million, and was 64% funded. By not paying a 1% postretirement adjustment on its retirees' pension benefits for two years, 2019 and 2020), SPTRFA saved nearly $6 million.

- Another relatively small plan, MSRS Correctional, had, as of the fiscal year end preceding the 2018 Act, benefit liabilities of $1,414.4 million, assets of 1,023.8 million (market value), a shortfall of $390 million, and was 72% funded. By paying a 1.5% postretirement adjustment rather than a 2% adjustment for 2019 (a reduction of 0.5%), this plan saved $7.7 million.

- TRA, on the other end of the spectrum in size, saved just over $141 million by paying a 1% postretirement adjustment for 2019, rather than a 2% postretirement adjustment for 2019. TRA had, as of the fiscal year end preceding the 2018 Act, benefit liabilities of $27.4 billion, assets of $21.3 billion (market value), a shortfall of $6.1 billion, and was 77% funded.

The PERA General Plan is not included in the 2018 savings analysis because the change from a 1% fixed postretirement adjustment to an inflation-tied variable postretirement adjustment added additional cost to the PERA plan. However, the additional cost was offset by removing the triggers for a higher postretirement adjustment rate once PERA's funding rate improved. In short, the changes made in 2018 to PERA General Plan's postretirement adjustment did not meaningfully affect funding. It should be noted that PERA reduced its postretirement adjustment from a fixed 2.5% to 1% in 2010 which resulted in substantial savings for the plan.

III. COLAs and protecting the purchasing power of pensions

Pensions provide a defined benefit to fund living expenses during retirement. Since inflation erodes the value of a pension over time, it is generally believed that providing a COLA will help maintain that value. In essence, a COLA protects the buying power of retirees' pension benefits.

As noted above, prior to 2008, Minnesota's approach to postretirement adjustments depended on the investment success of the Post Fund, which served as a vehicle for sharing surplus investment returns with retirees. However, in 2008, with the dissolution of the Post Fund, Minnesota's approach to postretirement adjustments changed to focus more on protecting retirees' pensions from the adverse effect of increasing cost of living.

This section will first examine the purpose of the Minnesota's postretirement adjustment and then examine the concept of inflation and its impact on retirees.

A. Purpose of Minnesota's postretirement adjustment

Research suggests that the purpose of a COLA is either to protect against erosion of the value of a benefit over time due to inflation or to share surplus investment returns with retired members. To determine the purpose of Minnesota's postretirement adjustment, we looked ~~first~~ to the statute ~~and then to relevant legislative records~~. The statute does not include a statement of legislative purpose but does describe the structure of the postretirement adjustment. Currently, most plans, with the exception of the PERA General and PERA

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~~ it appears 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.

age 75, when consumption levels off; the underfunded households see significant decline in consumption, at increasing rates as they age.

Morningstar does not conclusively answer the question of whether changes in expenditures as a retiree ages is by choice or by need, except to note that spending is not constant as retirees age, but rather has more to do with whether the retiree household is consuming "optimally." Households that are overfunded and not spending consistent with their net worth and income tend to increase consumption as they move from age 65 to age 75, but at a decreasing rate, while households that are underfunded and spending too much relative to their net worth and income tend to see considerable declines in spending during retirement.

IV. Minnesota's postretirement adjustments and protection against inflation

~~The primary purpose of Minnesota's postretirement adjustments is to mitigate the loss of purchasing power of retirement benefits due to inflation.~~ This section will analyze the amount of inflation protection the statewide pension plans have provided for current retirees and how much inflation protection can be reasonably expected in the future.

A. How well are current retirees protected from inflation?

Retirees in the MSRS and PERA General Plans, TRA, and SPTRFA

To understand how well current retirees are protected from inflation, we looked at a pension benefit in each of the last 30 years and increased it by actual postretirement adjustments to today (January 1, 2021). We compared that amount to the same pension benefit in each year increased by CPI-W for each of the following 30 years until today. This allows us to compare purchasing power for cohorts of plan participants retired in each of the last 30 years. For example, Figure 11 shows that an MSRS General Plan participant who retired in 1998 is currently (as of January 1, 2021) receiving a benefit that has a purchasing power that is approximately 120% of the retiree's initial benefit versus a participant who retired in the years after 2000 has purchasing power roughly in line with the retiree's initial benefit. This difference in purchasing power protection afforded different retirement cohorts within the same pension plan illustrates the concept of generational inequity, which is discussed further in Section V.

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.

VII. 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. With regard to whether postretirement adjustments are consistent with the purpose:~~ We considered how well the post retirement adjustment mitigates the effects of inflation and concluded the following:

- 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.