University of California Retirement Plan Cost-of-Living Adjustment (COLA) Training

Presented by

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Overview

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- Retained Purchasing Power
- Types of COLAs for Defined Benefit Plans
- What is the CPI?
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What is a COLA?

- COLA stands for “Cost-of-Living Adjustment”

- Typically, an annual increase in a benefit amount designed to keep up with inflation
  - Can also apply to a benefit threshold
    - Covered Compensation Limits (Internal Revenue Code (IRC) 401(a)(17), PEPRA)
    - 415 Dollar Limit
    - Social Security Wage Base

  - For UCRP, is also a component of a salary increase for certain inactive members (i.e. Inactive COLA)

Retained Purchasing Power

- COLA is designed to keep up with inflation – Why?

- Concept of "Retaining Purchasing Power"

- What is Purchasing Power?
  - *Purchasing power* is defined as the number of goods and services that can be purchased with a unit of currency.
  - Price inflation erodes purchasing power.

<u>Example</u>: Let's say you could purchase five of a certain item for $1, but then three years later the price of the item has gone up by 25% due to inflation. Now you can only buy four of the item for $1. Inflation has eroded purchasing power.

Retained Purchasing Power (cont.)

- After three years the $1 retains 75% of its original purchasing power or, said another way, after three years the $1 has 75% “Retained Purchasing Power”.

  - If there is no inflation, retained purchasing power will be 100%.

- In periods of high inflation, how can the erosion in retained purchasing power be minimized?

  - By increasing the units of currency by a COLA

What is the CPI?

- The Consumer Price Index (CPI) measures changes in the prices of a "market basket of consumer goods and services" purchased by households
  - Includes food, apparel, housing, energy, vehicles, medical care, etc.

- COLAs tied to inflation
  - Inflation-based COLAs are based on changes in a CPI published by Department of Labor - Bureau of Labor Statistics
    - UCRP COLAs
    - Covered Compensation Limits and 415 Benefit Limits
    - Social Security Benefits

Types of COLAs for Defined Benefit Plans

- COLAs can be applied on an annual or ad-hoc* basis
  - For UCRP, the annual COLA occurs on July 1

- Annual COLAs can be either "simple" or "compound"

  - Simple COLA - the increases in the benefit don't themselves earn COLA
    - **Example**: $1,000/mo. benefit that goes up by $20 each year is a simple COLA of 2% per year
  - Compound COLA - the increases in benefit also earn COLAs
    - **Example**: $1,000/mo. benefit that goes up by $20 in the 1st year, the 2nd year increase would be $20.40 rather than $20 and so on

- Annual COLAs for UCRP are applied on a compound basis

*Ad-hoc COLAs – granted at the discretion of the Regents

How are COLAs Determined for UCRP?

- UCRP COLAs Based on CPI Increase
  - Ratio of the average (LA and SF) CPI from the prior year's month of February to the current year's month of February

7/2023 Derivation of UCRP COLA	2/2022 CPI	2/2023 CPI
San Francisco Bay Area	320.195	337.173
Los Angeles Metro Area	302.164	317.571
Average CPI-U	311.180	327.372
		5.20%

**Source: Department of Labor, Bureau of Labor Statistics website*

UCRP provides an annual COLA that matches the increase in the CPI up to 2%, plus 75% of the CPI increase in excess of 4%, to a maximum COLA of 6%

July 1, 2023 Annuitant COLA

- July 1, COLA is based on <u>actual</u> change in CPI
  - The change in CPI through <u>2/2023</u> is 5.20%

  UCRP annual COLA formula: matches the increase in the CPI up to 2%, plus 75% of the CPI increase in excess of 4%, to a maximum COLA of 6%

  - "Baseline" COLA is 2.00%
  - CPI (5.20%) – Excess of (4.00%) = 1.20%
  - COLA is 1.20% X 75%= 0.90%
  - Total COLA is 2.00%+ 0.90% = **<u>2.90%</u>**

All UCRP annuitants with a retirement date of 7/1/2022 or prior will receive a <u>2.90%</u> COLA on 7/1/2023.

July 1, 2023 Inactive COLA

- Inactive COLA applies only to 1976 Tier and Safety members
- Upon retirement, an inactive member's Highest Average Plan Compensation (HAPC) will be adjusted with cost-of-living increases from the date of their inactive membership through their retirement date.
- The adjustment is equal to the lesser of 2.00% compounded annually or the actual increases in CPI during that time (*Minimum of 5.20% and 2.00%)*
- Members who separate between 6/30/2022 to 6/29/2023 will receive an Inactive COLA of 2.00% on July 1, 2023
- Members with an HAPC that is already limited by the IRC 401(a) (17) Covered Compensation Limit will not receive Inactive COLAs
  - Members in this situation do not need to have a one-day separation prior to retirement

Inflation and COLA Banks

- Each year's annuitant COLA % depends on both the CPI increase that year and the cumulative increase in the CPI since the Member retired

  - For this purpose, two banks are maintained
    - **Inflation Bank**
      - Accumulates in years in which the CPI increase > 2%
      - Can be used to increase the "baseline" COLA in years in which the CPI increase < 2%
    - **COLA Bank**
      - Accumulates in years in which the CPI increase < 2% as the difference between 2% and the CPI increase
      - Can be used to increase the "baseline" COLA in years in which the CPI increase > 2%

Inflation and COLA Banks (cont.)

- Both banks accumulate from the Member's initial eligibility for a COLA

  - The annual annuitant COLA is issued every July 1, after the member has been retired for 12 full months.

  - Possible to pay different annual COLA amounts in the same year to different Retired Member groups

    - Depends on year of retirement and the resulting amounts in the inflation bank and COLA bank

Note - Most California public pension plans do not provide a COLA bank; only an inflation bank, which ironically is called the "COLA bank".

Summary

On 7/1/2023 two COLAs will be awarded:

Annual Annuitant COLA: All UCRP members with a retirement date of 7/1/2022 or prior will receive 2.90% COLA.

Inactive COLA: Members (only 1976 Tier and Safety) who separate between 6/30/**2022** to 6/29/2023 will receive an Inactive COLA of 2.00%

Does the Inactive COLA apply? Yes/No

Date of Separation = 6/28/2023
Date of Retirement = 7/1/2023

Yes

Date of Separation = 5/1/2023
Date of Retirement = 5/3/2023

No

Date of Separation = 6/30/2023
Date of Retirement = 7/1/2023

No

Date of Separation = 5/1/2023
Date of Retirement = 7/1/2023

Yes

Date of Separation = 6/29/2023
Date of Retirement = 7/4/2023

Yes

Inactive COLA Scenario:

Jack is currently the Fire Chief at UC Davis. He is retiring on July 1, 2023. His HAPC is $29,000, which exceeds the current 401(a)(17) IRC (Internal Revenue Code) covered compensation limit of $27,500 on a monthly basis. He contacted his benefit office to determine the best separation date to be eligible for Inactive COLA, as he hopes to receive a higher retirement benefit.

Which of the following choices apply to his case?

a) As a Safety member in his position as Fire Chief, Jack would unfortunately not be eligible for the Inactive COLA.

b) In order for Jack to be eligible for the Inactive COLA, he should separate from employment on 6/29/2023, and retire on 7/1/2023.

c) In order for Jack to be eligible for the Inactive COLA, he should separate on 6/30/2023 and retire on 7/1/2023.

d) Jack is not eligible for the Inactive COLA due to his HAPC being above the IRC limit. His HAPC is unaffected whether he separates from employment on 6/29/2023 or 6/30/2023 and retires on 7/1/2023.

Questions & Answers