State of Minnesota \ LEGISLATIVE COMMISSION ON PENSIONS AND RETIREMENT

COLA Study Report

Presentation by
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2018 Pension and Retirement Bill

- **The 2018 Pension and Retirement Bill directed the LCPR to study postretirement adjustments.**
- **A postretirement adjustment, also called a cost-of-living adjustment or COLA, is an annual percentage increase in a retiree's pension amount.**
- **The LCPR study was required to:**
  - "take into account the purpose of postretirement adjustments and whether governing statutes are consistent with the purpose of postretirement adjustments";
  - "consider alternative methodologies for determining postretirement adjustments"; and
  - evaluate PERA's new method for determining the postretirement adjustment rate.
- **The LCPR must "report its conclusions based on the study during the 2021 legislative session."**

2018 Pension and Retirement Bill

- **The bill reduced postretirement adjustments and eliminated the triggers* for most statewide pension plans:**

Plan	Changed From	Changed To
MSRS General Plan	2% subject to funding triggers*	1% for 5 years (through 2023); 1.5% thereafter
MSRS Correctional Plan	2% subject to funding triggers*	1.5%
PERA General Plan	1% subject to funding triggers*	½ SSA COLA, but not less than 1% or more than 1.5%
PERA Correctional Plan	2.5% subject to funding triggers*	SSA COLA but not less than 1% or more than 2.5%
TRA	2% subject to funding triggers*	1% for 5 years (through 2023) 2024 - 1.1%; 2025 - 1.2%; 2026 - 1.3%; 2027 - 1.4%; 2028 and thereafter - 1.5%
SPTRFA	1% subject to funding triggers*	0% through 2020; 1% thereafter

- **The bill also delayed the commencement of COLAs for members retiring early until the member reaches normal retirement age (65 or 66), in MSRS General, PERA General, TRA, and St. Paul Teachers, beginning in 2024.**

** Funding trigger: COLA rate increases or decreases automatically when specified funding thresholds are met.*

Study Process

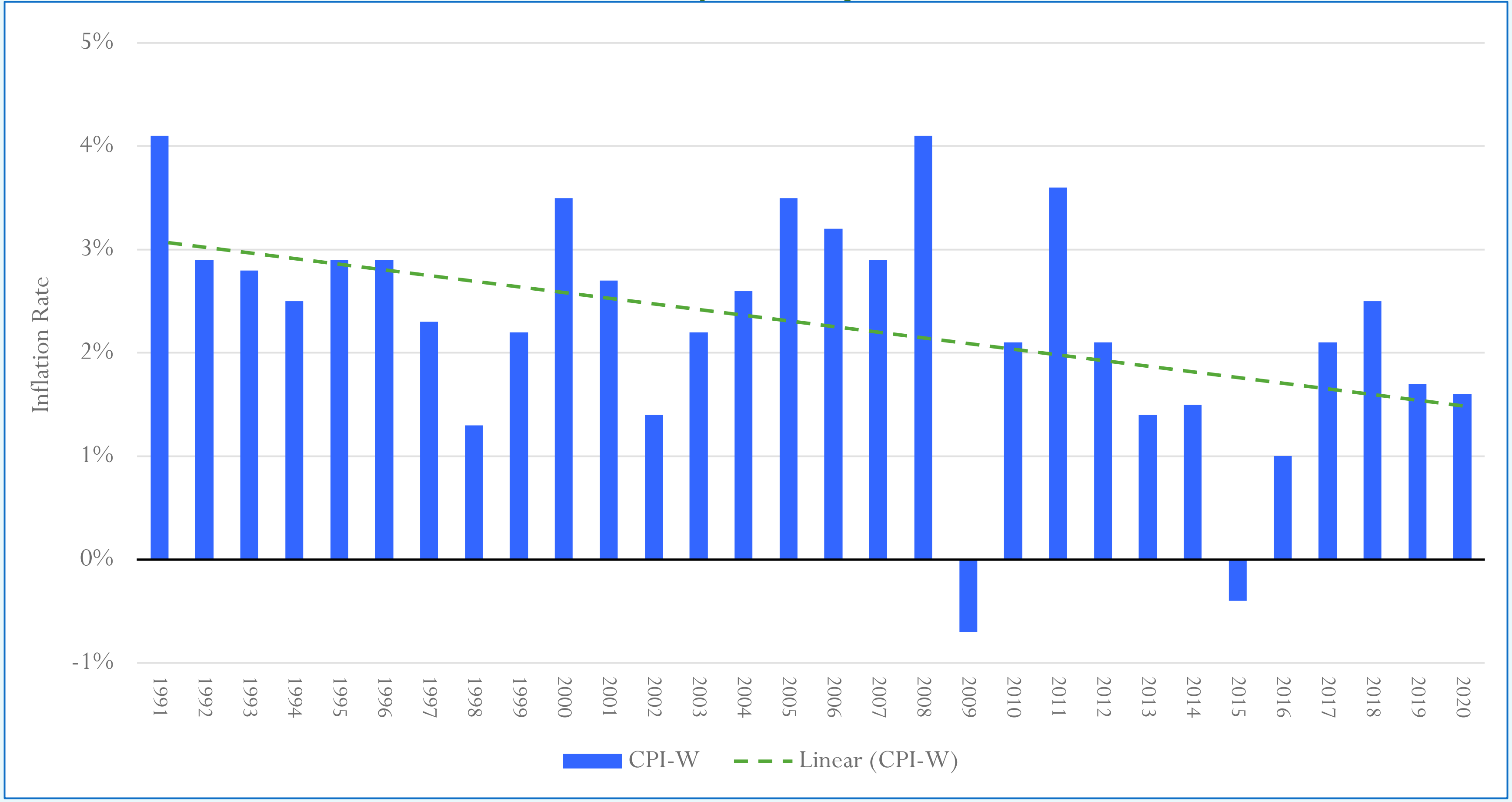
- **Led by LCPR staff, the work group consisted of the executive directors and legislative staff from MSRS, PERA, TRA, and SPTRFA.**
- **Work group members conducted research and analysis and prepared summaries that were compiled into a first draft.**
  - The work group began its work in 2019 and continued through 2020.
  - The work group interviewed directors of the pension plans of Colorado, South Dakota, and Wisconsin regarding their approach to COLAs.
  - First draft made available to the public mid-November.
- **Members of the public provided written comments on the first draft and participated in a public comment forum on December 8.**
- **First draft was revised to incorporate work group and public comments.**
- **Final draft of the report was completed on January 11.**
  - Written public comments appended to the report.

