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STATE OF VERMONT
LEGISLATIVE JOINT FISCAL OFFICE

MEMORANDUM

TO: House Committee on Ways and Means

FROM: Chris Rupe, Associate Fiscal Officer

DATE: January 10, 2024

SUBJECT: Fiscal Year 2024 Budget Adjustment Act VSTRS COLA Modification

Language is under consideration for the fiscal year 2024 Budget Adjustment Act to modify the cost of living adjustment (COLA) formula for retired members of the Vermont State Teachers' Retirement System (VSTRS). The change is to apply the statutory maximum to the size of the COLA, rather than to the size of the net percentage change in the Consumer Price Index (CPI) used to calculate the COLA. This modification conforms to the legislative intent previously expressed in Section E.514.2 of Act 78 (2023; fiscal year 2024 Big Bill) to revert the calculation to the method employed prior to Act 114 (2016) and fund the present value of the estimated cost of the change moving forward: **$9.34 million.**

Background and Details

Retired members and beneficiaries of the VSTRS pension system are entitled to an automatic annual post-retirement adjustment allowance (COLA) that is calculated based on the net change in the Consumer Price Index (CPI) each fiscal year. The CPI experience during a fiscal year informs the COLA in the subsequent calendar year (i.e., the CPI experience during fiscal year 2023 informs the COLA for calendar year 2024).

Under current law, most members of the VSTRS pension system (Group C) receive a COLA that is calculated from 50 percent of the year-over-year net percentage change in the CPI. Statute sets forth minimum and maximum values to be used in the COLA calculation. For most current retirees, the statutory maximum is 5 percent.[1]

Prior to 2016, COLA statutory maximums applied to the size of the COLA itself. Act 114 (2016) revised this construct to apply the statutory maximums to the net percentage change in the CPI that

[1] See 16 V.S.A. § 1949. Act 114 (2016) and Act 173 (2022) reduced this maximum to 4 percent for most future retirees per the recommendations of the Pension Benefits, Design, and Funding Task Force. The 4 percent maximum applies to VSTRS Group C members who are eligible for retirement and leave active service on or after July 1, 2022. In order to receive a COLA, this cohort of members must be in receipt of a retirement allowance for at least 24 months prior to the January 1 effective date of any COLA.

is used for calculating the COLA – *not to the size of the COLA itself.*[2] That 2016 change was made within a broader context of modifications intended to avoid situations where negative CPI growth could result in a reduced pension benefit. Most Vermont State Employees' Retirement System (VSERS) members receive a COLA calculated at 100 percent of the net CPI change, whereas most VSTRS members receive a COLA calculated at 50 percent of the net CPI change.[3] Acts 114 and 173 (2022) reorganized this section of VSTRS statute but otherwise maintained the post-2016 calculation construct of applying the statutory COLA maximums to the net CPI change.

In an environment when inflation trends above the statutory maximum (5 percent for most current retirees, 4 percent for future retirees), material differences will arise based on the order in which the statutory maximums apply to the COLA formula. Fiscal year 2022 was the first year in more than three decades that featured a CPI higher than the 5 percent statutory maximum, which highlighted the difference between the methodology enacted in 2016 and the methodology that was previously used (see *Table 1*). Inflation subsided in fiscal year 2023, and the 2.2 percent CPI for the year led to COLAs of 1.1 percent in calendar year 2024.

- <u>Current law:</u> Applies the 5 percent statutory "maximum" to the *net percentage change in the CPI* used to calculate the COLA results in a maximum COLA of 2.5 percent for VSTRS.

- <u>Pre-2016 Law</u>: Applied the 5 percent statutory "maximum" *to the COLA itself.* Resulted in a maximum COLA of up to 5 percent for VSTRS (if the net CPI change was 10 percent or greater). If the CPI change was between 5 and 10 percent, the VSTRS COLA would fluctuate between 2.5 and 5 percent (50 percent of the net CPI change).

Table 1: **Examples of Differences in COLA Methodology**

Current Law	
Year-Over-Year Net CPI Change	7.60%
Apply 5% Statutory Max to Net CPI Change	5.00%
VSTRS COLA Formula (50% of Net CPI Change)	**2.50%**
Proposed Reversion to Pre-2016 Law	
Year-Over-Year Net CPI Change	7.60%
VSTRS COLA Formula (50% of Net CPI Change)	3.80%
Apply 5% Statutory Max to COLA	**3.80%**

Consistent with current law, the calendar year 2023 COLA was calculated by applying the statutory maximums to the net CPI change, not to the COLA itself. With a net CPI change of 7.6 percent during fiscal year 2022, this resulted in a calendar year 2023 COLA of 2.5 percent. As shown in *Table 1*, reverting to the pre-2016 methodology and applying the maximums to the COLA itself would have resulted in a 3.8 percent COLA benefit. The cost impact of a higher COLA in one year is compounded in future years because it increases the "base" upon which future COLAs are calculated.

