The Commission supports action to address the inflationary impact on State and Teachers' pensions, for which there has been no increase in the COLA base since 2012, resulting in a maximum annual COLA increase of $390 for the past 13 years.

Chapter 17, Acts of 1997, established a $12,000 COLA base for the State and Teachers' systems, as well as for the other 102 retirement system throughout the Commonwealth, which resulted in a maximum $360 annual increase. In 2010 the local and regional systems were allowed to increase the $12,000 base with local legislative approval.

Shortly thereafter, in 2012, the State and Teachers' base was increased to the current $13,000 level, resulting in a maximum $390 annual increase in the COLA benefit. Essentially, there has only been one $30 increase in the State and Teacher COLA benefit in more than 27 years. As a result, retirees of the State and Teacher systems have amongst the lowest COLA benefit in the state. Currently one system is at $12,000, 12 systems have a base of $13,000 and 88 systems are over $13,000 – with 49 of those at $16,000 or greater.

In addition, the Commission recognizes that the longest retired members of our 104 public retirement systems have been most severely impacted by limits placed on COLA increases. The average benefit for retirees who are 80 or older is less than the average benefit for each system, and for retirees over the age of 90, the average benefit is only $33,359 for state retirees and $30,145 for retired teachers. At the local level, the average benefit is even lower.

Such data reviewed by the Commission for the State and Teachers' systems identified the inflationary deterioration of benefits resulting from the stagnate COLA base in existence since 1997 to the present base of $13,000 for State and Teacher long-term retirees. As a result, there has been a significant focus by the Commission to address the need to provide an additional cost-of-living enhancement for that population.

The Commission also recognizes that any action needs to be fiscally responsible for the Commonwealth, local governments, and the health of the retirement systems.

The longstanding concern around this issue has been cost. As of January 1, 2024, each $1,000 increase in the COLA base for the State and Teachers' systems – which would represent an extra $30 per year to each retiree – increases present value pension obligations by approximately $600 million. Under the current funding schedule, that would represent an increase of $72.7 million in FY25, with this amount increasing 4% each year through FY34 (10 years). Recognizing the cost issue, the Commission's proposals do not require additional Commonwealth contributions as part of the ongoing pension schedule.

The Commission makes three recommendations: creating a mechanism to sustainably fund COLA base improvements; developing an Enhanced COLA that is targeted to those who have been retired longer and whose benefits are below a designated benchmark; and instituting a COLA base increase process that will ensure such increases can be both financed and occur on a more regular basis.

The Commission recommends setting aside a fiscally responsible percentage of excess investment gains into a COLA reserve account to fund COLA enhancements while causing the least stress on Commonwealth budgetary appropriations and the retirement systems.

This reserve account's assets would remain invested with PRIM but would not be attributed to the assets of the State and Teachers' Retirement Systems.

When the reserve account has sufficient funds to pay for a COLA enhancement, PERAC will notify the Governor, the Speaker of the House, the Senate President, and the Chairs of the Joint Committee on Ways and Means. Consistent with current statute, the Legislature must pass, and the Governor must approve a COLA increase. If this recommendation is adopted, going forward, the Governor and Legislative leadership would know there are sufficient funds available for a COLA increase without budgetary impact.

The Commission recommends that excess investment gains are defined as any amount over the assumed rate of return, currently set at 7%. Setting the assumed rate of return as the threshold is recommended to prevent any added expectations, mixed messages or increased stress on PRIM whose mission is to maximize returns while mitigating risk.

The Commission considered and analyzed a variety of proposals while examining what percentage of the excess investment gains should be moved to the COLA reserve account. Those estimates are a part of this report. The Commission recommends that, beginning with the 2025 investment gains 10% of the gains in excess of the assumed rate of return should be moved to the reserve.

In any year where excess investment gains are realized, the designated portion of the gains would be moved to the COLA reserve fund upon final year-end calendar reporting. If the intention of the reserve fund is to be able to provide COLA improvements, whether it be a COLA base increase or adjustments to the Enhanced COLA, with no further contribution from the Commonwealth, this can only be achieved by creating a reserve account which is to be separate from the assets used to determine the funding status of the plan. Under this concept, when a COLA increase is provided, the increase in liability due to the COLA would be fully funded by a transfer from the Reserve account into the plan assets, there would be no change to the overall unfunded liability of the plan. If the excess earnings were not separated from the plan assets, the unfunded liability of the plan would be determined at the time of the valuation and the cost of any subsequent COLA increase would then be added on top of the unfunded liability, showing an increase in the unfunded liability.

The Commission considered determining any excess investment gains at the end of each three-year funding schedule, but for the reasons stated here, it was not feasible.

System members who have been retired longer with lesser retirement allowances feel the effects of inflation the most and need the most help. The Commission examined numerous scenarios of what an Enhanced COLA could look like that would provide additional benefits to certain segments of the retiree population. These scenarios included the number of years of public service required, the number of years retired, retirement allowance thresholds for eligibility, and the amounts of the benefit based on the number of years retired. Many of these scenarios cost less than a $1,000 COLA base increase. Recognizing the state's fiscal position, the time lapse since the last COLA base increase, inflation since the last COLA base increase, the cost of a $1,000 COLA base increase, the reduced cost of an Enhanced COLA, and the fact that it would provide relief to those who need it most, the Commission recommends instituting an Enhanced COLA as a priority. The Commission recommends instituting an Enhanced COLA with parameters that cost less than a $1,000 COLA base increase. The various parameters the Commission analyzed are attached to this report. There are other possible scenarios based on those presented.

Additionally, the Commission envisions that the creation of a new Enhanced COLA benefit could be utilized by the 102 local retirement systems through local option.