Outline of the Report

- **Provide information on Minnesota's postretirement adjustment**
  - History of changes to the postretirement adjustment
  - Recent changes to the postretirement adjustment and PERA's new method
  - Cost of postretirement adjustments
- **Consider the purpose of Minnesota's postretirement adjustments**
  - Focus on inflation
  - Retiree spending patterns and health care costs
- **Analyze whether Minnesota's COLAs satisfy the purpose**
  - Compare to inflation, under PERA's variable rate method and the fixed rate method
  - Basic versus Coordinated members and importance of COLAs
- **Evaluate PERA's new method of calculating COLA benefits**
- **Consider alternatives to Minnesota's current COLA methods**
  - Common types and features
  - Other states' approaches and case studies of Colorado, South Dakota, and Wisconsin
  - Trends in the public and private sectors

Measuring Inflation

Inflation over the past 20 years – CPI-W*



**Selection from Figure 9*

Summary of COLA Rates by Plan

Plan	COLA Provision
MSRS General/Unclassified/Legislators	1%, increasing to 1.5% in 2024
MSRS Correctional	1.5%
MSRS State Patrol	1%
MSRS Judges	1.75%
PERA General	50% of CPI-W but between 1% and 1.5%
PERA Police and Fire	1%
PERA Correctional	100% of CPI-W but between 1% and 2.5%
TRA	1% through 2023; 2024: 1.1%; 2025: 1.2%; 2026: 1.3%; 2027: 1.4%; 2028 and thereafter: 1.5%
SPTRFA	1%

How well are current retirees protected from inflation?

MSRS and PERA General Plans and TRA: Retiree Benefits as a Percentage of Purchasing Power by Year Retired*