Act 78 appropriated $3 million from the Education Fund to VSTRS to fund one-time payments to eligible VSTRS retirees and beneficiaries in 2023 at an amount equivalent to the difference between the 2.5 percent actual COLA and 3.8 percent (50 percent of CPI). These one-time payments are not factored into the "base" upon which future COLAs are calculated. Of the $3 million, approximately

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[2] Coincidentally, the 2016 miscellaneous retirement bill and the 2022 Pension Task Force legislation were both designated as "Act 114." Act 173 (2022) included some technical corrections to the teacher COLA statute, as well. Neither 2022 act modified the provision that applies the statutory maximum to the net percentage change in the CPI used to calculate the COLA.

[3] Since the VSERS COLA formula is based on 100 percent of the net CPI change, applying the 5 percent statutory maximum to either the net CPI change or the COLA itself produces the same result for VSERS.

$2.84 million was expended on the payments and related actuarial services, yielding a surplus payment of $160,000 into VSTRS.

Fiscal Impact

Act 78 expressed legislative intent to revert the COLA formula back to its pre-2016 method and to fully fund the present value of the estimated cost of the benefit up front so as not to increase the unfunded liability of the pension system. The cost was estimated to be $9.1 million in early 2023. After the Act's passage, the pension systems performed experience studies that lead to revised actuarial assumptions, changing the cost estimate. The General Assembly was aware of the upcoming experience studies and reserved $9.1 million in the Education Fund in fiscal year 2024 to fund this change. Act 78 also directed the State Treasurer to perform additional actuarial analysis to estimate the cost once actuarial assumptions were revised following the 2023 experience studies. That recent actuarial analysis revised the cost estimate to $9.5 million. **When factoring in the $160,000 surplus payment to VSTRS, a net payment of $9.34 million is required to fully fund the present value of future benefits without increasing the unfunded liability (all else being equal).**

Act 78 (2023) References

Sec. B.1104 FISCAL YEAR 2024 ONE-TIME APPROPRIATION; RETIRED TEACHERS' COST OF LIVING PAYMENT

(a) In fiscal year 2024, notwithstanding any provision of 16 V.S.A. § 4025 to the contrary, the amount of $3,000,000 is appropriated to the Vermont State Teachers' Retirement System from the Education Fund for Calendar Year 2023 supplemental payments made in Sec. E.514.2(b) of this act and associated costs.

Sec. D.104 EDUCATION FUND RESERVE; FUTURE SUPPLEMENTAL COST OF LIVING PAYMENTS

(a) In fiscal year 2024, notwithstanding any provision of 16 V.S.A. § 4025 to the contrary, the amount of $9,100,000 is reserved in the Education Fund to fund future supplemental cost of living payments to qualifying retired members and beneficiaries of the Vermont State Teachers' Retirement System or the present value of any changes made to the methodology for calculating the postretirement adjustments allowance set forth in 16 V.S.A. § 1949, or both.

Sec. E.514.2 VERMONT STATE TEACHERS' RETIREMENT SYSTEM; CALENDAR YEAR 2023–2024 SUPPLEMENTAL COST OF LIVING PAYMENTS; INTENT; ACTUARIAL COST ANALYSIS

(a) Intent. It is the intent of the General Assembly that:

(1) The maximum percentage value methodology set forth in 16 V.S.A. § 1949 that applies to the postretirement adjustment allowances for the Vermont State Teachers' Retirement System (VSTRS) shall be actuarially evaluated to determine the cost required to revert to the methodology used prior to the enactment of 2016 Acts and Resolves No. 114.

(2) The General Assembly further intends to make such a reversion by future legislative action amending 16 V.S.A. § 1949, provided that the present value of changes to the postretirement adjustment allowance methodology be fully funded at the time the change is made and not increase the unfunded liability in VSTRS.

(3) The General Assembly further intends that if the June 30, 2023, change in the Consumer Price Index exceeds the statutory maximum percentage values set forth in 16 V.S.A. § 1949 (b)(1), the General Assembly will provide a sufficient appropriation in the 2024 Budget Adjustment Act to make a one-time supplemental payment, similar in form to that described in subsection (b) of this section, to qualifying VSTRS retired members and beneficiaries in calendar year 2024.

(b) Calendar year 2023 supplemental payment. A one-time supplemental payment during calendar year 2023 shall be made to VSTRS retired members and beneficiaries who received a 2.5 percent postretirement adjustment allowance in an amount equal to the net difference between what members actually received in calendar year 2023 and what they would have received under a 3.8 percent postretirement adjustment allowance.

(c) Actuarial cost analysis. Following the completion of the next experience study, expected in fall 2023, the State Treasurer shall conduct an actuarial analysis to evaluate the cost of changing the current methodology for calculating the postretirement adjustment allowance for the Vermont State Teachers' Retirement System to a methodology calculated by applying the maximum percentage values set forth in 16 V.S.A. § 1949(b)(1) to the postretirement adjustment allowance rather than applying the statutory maximum percentage values to the net percentage change in the Consumer Price Index. The actuarial analysis shall take into account any changes to actuarial assumptions that may occur following the experience study to be performed at the end of fiscal year 2023, as required by 16 V.S.A. § 1942.

(d) Report. Based on the actuarial cost analysis described in subsection (c) of this section, on or before January 15, 2024, the State Treasurer shall submit a report to the House and Senate Committees on Appropriations with an actuarial cost estimate for changing the VSTRS postretirement adjustment allowance methodology as set forth in subsection (c) of this section.