COLA Study Report

Amendment COLA-1A

_______________________ moves to amend the "Report on the LCPR Study of Postretirement Adjustments (COLAs)" as prepared by Commission staff, as follows:

Page 17, strike:

"We note that as with other statements found in the Principles, this statement's precise meaning is ambiguous. Should the postretirement-increase partially or completely "offset the impact of economic inflation over time"? How much value can a benefit lose and still be one that "was adequate at the time of retirement"? Ultimately, the question of precisely how much protection should be provided is a political one and beyond the scope of this report. Therefore, ***we conclude that the purpose of Minnesota's postretirement adjustments is to mitigate the loss of purchasing power of retirement benefits due to inflation.***"

Page 57, strike:

"We conclude that the purpose of Minnesota's postretirement adjustments is to mitigate the loss of purchasing power of retirement benefits due to inflation."

and insert:

" We conclude that retirement benefits should be increased during the period of retirement to offset the impact of economic inflation over time in order to maintain a retirement benefit that was adequate at the time of retirement."

Correctional Plans, provide an annual increase by applying a fixed rate that is between 1% and 1.75% per year. In the case of the PERA General and PERA Correctional Plans, the postretirement adjustment is a variable rate that changes depending on inflation and is subject to a floor and cap. Because none of these postretirement adjustments are tied to investment returns, we conclude that the postretirement adjustment is not intended as a vehicle for sharing surplus investments, but rather to protect against the erosion of the value of a benefit.

The question then becomes how much protection is the postretirement adjustment intended to provide? The current structure of the postretirement benefit suggests that the purpose is to protect against some, but not all, erosion of the value of pension over time. The amount of protection is limited to the fixed rate, in most plans, or the caps on the variable rates, in two of the PERA plans.

Looking to the legislative records, in 2009 the LCPR amended and adopted "Legislative Commission on Pensions and Retirement Principles of Pension Policy" (the "Principles"). Section II(B)(8)(a) of the Principles states the following:

> *Retirement benefits should be increased during the period of retirement to offset the impact of economic inflation over time in order to maintain a retirement benefit that was adequate at the time of retirement.*

~~We note that as with other statements found in the Principles, this statement's precise meaning is ambiguous. Should the postretirement increase partially or completely "offset the impact of economic inflation over time"? How much value can a benefit lose and still be one that "was adequate at the time of retirement"? Ultimately, the question of precisely how much protection should be provided is a political one and beyond the scope of this report. Therefore,~~ ~~***we conclude that the purpose of Minnesota's postretirement adjustments is to mitigate the loss of purchasing power of retirement benefits due to inflation.***~~

Much of the remainder of this report will focus on how well Minnesota's postretirement adjustment mitigates the effects of inflation on retirement benefits.

B. Inflation

Inflation occurs when the cost of goods and services increases across the economy. Put another way, inflation occurs when the value of money (that is, the amount of goods and services that money can be exchanged for) decreases across the economy. For example, a person with $100 in 1990 might be able to buy groceries for a month, while a person with $100 in 2020 may only be able to purchase groceries for a week. The same $100 has more value in 1990 than in 2020. Similarly, a retirement annuity of $1,000 per month could buy more groceries, gas, healthcare, and housing in 1990 than the same $1,000 will buy in 2020. If left unaddressed, inflation may contribute to less financial security later in retirement, as the cost of living increases.

- requirement to fully fund Minnesota's public pension plans, the Legislature has less incentive to reduce or eliminate COLAs.

- The Internal Revenue Code prohibits the reduction or elimination of protected benefits, including a COLA, as a condition of plan qualification and ERISA gives participants the ability to enforce their right to those benefits. If a private sector employer's financial condition declines or the plan's investment earnings decline, a private sector employer does not have the option to reduce or eliminate a COLA. This has led private sector employers to phase out COLAs, by eliminating COLAs for future accruals and new hires.

  Under Minnesota law, employees have no constitutional, contractual, quasi-contractual, or property ownership right in a COLA in public sector defined benefit pension plans. When public pension plan investments have underperformed, the legislature has reduced or frozen COLAs as determined necessary to maintain a funded status that is considered sustainable. This ability to reduce or freeze COLAs without fear of litigation may be one reason Minnesota's public sector pension plans will not find it necessary to follow the lead of the private sector by eliminating COLAs altogether.

II. Conclusion

This report was required to "take into account the purpose of postretirement adjustments and whether governing statutes are consistent with the purpose of postretirement adjustments." ~~We conclude that the purpose of Minnesota's postretirement adjustments is to mitigate the loss of purchasing power of retirement benefits due to inflation.~~ We conclude that retirement benefits should be increased during the period of retirement to offset the impact of economic inflation over time in order to maintain a retirement benefit that was adequate at the time of retirement. With regard to whether postretirement adjustments are consistent with the purpose:

- For SPTRFA and the statewide plans other than the PERA Correctional Plan, governing statutes prescribe a postretirement adjustment that provides some protection from the loss of purchasing power due to inflation. However, members of those plans will experience erosion of their purchasing power if actual inflation matches the assumed rate of inflation.
- For the PERA Correctional Plan, governing statutes provide for a postretirement adjustment that is likely to substantially or completely offset future inflation if inflation assumptions are met.
- A subset of the statewide plans, PERA's 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.

Whether the protection against inflation provided by these postretirement adjustments is sufficient is a political question for the Legislature.

This report was also required to "evaluate PERA's new method for determining the postretirement adjustment rate." We found that PERA's new method is not likely to provide additional protection against inflation, but it may provide moderately more intergenerational equity than the fixed-rate method.