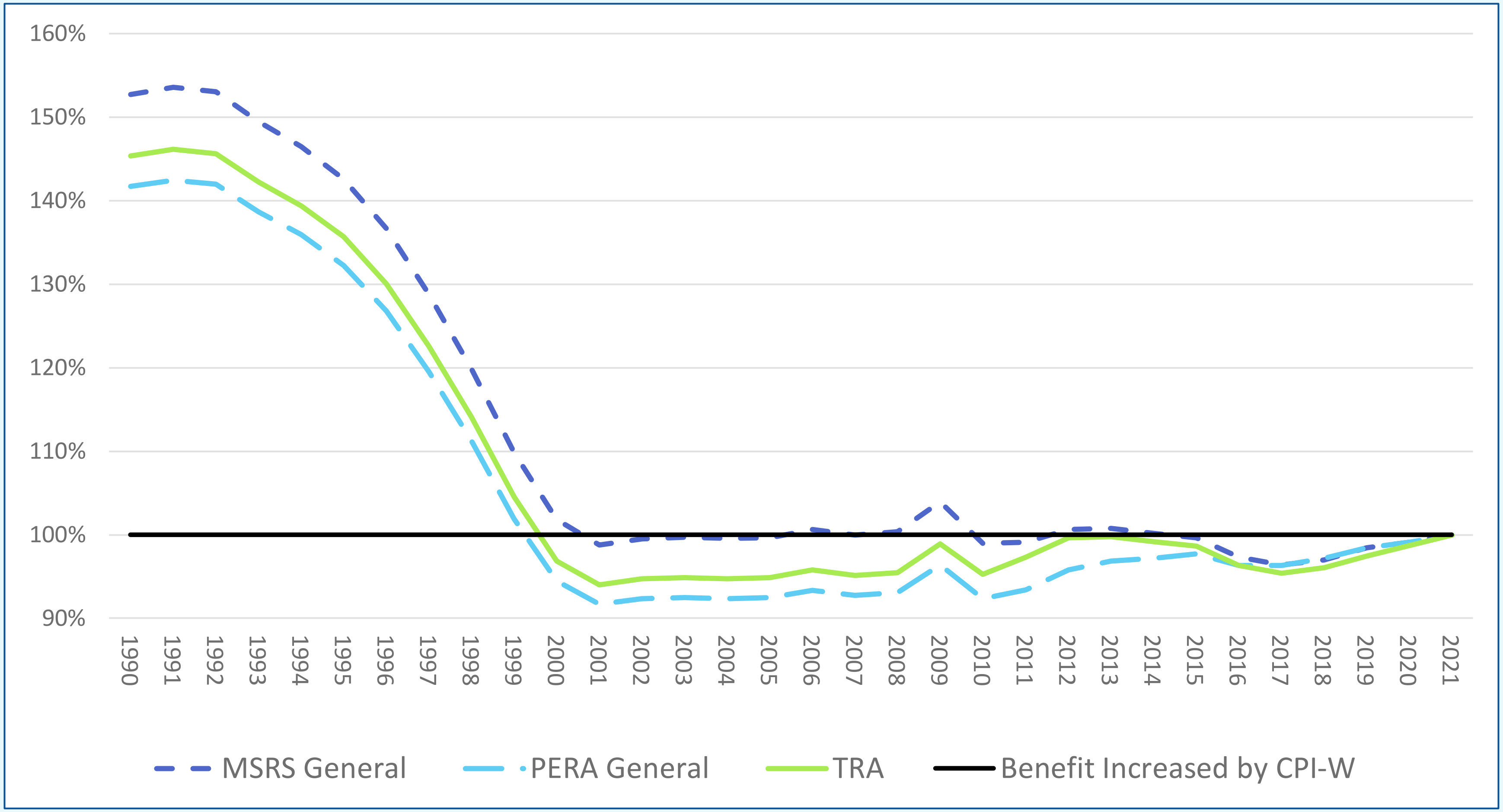


*Figure 11

How well are current retirees protected from inflation?

Public Safety and Judges Plan: Retiree Benefits as a Percentage of Purchasing Power by Year Retired*

