer contributions paid over a member's career should pay for the future retirement benefits of those members. These contributions are invested to gain the best possible return while maintaining a reasonable level of risk. Your Board of Trustees oversees the investment of the ERS Trust Fund and their decisions (investments, benefits, or otherwise) are for the sole and exclusive benefit of the ERS members and beneficiaries.

Q: What is the significance of ERS's -1% investment performance number that has been in the press lately?

A: The -1% performance number measures the past 12-month investment return from June 30, 2016 back to July 1, 2015. That is a 12-month return for the fiscal year 2016. This fiscal year return has significance because it is used by the ERS Board on the advice of the ERS's actuary to value the plan's assets and to project its funding status into the future. For perspective, the same 12-month look-back number measured in September 2016 and December 2016 was approximately +10% and +8%, respectively.