AGENDA ITEM K

UCRS – Methodology for COLAs and Measurement of Annuitant Purchasing Power

COLA Methodology

The UCRP Cost-of-Living Adjustment (COLA) is based on the average increase in the Consumer Price Index (CPI) for All Urban Consumers in the metropolitan areas of San Francisco and Los Angeles for the month of February in the prior and current years.

UCRP provides an annual COLA that generally 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%. The COLA percentage to be applied to a Member's benefit for a specific year depends not only on the CPI increase that year, but also on the cumulative increase in the CPI since the Member retired. For this purpose, two banks are maintained, an "inflation bank" and a "COLA bank", which are then used to determine the total COLA amount that an annuitant is entitled to in a given year.

The inflation bank accumulates in years in which the CPI increase is greater than 2%. The inflation bank represents the portion of the cumulative increase in the CPI since the Member's Retirement Date for which the annuitant has not received a COLA. For example, the annual CPI increase as measured in February 2003 was 3.45%, but based on Plan provisions the July 2003 COLA was only 2%. The remaining 1.45% is adjusted for compounding, resulting in an inflation bank of 1.42% (i.e., 1.0345/1.02 – 1 = 1.42%) for annuitants who were first eligible for a COLA in July 2003. The inflation bank can be used to increase the COLA that would be payable in years in which inflation is less than 2%. For example, the inflation bank was used to provide Members who retired on or before July 1, 2002 a 2% COLA on July 1, 2004, even though the increase in the CPI average was less than 2% in 2004.

The second bank is the COLA bank. In years in which inflation is less than 2%, the difference between 2% and the CPI increase is accumulated in the COLA bank. The COLA bank represents the portion of the potential COLA that has not been paid to the annuitant due to low inflation. For example, the annual CPI increase as measured in February 2004 was 1.04%. Annuitants who received a 1.04% COLA in July 2004 accumulated 0.96% in their COLA bank. Two years later, the CPI increase measured in February 2006 was 4.01%. Based on Plan provisions, those annuitants with nothing accumulated in their COLA bank were entitled to receive a 2.01% COLA on July 1, 2006. However, those annuitants who had 0.96% in their COLA bank after the July 1, 2004 effective date still had 0.28% left to use on July 1, 2006 (after 0.68% was used on

July 1, 2005). This COLA bank was used to give these annuitants a 2.29% COLA on July 1, 2006 (2.01% + 0.28%).

Both banks start accumulating from the Member's initial eligibility date for a COLA. Therefore, when economic conditions warrant using either of the banks, it is possible for the Plan to pay different annual COLA amounts in the same year to different Retired Member groups, depending on the year in which the Members retired and the resulting amounts in their inflation bank and COLA bank.

Measurement of Annuitant Purchasing Power – UCRP Annuitants

Historically, The Regents have striven to protect annuitants' benefits from being significantly eroded by inflation. However, this is not a guaranteed contractual benefit. Rather, in February 1988, the UCRS Advisory Board passed a resolution indicating its intent to recommend from time to time, and subject to the availability of funds, adjustments to approximate a 75% minimum level of purchasing power. One-time, otherwise known as "ad hoc", COLAs were given in January 1986 and July 1988 to restore the purchasing power of annuitants' UCRP benefits to a 75% level. In January 1991, an ad hoc COLA was given to restore retirement benefits to a floor of 80% of purchasing power and in January 2001 an ad hoc COLA was given to restore retirement benefits to a floor of 85% of purchasing power. The 85% level was recommended so that it would not be necessary to provide additional ad hoc COLAs as frequently to restore the 75% purchasing power level.

Data on the CPI needed to determine the UCRP COLA is generally available from the Bureau of Labor Statistics by late March of each year. Once the UCRP COLA amount is determined, the Board will be appropriately advised.