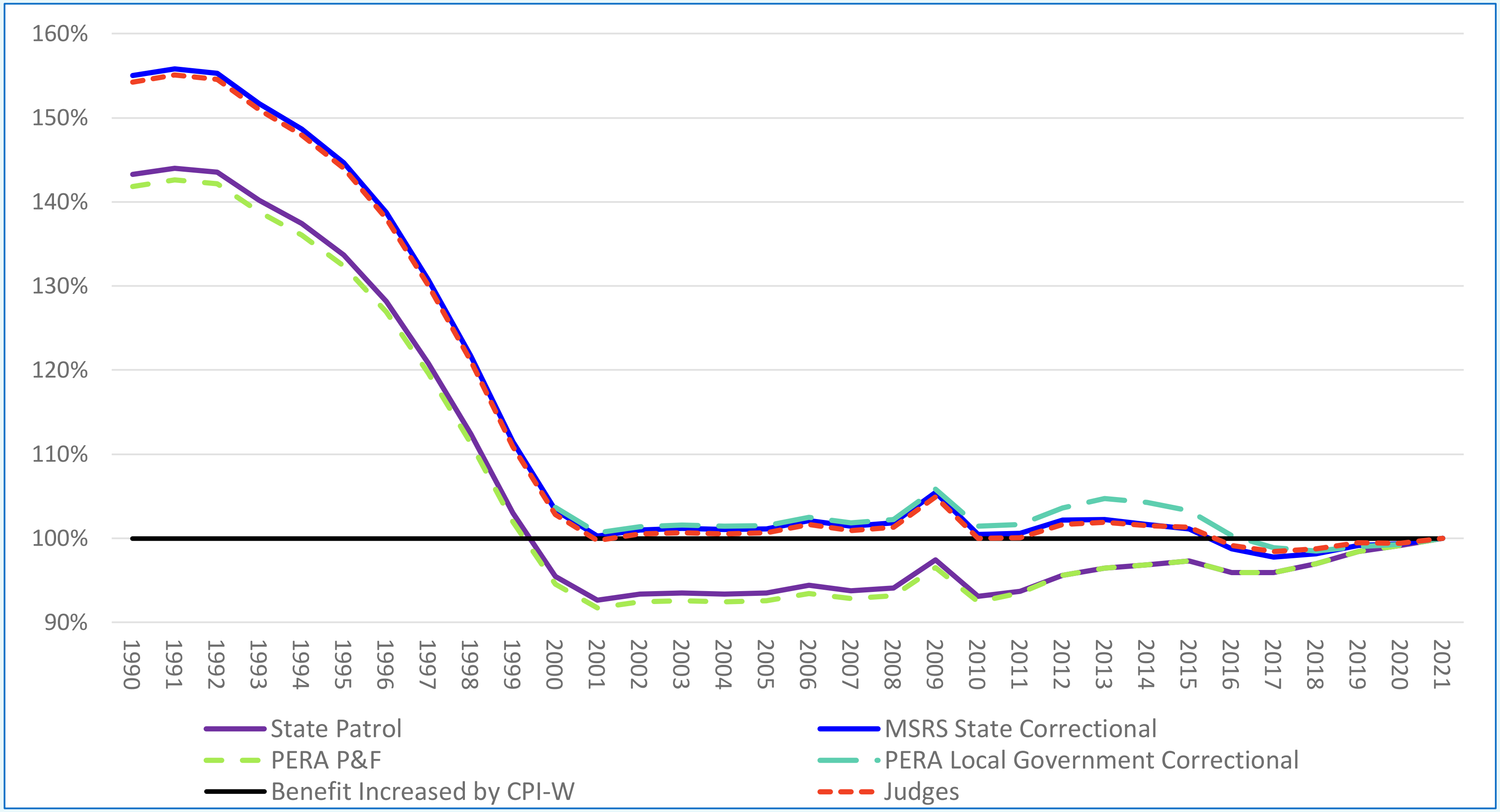


*Figure 12

Cost of Providing COLAs

- **Changes to current COLA provisions would involve tradeoffs**
- **Multiple ways to approach measuring cost**
  - ARC (Actuarially Required Contribution)

Cost of Providing a 1% Fixed Annual Postretirement Adjustment for TRA as a Percentage of Covered Payroll*

	1% COLA	0% COLA	Difference
Normal Cost	8.83%	8.22%	0.61%
Actuarially Accrued Liability	6.90%	4.77%	2.13%
Administrative Expense	0.32%	0.32%	0.00%
Total (ARC)	**16.05%**	**13.31%**	**2.74%**

**Figure 7*

Conclusion #1

"…take into account the purpose of postretirement adjustments and whether governing statutes are consistent with the purpose of postretirement adjustments…"

- **Purpose of the postretirement adjustment (COLA) is to mitigate the loss of purchasing power of retirement benefits due to inflation.**
  - Plans (other than PERA Correctional) provide members with some protection but will experience erosion if inflation assumption is met.
  - PERA Correctional is likely to substantially or completely offset future inflation if inflation assumptions are met.
  - PERA Police and Fire Plan and MSRS State Patrol Plan are most vulnerable to loss of purchasing power because they are not coordinated with Social Security.

How well will current postretirement adjustments protect against inflation in the future?

General and Teacher Plans: Projected Purchasing Power Over 20 Years for 2021 Retirees; Assuming 2.5% Inflation *

