Advisory Committee on Retirement Matters Meeting – COLA Options

April 4, 2014

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Current COLA Options

- 30%, 50% or 70% of CPI-U
- Repeating COLAs are advance funded over each active employee’s working career
- Ad-hoc COLAs are funded when granted over 15 years with level dollar amortization
Short Term Analysis

- Ad hoc rates lower in short run, but costs increase with each adoption; repeating rates are stable, but higher initially
- After 10 years, rate for a plan granting ad hocs is similar to the repeating rate and will continue to increase thereafter
- UAAL increases over time with ad hocs, decreases over time for repeating
- Funded ratio improves over time with repeating, declines with ad hocs
Long Term Analysis

- In the long run, cumulative contributions for ad hoc COLAs exceed those for repeating COLAs.
- Investment earnings accumulated through advance funding accounts for difference in long term costs.
Total Cumulative Contributions

- 30% Ad hoc, Granted Annually
- 30% Repeating
COLAs are Retroactive

- Increases are calculated as if COLA had always been in effect since date of retirement
  - Typically referred to as “catch up” provision
- Initial COLA or an increase in CPI percent results in large benefit increases for the year adopted; longer retired, higher the increase
- Reduction in CPI percent results in lower or no increase until cumulative increase at lower percent exceeds current benefit; longer retired, longer until another increase will be granted
The cost of the “catch up” provision
## Example ad hoc “catch up” provision and flat rate ad hoc

<table>
<thead>
<tr>
<th></th>
<th>Baseline * (No COLA)</th>
<th>70% CPI Ad hoc with Catch-up (9.64%)</th>
<th>70% CPI Ad hoc without Catch-up (1.22%)</th>
<th>Flat 3% Ad hoc</th>
</tr>
</thead>
<tbody>
<tr>
<td>UAAL</td>
<td>$9,797,444</td>
<td>$30,966,454</td>
<td>$13,037,603</td>
<td>$17,765,051</td>
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<tr>
<td>Funded Ratio</td>
<td>98.6%</td>
<td>95.8%</td>
<td>98.2%</td>
<td>97.5%</td>
</tr>
<tr>
<td>ER Current Service %</td>
<td>10.73%</td>
<td>10.73%</td>
<td>10.73%</td>
<td>10.73%</td>
</tr>
<tr>
<td>Prior Service %</td>
<td>0.48%</td>
<td>2.20%</td>
<td>0.74%</td>
<td>1.13%</td>
</tr>
<tr>
<td>Full Rate</td>
<td>11.21%</td>
<td>12.93%</td>
<td>11.47%</td>
<td>11.86%</td>
</tr>
<tr>
<td>Estimated Contribution</td>
<td>$15,085,136</td>
<td>$17,399,715</td>
<td>$15,435,014</td>
<td>$15,959,832</td>
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<tr>
<td>Annual Cost to Provide COLA</td>
<td>$2,314,579</td>
<td>$349,878</td>
<td>$874,696</td>
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</tbody>
</table>

* City last adopted a COLA on January 1, 2008
Example Repeating Provisions

<table>
<thead>
<tr>
<th></th>
<th>Baseline * (No COLA)</th>
<th>70% CPI Repeating with Catch-up (9.64%)</th>
<th>70% CPI Repeating without Catch-up (1.22%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>UAAL</td>
<td>$9,797,444</td>
<td>$166,463,309</td>
<td>$148,062,946</td>
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<tr>
<td>Funded Ratio</td>
<td>98.6%</td>
<td>80.9%</td>
<td>82.6%</td>
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<tr>
<td>ER Current Service %</td>
<td>10.73%</td>
<td>14.11%</td>
<td>14.11%</td>
</tr>
<tr>
<td>Prior Service %</td>
<td>0.48%</td>
<td>7.29%</td>
<td>6.49%</td>
</tr>
<tr>
<td>Full Rate</td>
<td>11.21%</td>
<td>21.40%</td>
<td>20.60%</td>
</tr>
<tr>
<td>Estimated Contribution</td>
<td>$15,085,136</td>
<td>$28,797,673</td>
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</tr>
<tr>
<td>Annual Cost to Provide COLA</td>
<td></td>
<td>$13,712,537</td>
<td>$12,635,988</td>
</tr>
</tbody>
</table>

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Pros and Cons of no “catch up” or a “flat rate” approach

Pros:

- Employer may be able to better “afford” a COLA without the cost of the “catch up” requirement
- Employer may be able to better control the cost of COLAs given the flat rate design
- A lower flat rate can be utilized to dampen growth of plan liabilities when returns are low
- Can be repeating or ad hoc

Cons:

- May not keep pace with inflation if not tied to CPI
- If there has been a period of no COLAs, a flat rate COLA or no “catch up” does not restore lost purchasing power evenly across retirees
Another alternative

- The one-time window concept:
  - Allow TMRS employers a “window of opportunity” to grant a one-time or add a repeating COLA without the current retroactive or “catch up” requirement

- May be complex and costly to administer as a stand alone provision
Other options?
Next steps?

- May 15th meeting expectations