Alternative Mechanism to Provide Future Cost-of-Living Adjustments (COLAs)

Senate Bill 18 *by Sen. Price & Sen. Cortez*

A proposal for Louisiana's state public retirement systems

Objective: To provide meaningful benefit increases on a regularly scheduled basis, designed to preserve the purchasing power of the recipients.

FUNDING SOURCE:

- End current method of indirect COLA funding through gainsharing and eliminate experience account
- Create COLA account to hold funds for future COLAs
- COLA funding becomes a component of employer contribution rate

Clear, simple funding source. A funding source not tied to market performance makes granting COLAs more probable and foreseeable.

GRANTING CRITERIA:

- Eliminate complex granting matrix that determines COLA amount and frequency
- Have sufficient funding in newly created COLA account
- **Legislature retains COLA granting authority**

Straightforward granting criteria. Simple COLA granting rules provide clarity for retirees, employers, and legislators. Objectives of current granting matrix achieved through employer safeguards.

COLA AMOUNT:

- Up to 2% of annual retirement benefit
- Lower amount on which COLAs are calculated *(Current cap is greater than $60,000 due to indexing of CPI);* lower cap increases dollars available to fund COLAs more frequently

Controls costs and creates equity. Lowering the COLA cap amount helps achieve parity among older, career retirees with smaller benefits and recent career retirees and/or high earners. The current calculation cap is favorable to high earners and recent retirees as their higher benefits (based on higher salaries) generate a larger COLA amount than for older retirees whose salaries were smaller.

WHY NOW?

- Passing the legislation in the current session is important since, due to legislative reforms, the employer contribution rate is expected to steadily decline following the 2024 reamortization of certain system gains. These steady declines will be followed by significant declines once debt is paid off in 2029 and 2040.

COLA FREQUENCY:

- Given the proposed change in funding source, more frequent COLAs every two to three years—is the desired objective. **Still, the frequency of paying COLAs would be subject to sufficient funding and legislative approval.**

Consistency in providing protection against inflation. Proposed alternative mechanism provides retirees with a reasonable expectation of receiving COLAs on a more consistent basis, giving them more reliable protection against inflation and the ability to better preserve their purchasing power.

ELIGIBILITY CRITERIA:

- **At least age 62; retired at least 2 years**

Controls costs. Reasonable changes to eligibility criteria will reduce the cost of COLAs. Specifically, raising eligibility age is advisable given that regular retirement eligibility for 2015 members (rank-and-file employees) is age 62. Furthermore, receiving a COLA two years after retirement is not unreasonable.

EMPLOYER SAFEGUARDS:

- **Direct COLA funding through employer contribution rate** *(Beginning, July 1, 2024, as the employer contribution rate decreases, 50% of the decrease will be deposited into the COLA side account.)*
- COLA component of employer contribution rate shall not exceed **2.5%**
- The COLA rate shall not cause the total employer contribution rate to exceed the rate determined for FY 23-24 for any given year through FY 38-39. Beginning in FY 39-40, the COLA rate shall not cause the total employer contribution rate to exceed **22%** per year. If the COLA rate causes the total employer contribution rate to exceed these caps, the COLA rate shall be temporarily reduced.
- Cap COLA side account balance to cost of providing two COLAs

Straightforward employer COLA costs and employer protections. Currently, employers indirectly pay for COLAs as the portion of excess earnings allocated to experience account could otherwise be used to pay debt and reduce employer contribution rates. Direct payment by employers with safeguards provides more transparency in COLA funding and establishes COLA-related rate protection for employers. **Recognizing that as the UAL is paid off employer rates will significantly decrease**; the proposal would gradually phase in direct payment by employers. Employer safeguards achieve objectives of current granting matrix.

Summary of Projected Outcomes:

- ✓ Provide COLAs on a more consistent basis
- ✓ Establish a reliable source of COLA funding
- ✓ Shift from indirect to direct funding of COLAs
- ✓ Establish employer protections
- ✓ Control costs
- ✓ Preserve beneficial legislative pension reforms

Current COLA Cost:

- COLAs funded by one-half of investment experience gains ABOVE the statutory hurdles.
- FREQUENCY and COST of future COLAs depends on FREQUENCY and SIZE of extreme market peaks which are not predictable.
- Employers will forfeit an estimated 35 basis points (on average) annually of investment earnings transferred to the experience account to fund future COLAs.
- With a discount rate of 7.25%, system needs to earn 7.60% (7.25% + 0.35%) to offset these “forfeited” gains.
- Forfeited gains become a cost that is amortized over 10 years; paid by employer contributions.
- The table below shows the cost of one 2% COLA with current eligibility requirements, based on 2021 data for a COLA payable in 2022:

	Present Value Cost of 1 COLA:	10-Yr Amortization Annual Payment	% Payroll	10-Yr Amortization Interest Cost
LASERS	$217 M	$30 M	1.5%	$85 M

	Expected Annual $ Payment Required to Fund COLA granted every:			Expected Annual % of Pay Required to Fund COLA granted every:		
	2 Years	3 Years	5 Years	2 Years	3 Years	5 Years
LASERS	$150 M	$90 M	$60 M	7.5%	4.5%	3.0%

Proposed COLA Cost:

- Beginning July 1, 2024, direct payment as a percentage of payroll increases only when the contribution rate decreases. Direct payment is one-half of the decrease in the contribution rate, up to 2.5%.
- **Cost of proposed provisions are nearly certain to be less than cost of current COLA provisions, while providing more predictable, more frequent COLAs.** Cost of current provisions cannot be precisely identified, as it depends on unknown market volatility.
- Future cost becomes a KNOWN, transparent cost, set by the legislature.
- COLA frequency becomes much more predictable.
- Employer safeguards will be built into the new model.
- Legislature retains full control over COLAs granted.