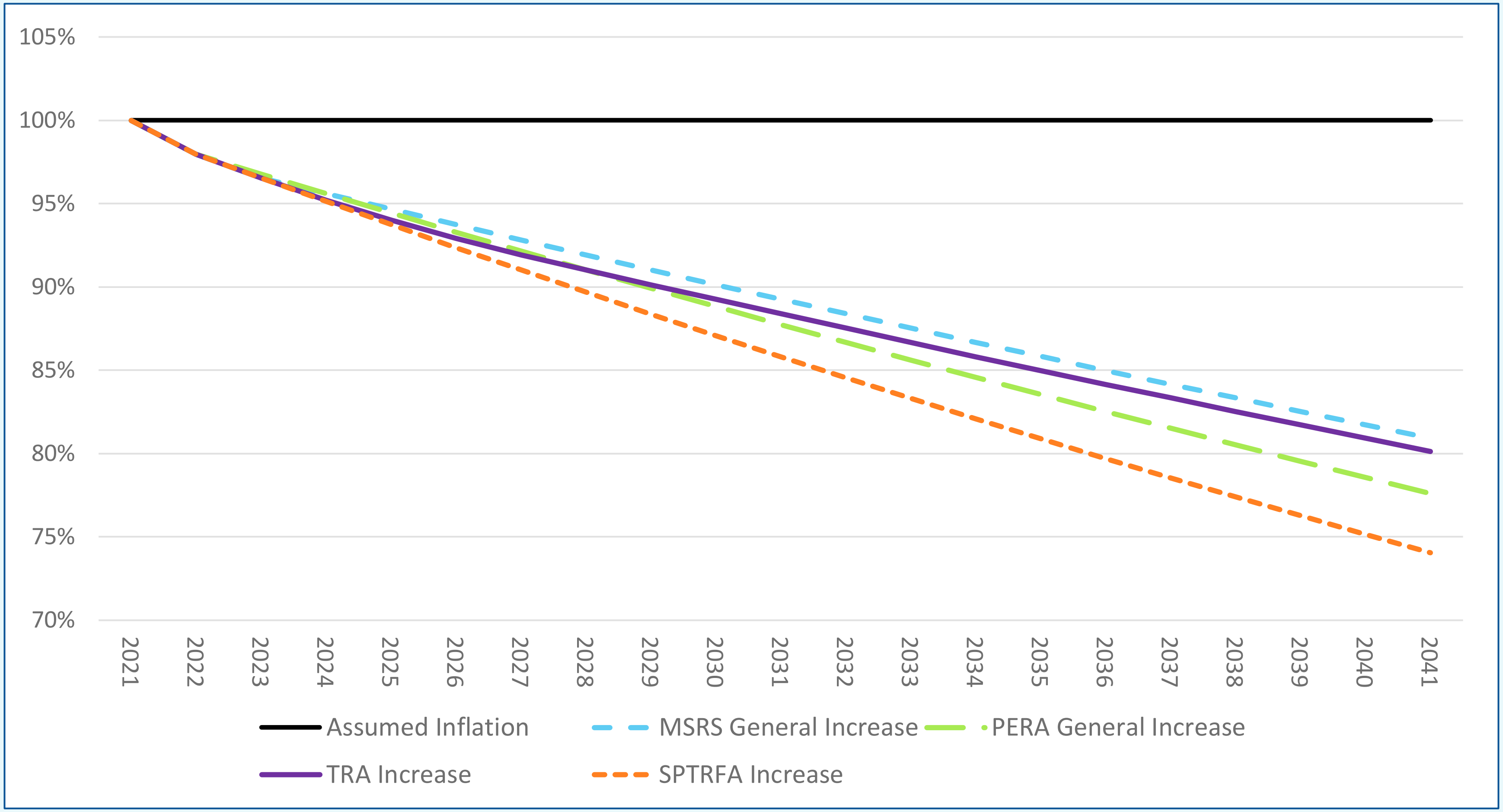


**Figure 14*

How well will current postretirement adjustments protect against inflation in the future?

Public Safety Plans: Projected Purchasing Power Over 20 Years for 2021 Retirees; Assuming 2.5% Inflation*

