Joint Committee on Pensions, Investments, and Benefits

Cost-of-Living Adjustments

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November 20, 2024

KPERS

Purpose Cost-of-Living Adjustments

The value of a fixed pension benefit payment will erode over time due to inflation.

The longer a member lives in retirement, the larger the total effect inflation will have.

A cost-of-living adjustment, or COLA, is a plan design feature that helps to mitigate the impact inflation has on the purchasing power of benefits.

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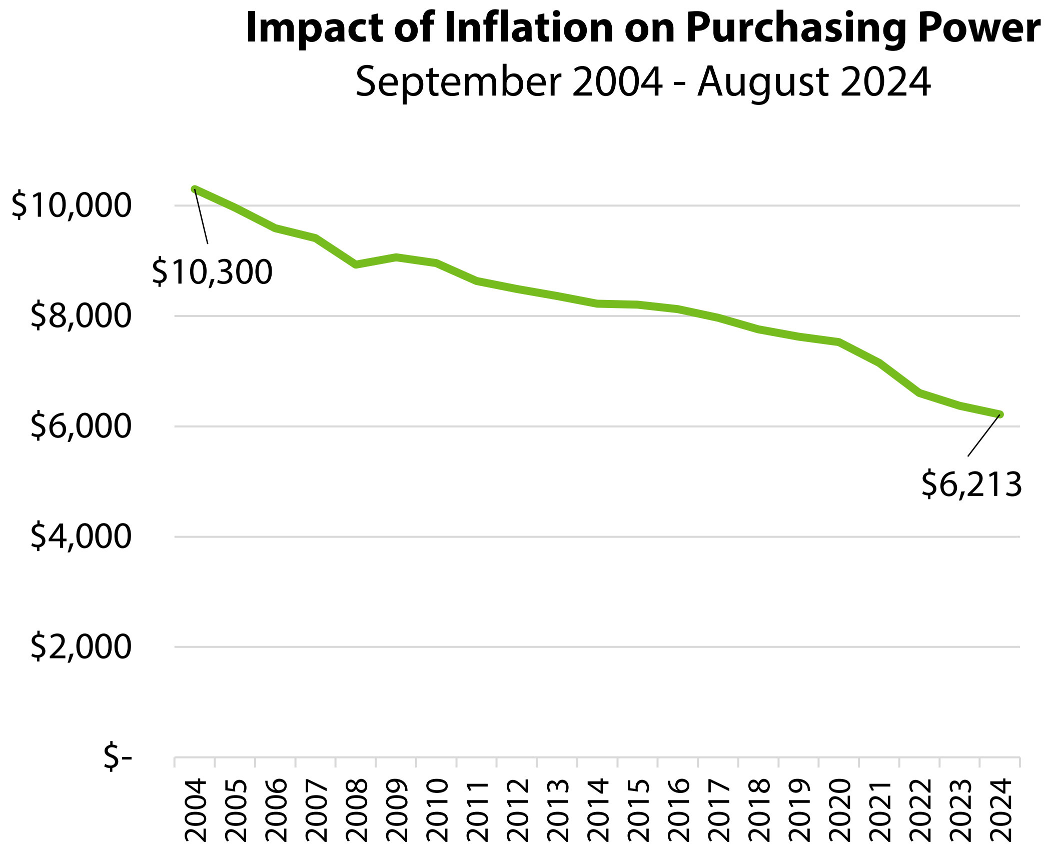
Loss of Purchasing Power

In 2004, the average retirement benefit was about $10,300.

The average annual inflation in the CPI-U over the past 20 years (through August 2024) was just above 2.5%.

The purchasing power of that $10,300 benefit in 2004 is only about $6,100 in 2024, a decline of almost 40%.



Cost-of-Living Adjustment Approaches

Public sector retirement plan designs vary on the inclusion of cost-of-living adjustments, but generally there are two approaches:

Automatic Adjustments

- Automatic adjustments occur on a regular, pre-determined schedule and require no additional action by the plan sponsor.
- There may be certain conditions that need to be met (e.g. investment returns).
- The amount may be tied to an index (e.g. CPI-U) and capped.

Ad Hoc Adjustments

- Ad hoc adjustment require approval of the plan sponsor or delegated authority.
- For Kansas (and most public plans) that is the Legislature.
- No adjustments are granted without action from the governing body.

Cost-of-Living Adjustment Approaches

The National Association of State Retirement Administrators (NASRA) maintains a report* of cost-of-living adjustments across public sector plans.

In the May 2024 update to the document, a selection of 101 public sectors plans showed that 74 plans included an automatic COLA of some kind and 27 (including Kansas) utilized ad hoc COLAs.

The most common COLA design tied the cost-of-living adjustment to the Consumer Price Index, but some plans tie their COLA to investment performance and/or funding level.

*National Association of State Retirement Administrators, "NASRA Issue Brief: Cost-of-Living Adjustments," May 2024

COLA Costs

COLA costs vary widely depending on the characteristics of the COLA.

- Automatic vs. Ad hoc
- One-time payments vs. permanent adjustments
- Adjustment to base benefit vs. compound adjustments
- Onset of benefit (e.g. number of annuitants included)

An actuarial analysis* of the cost-of-automatic COLAs has estimated:

- A 1%, compounding COLA increases liabilities by 7%
- A 2% automatic, compounding COLA increases liabilities by 16%
- A 3% automatic, compounding COLA increases liabilities by 26%

*Gabriel, Roeder, Smith & Company, "Postemployment Cost-of-Living Adjustments: Concepts and Recent Trends," April 2011

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COLA Costs

KPERS' consulting actuary provided an analysis on adding a 1% automatic cost-of-living adjustment to the plan design based on the most recent valuation.

- For the State/School group, a 1% automatic COLA increases unfunded actuarial liability by $760 million and increases the normal cost rate by 1.17% (about $66 million annually).

KPERS' actuary also calculated how many of the current 116,000 retirees could receive a one-time, 5% benefit increase for all future years starting with members retired the longest.

- $25 million would fund a 5% increase for about 7,800 members (retired prior to July 1, 1998).
- $50 million would fund a 5% increase for about 13,000 members (retired prior to July 1, 2001).
- $100 million would fund a 5% increase for about 22,400 members (retired prior to July 1, 2005).

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Kansas COLA history

With three exceptions, KPERS plan design has not included a cost-of-living adjustment since the plan was created in 1961.

1. KPERS 2 included an automatic 2% COLA when it was created in 2007, but that was removed in 2012. There are 5 members receiving this COLA.

2. KPERS 3 has a self-funded COLA of 1% or 2%. The member's benefit is reduced at retirement and then grows over time by the selected percentage. The reduction is actuarially equivalent to the base benefit (after option). 75 KPERS 3 members have elected the COLA and received an adjustment, the number of members who have elected a COLA since January are being compiled.

3. A 13th check benefit was paid to members from 1980 to 1987, when it was closed to new participants. There are about 500 members who receive the 13th check benefit.

No other KPERS, KP&F or Judges members receive automatic cost-of-living adjustments.

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Kansas COLA history

The Legislature has approved both permanent and one-time ad hoc COLAs throughout the history of the plan, including:

- 16 permanent adjustments, most recently in 1998.
- 5 one-time benefit payments, most recently in 2008 (applying to members retired at least 10 years).

No cost-of-living adjustments have been approved by the Legislature since 2008.

As of the 12/31/2023 valuation 10,981 members met the criteria to receive at least one cost-of-living adjustment since they retired. This represents 9.5% of the population of retirees and beneficiaries. The remaining 90.5% have never received a cost-of-living adjustment.

Questions?