NASRA

Overview of variations to cost-of-living adjustments among public retirement systems

Prepared by NASRA, 2021

A majority of retired public employees participate in a pension plan that offers some form of automatic cost-of-living adjustment (COLA). A COLA is intended to offset the effects of inflation on a pension benefit.

A typical automatic COLA provides an annual benefit increase beginning within the first year of retirement, compounded, based either on a specified percentage of the benefit, such as 2.0 percent; or on the Consumer Price Index, a measure of inflation published by the U.S. Bureau of Labor Statistics. Most plans that link their COLA to the CPI also place a limit on its size, such as one-half of CPI, or not to exceed 3.0 percent.

Experts estimate that an automatic COLA of 2.0 percent, compounded annually, will increase the cost of the benefit by 16 percent. To alleviate this cost, or to achieve other retirement plan objectives, or both, some public pension plans have established COLAs different from the typical compounded percentage increase that begins in the first year of the retirement of the plan participant. Some of these variations are described below, with one or more examples of plans that use such methods.

It is generally considered good pension plan policy to pre-fund benefits, including COLAs. This means that the cost of a COLA should be paid during the working life of the plan participant who will receive it. If a COLA is not paid for in advance, a mismatch may result between those who receive public services, and those who pay for them.

This list is not exhaustive.

Delayed onset/minimum age of eligibility

- Colorado PERA – 2018 legislation suspended the COLA for two years, increased the waiting period for new hires to receive a COLA from one year to three, and thereafter reduced the automatic COLA cap from 2.0% to 1.5%, and tied payment of future COLAs to the length of the plan's amortization period.
- Nevada PERS – Employees hired since 7/1/15 receive a COLA of 2% after 3 years of receiving benefits, 2.5% after 6 years, and the lesser of 3% or the preceding year's increase in CPI after 9 years and thereafter.
- New Mexico Public Employees Retirement Fund – Automatic after retiree has been retired two full calendar years (i.e., January 1 through December 31), or upon reaching age 65, whichever is sooner
- New York State and Local RS and New York State Teachers Retirement System – Retirees must be age 62 and retired for 5 years, or age 55 and retired for 10 years, to receive COLA
- Ohio Police & Fire – Onset of COLA begins at age 55 and one year after retirement
- Virginia RS – Deferred for one full calendar year after the member reaches unreduced retirement age. The deferred COLA does not apply to employees within 5 years of eligibility for unreduced retirement as of January 1, 2013 and to members who retire with twenty or more years of service.

Simple, not compounded

- Ohio PERS, California STRS and Michigan PSERS – Automatic 3.0% based on original benefit
- Hawaii ERS – Automatic 1.5% percent increase based on original benefit
- Michigan SERS – Automatic 3.0% simple, up to $300 annually

Estimates are that a 3.0% simple auto-COLA costs about the same as a 2.5% auto-COLA

Simple until age certain, then compounded

- Mississippi PERS – automatic 3.0% simple until reaching age 60; compounded thereafter

Suspended COLAs

- Colorado PERA – COLA was suspended in 2018 for two years
- Maine State & Teacher plan – COLA was suspended in 2011 for three years
- Kentucky Retirement Systems COLA was suspended in 2011 for two years
- New Jersey – suspended its COLA indefinitely, until the plans reach a designated funding level
- Ohio School Employees – suspended its COLA for three years beginning 2018

Tied to investment performance

- Connecticut Teachers Retirement System – Equal to Social Security COLA with a maximum of 1.0% if investment return is <8.5%; a maximum of 3.0% if return is 8.5%-11.5%; and limited to 5.0% if return is >11.5%.
- Arizona State Retirement System and Public Safety Personnel Retirement System – For those hired until 2013, when actuarial investment return exceeds 8.0 percent, a proportionate share of "excess earnings" are calculated and distributed as a permanent benefit increase based on years of service (not benefit amount).
- Wisconsin RS – COLA is based on investment performance in excess of actuarial investment return (smoothed over five years); COLA is added to base benefit until actuarial investment return increases or decreases it. Base benefit cannot be reduced.

Tied to funding level

- South Dakota Retirement System – The COLA is calculated annually and is linked to the actual rate of inflation, with a maximum of 3.5 percent and limited to the percentage that, if assumed to be paid in all future years, results in maintaining a funded ratio (using the market value of assets) of at least 100 percent.

Applied only to a portion of base benefit, with delayed onset

- New York State Teachers Retirement System – Automatic, equal to one-half of CPI, with a minimum of 1% and a maximum of 3%, compounded, applied to the first $18,000 in annual benefits.
- New York State & Local Retirement System – Automatic, based on one-half the CPI, applied to first $18,000, compounded.
- Massachusetts State Employees Retirement System and Teachers Retirement System - Automatic, based on CPI up to 3% on first $13,000 of benefit
- Oregon PERS - For new hires since 2013: 1.25% COLA applied only to the first $60,000 of benefit, and 0.15% on amounts above $60,000.