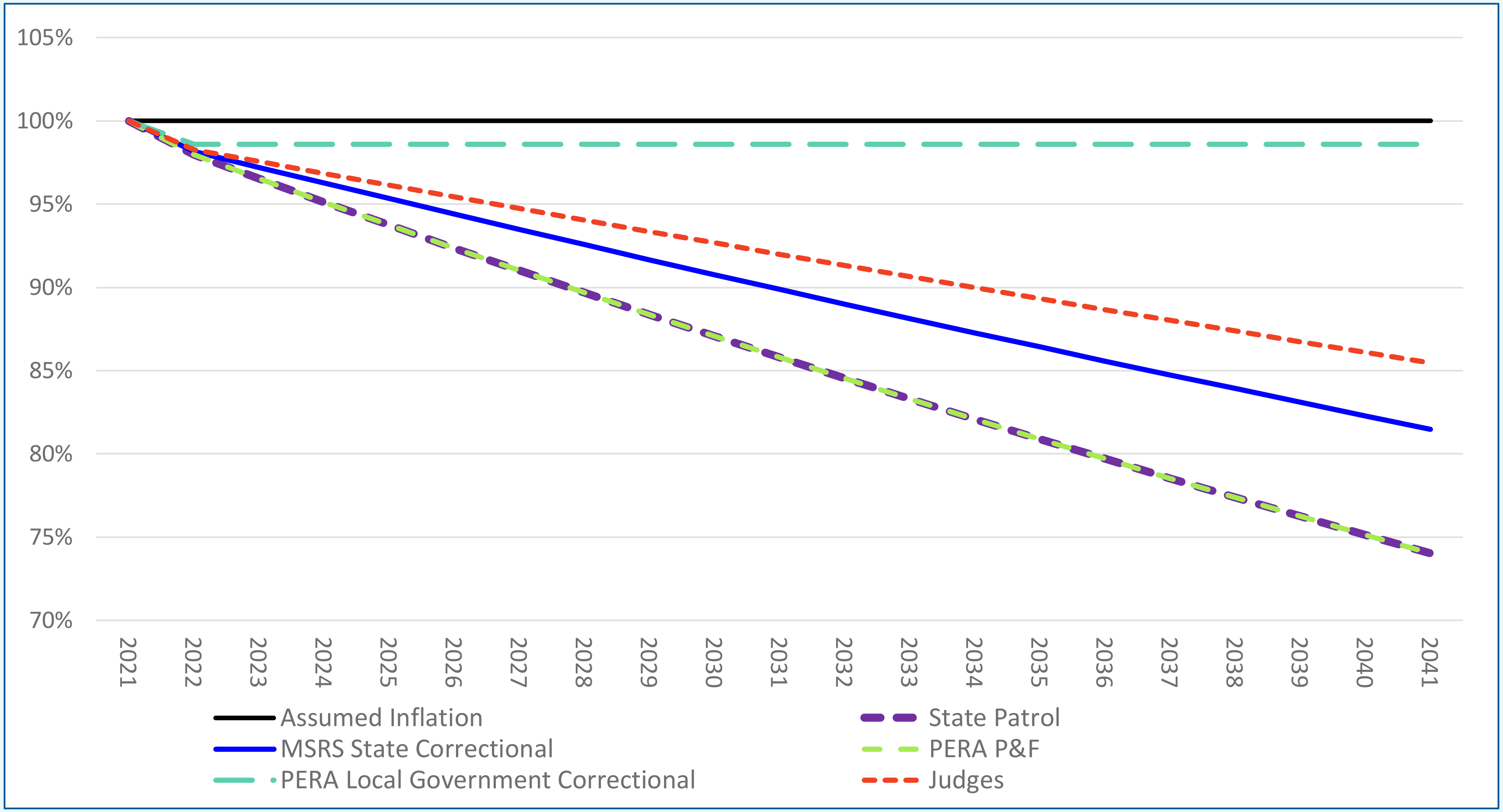


*Figure 17

Comparing inflation protection for coordinated and basic members

Projected Benefit of Coordinated vs Basic Benefit; Assuming 2.5% Inflation,
1% Postretirement Adjustment, Starting Benefit of $3,400 ($1,900-plan, $1,500-SSA)*

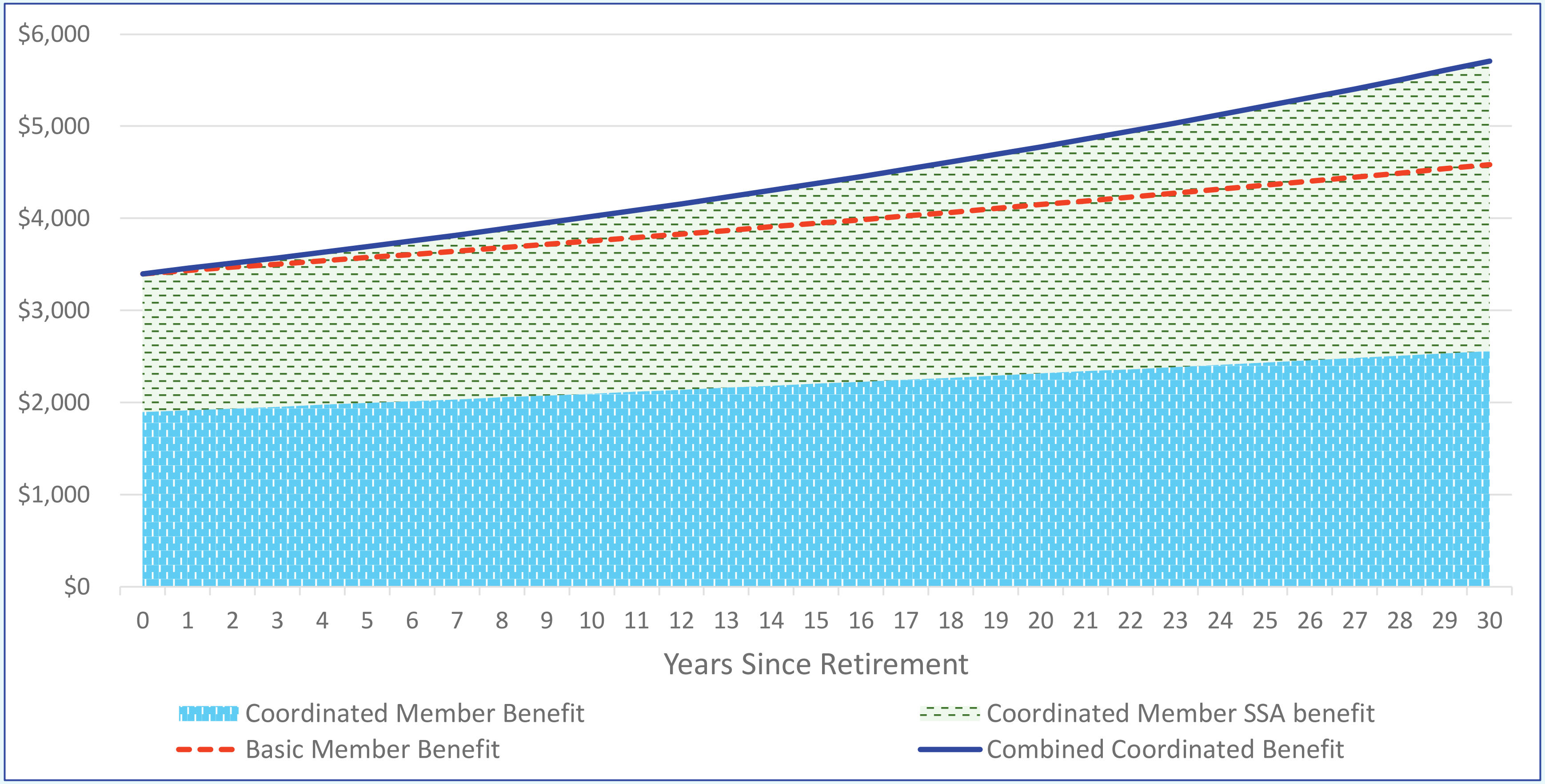


*Figure 19

Conclusion #2

"…evaluate PERA's new method for determining the postretirement adjustment rate…"

- **PERA's new method is not likely to provide additional protection against inflation.**
  - Improvements in inflation protection for the PERA General Plan are due to the increase in the rate, not to the change from a fixed-rate to variable-rate method.
- **PERA's variable rate method may provide moderately more intergenerational equity than the fixed-rate method.**

Fixed vs. variable: Is the new PERA method better?

