Preview of UCRP
July 1, 2021
Cost-of-Living Adjustment (COLA)

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Overview

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

- C.O.L.A. 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
    - 415 Dollar Limit
    - Social Security Wage Base
  - For UCRP, is also a component of a salary increase for inactive members (i.e. Inactive COLA)

Retained Purchasing Power

- COLA is designed to keep up with inflation – Why?
  - Concept of “Retained 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
    - Example: Let’s say you could purchase 5 of a certain item for $1, but three years later the price of the item has gone up by 25% due to inflation. Now you can only buy 4 of the item for $1. Inflation has eroded purchasing power.
  - In inflationary times, how can the erosion in retained purchasing power be minimized?
    - By increasing the units of currency by a COLA

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 COLAs
    - 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

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

How are COLAs Determined for UCRP?

- CPI Increase Basis for UCRP
  - Ratio of the average (LA and SF) CPI from the prior year's month of February to the current year's month of February – This is the CPI increase basis

7/2020 Derivation of UCRP COLA	2/2019 CPI	2/2020 CPI
San Francisco Bay Area	291.227	299.690
Los Angeles Metro Area	269.608	278.657
Average CPI-U	280.418	289.174
CPI Pct for COLA = Ratio - 1		**3.12%**

- 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%
  - The "baseline" COLA for 2020 was 2.00%

How are COLAs Determined for UCRP? (cont.)

- 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%

How are COLAs Determined for UCRP? (cont.)

- Both banks accumulate from the Member's initial eligibility for a COLA
  - There is a 12-month waiting period after retirement date to receive the first annual annuitant COLA
  - 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 plans do not provide a COLA bank; only an inflation bank, which interestingly enough, they call the "COLA bank"

Preview of July 1, 2021 COLA

- July 1, 2021 COLA will be based on actual change in CPI from 2/2020 through 2/2021
  - Actual change in CPI through 12/2020 is +0.7%
    - Recovering from large decrease that occurred in 4/2020
    - Main driver in low inflation on a nationwide basis over last twelve months is a large decrease in the “energy” (mainly gasoline and fuel oil) component of the CPI
  - “Baseline” COLA will likely be less than 2%
  - Following slides show how this could impact July 1, 2021 COLA

Preview of July 1, 2021 COLA (cont.)

- Sample July 1, 2021 Annuitant COLA Calculations
  - UCRP member with retirement date of 7/1/19 or prior
    - Hypothetical CPI Increase for 2/2020 to 2/2021 is 1%
    - 7/1/2020 Inflation Banks for these retirees are greater than 1%
    - These retirees would all receive 2% COLA on 7/1/2021
  - UCRP members with retirement dates 7/2/19 through 7/1/20
    - Hypothetical CPI Increase for 2/2020 to 2/2021 is 1%
    - There is no 7/1/2020 Inflation Bank for these retirees
    - These retirees would all receive a 1% COLA on 7/1/2021
    - 7/1/2021 COLA Bank balance would be 1% for this group

Preview of July 1, 2021 COLA (cont.)

- Sample July 1, 2021 Inactive COLA
  - Upon retirement, inactive members have their Highest Average Plan Compensation (HAPC) at their date of inactive membership adjusted for cost-of-living increases through their retirement date
  - Inactive COLA applies only to 1976 Tier and Safety
  - The adjustment is equal to the lesser of 2.00% compounded annually or the actual increases in CPI during that time
  - Members who separate between 6/30/2020 to 6/29/2021 will receive an Inactive COLA on July 1, 2021
    - Would be +0.7% based on changes in CPI through December 2020

Questions & Answers