PERA General: Comparing Purchasing Power for the Old Method and New Method*

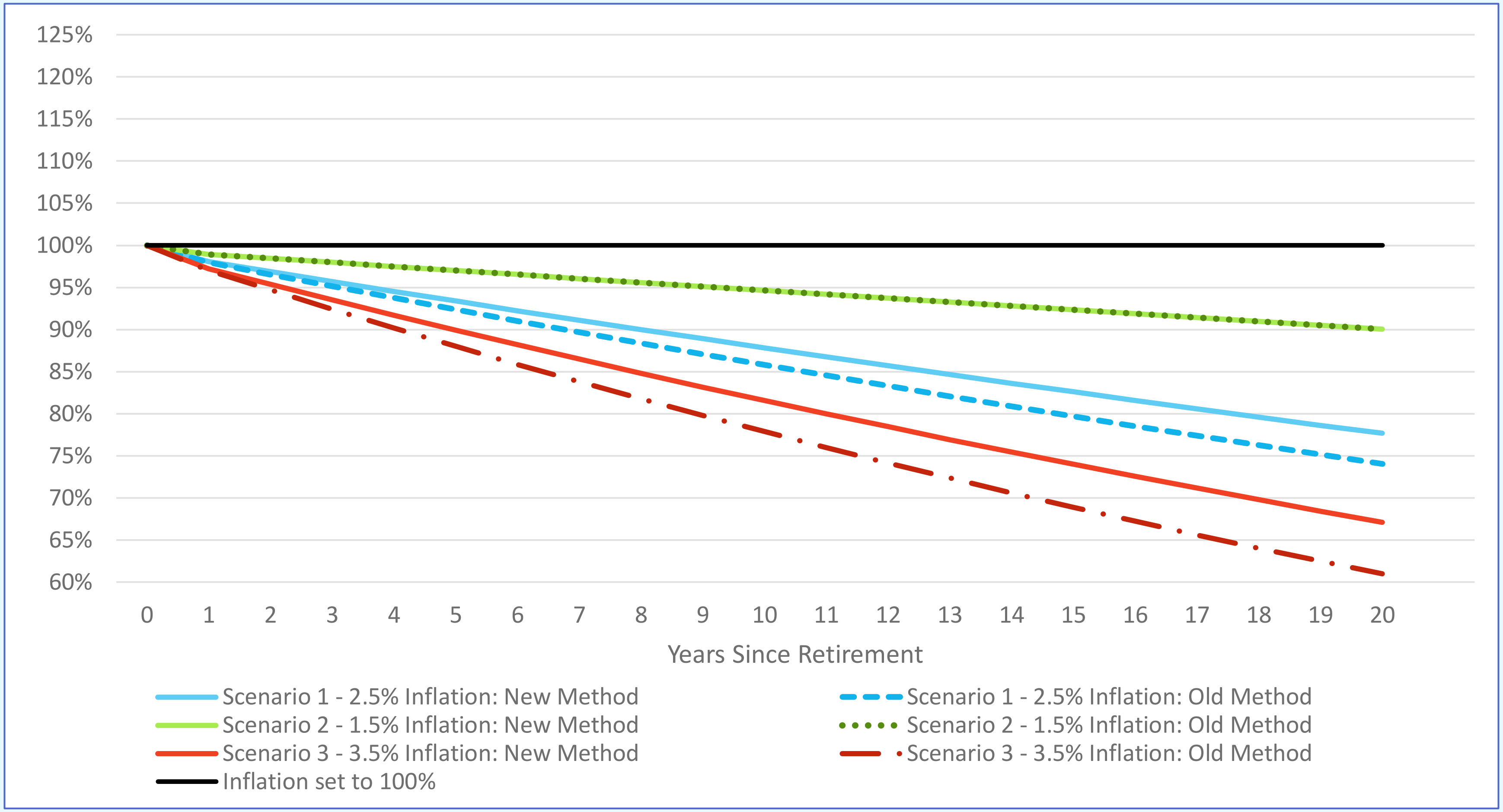


*Figure 22

Fixed vs. variable: Is the new PERA method better?

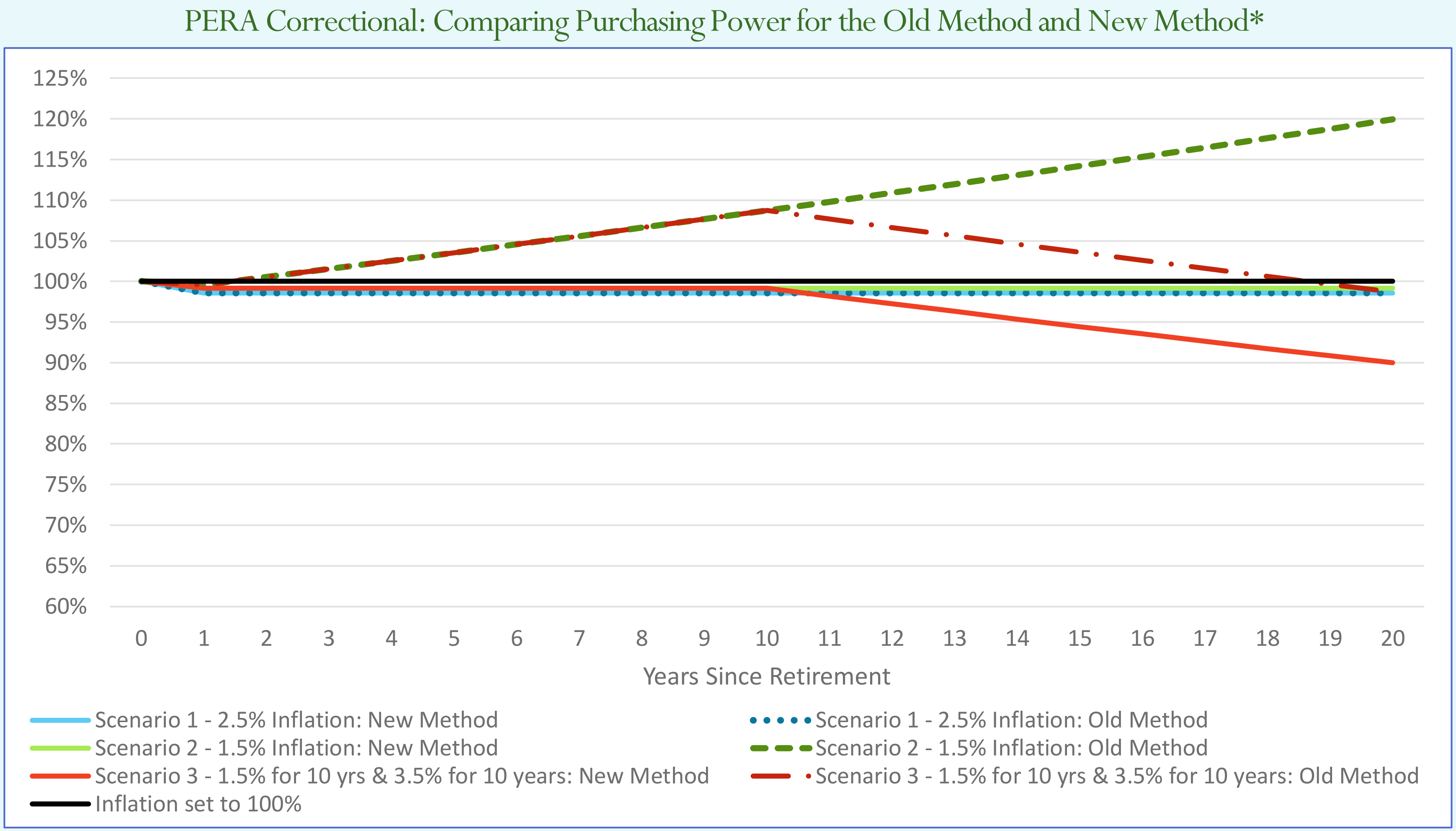


**Figure 23*

Intergenerational equity

Measuring Generational Inequity*

	PERA General (New Method) Cohort Gap		Fixed 1.25% (Old Method) Cohort Gap		PERA Correctional (New Method) Cohort Gap	
	10-Year	**20-year**	**10-Year**	**20-year**	**10-Year**	**20-year**
Fixed 2.25% Inflation	0%	0%	0%	0%	0%	0%
Higher Inflation Scenario	2%	6%	2%	9%	1%	4%
Lower Inflation Scenario	6%	6%	7%	9%	4%	4%

**Figure 24*

Conclusion #3

"…consider alternative methodologies for determining postretirement adjustments…"

- **The report sets forth a summary of different methodologies, but we could not identify a clearly superior approach to Minnesota's current COLA benefits.**
- **Several alternatives could be appropriate if Minnesota wants to consider cost-saving measures or other factors.**

COLA Ingredients and Varieties

Amount	Governance	Limitations
❖ Flat (specified %) ❖ Inflation-based (i.e., x% of CPI-W) ❖ Based on prior year's benefit or original benefit (i.e., compound or simple) ❖ Investment performance-based	❖ Automatic ❖ Ad hoc ❖ Statutory protections	❖ Minimum COLA ❖ Maximum COLA ❖ Funded status triggers ❖ Investment return triggers

**Figure 25*

Options for Action by the Commission

- **Adopt the report**
- **Amend and adopt the report as amended**
- **Table the report**
- **In addition to any of the above, the Commission could direct staff to prepare options for legislation to change current postretirement statutes.**