Special Cost of Living Adjustment (COLA) Commission Meeting Minutes

February 4, 2025

PERAC Executive Director & Chairman Bill Keefe called the meeting (remotely via Zoom) to order at 10:35 AM. Mr. Keefe explained that because the meeting was remote, all motions made during the meeting would be voted on by roll call and that the meeting would be recorded.

Special COLA commission members in attendance at the Zoom meeting included State Senator Michael Brady, MTRS Executive Director Emerita Erika Glaster, State Representative Ken Gordon, Mass. Taxpayers Foundation President Doug Howgate, PERAC Executive Director Bill Keefe, State Retirement Board Executive Director Kathryn Kougias, Executive Office of Administration and Finance Assistance Budget Director Amelia Marceau, PRIM Executive and Chief Investment Officer Michael Trotsky, and President of Mass. Retirees Frank Valeri.

PERAC Staff, including First Deputy Executive Director Caroline Carcia, Assistant Deputy Director Patrick Charles, Actuary John Boorack, Actuarial Assistant Nate Geitz, and Investment Analyst Anna Huang, were present at the Zoom meeting to provide technical expertise and support to the Commission members.

Other attendees at the Zoom meeting: Al DeGirolamo (Sen. Brady's Ofc.), Carol Ziemian, Fiona Bruce-Baiden (Rep. Ken Gordon's Ofc.), Francesco Daniele (PRIM), Jay Leu (PRIM), Jim Machado (Fall River Retirement Board), Parak Emeritus (PRIM), Jay McGowan, Laura Barrett, Patrick Brock (Hampshire County Retirement Board), Robert Clayman, Sarah Singer, Sean King (Mass Teachers Association), Sada Korroch (Rep. Ken Gordon's Ofc.), Seth Gitell (PRIM), Shannon Erickson (PRIM), Sharon Sullivan (Mass State Retirement Board), Shawn Duhamel and Tom Bonarrigo (Mass Retirees).

Minutes Approval

Before the motion to approve the January 31, 2025 meeting minutes, Mr. Keefe clarified that he made a minor change on pages 3-4 in the "Stabilization Fund Task Force" section, clarifying that the 3% was applied to the $13,000 COLA base.

Commission member Ken Gordon motioned to approve the January 31, 2025 meeting minutes. State Senator Michael Brady seconded the motion, and a vote was taken:

Michael Brady YES, Erika Glaster YES, Ken Gorden YES, Doug Howgate YES, Bill Keefe YES, Kathryn Kougias YES, Amelia Marceau YES, Michael Trotsky YES, Frank Valeri YES, and the minutes were adopted.

Logistical Issues

Mr. Keefe confirmed that the next meeting is scheduled for March 10th at 11:00 AM. A meeting invite will be sent for that date. He also mentioned that the website is live on PERAC's front page, with a section dedicated to the Special COLA Commission under "More PERAC Information." Additionally, Mr. Keefe noted that a 2005 report produced by PERAC would be added to the reference materials list on the website for everyone's review. He noted that the figures in the report are over 20 years old, and at that time, the PERAC commission had voted to support a $16,000 COLA base.

An Overview of Actuarial Valuation and Pension Funding Basics

PERAC Actuary John Boorack provided an overview of actuarial valuation and pension funding, covering four key components: the purpose of pension funding, actuarial valuation methodology and liability, the Commonwealth's financial schedule and liabilities, and an analysis of asset returns and funding scenarios.

- ❖ *The purpose of pension funding*

Pension funding serves two primary objectives:

1. To provide retirement security for plan participants by accumulating assets to ensure promised benefits are paid.
2. To ensure equitable treatment across generations by allocating pension costs based on the period employees provide service.

- ❖ *The actuarial valuation methodology and the explanation of actuarial liability*

The actuarial valuation process is a mathematical method for assessing a plan's financial condition and funding progress. It helps determine the annual contributions required to fund the plan's benefits. The funding evaluation provides a snapshot of the valuation date, estimating future cash flows for all active and retired participants. These future cash flows are then discounted to present value using actuarial assumptions.

The actuarial assumptions include both economic and demographic assumptions. Economic assumptions include factors such as salary increase projections and COLA percentage inflation. Demographic assumptions cover rates such as mortality, retirement, and disability. Mr. Boorack explained that the accuracy of these assumptions is assessed through a gain-loss analysis, comparing actual results to the assumptions used in the previous valuation.

Chapter 32 mandates actuarial valuations every two years. However, the state, teachers'and Commonwealth reports are conducted annually (except during the COVID-19 pandemic). In an actuarial valuation, the key figure is the present value of future benefits, representing the current value of all benefits expected to be paid to plan members. The portion attributed to future service is the present value of future normal costs, representing the value today of benefits accruing in each future year. The portion attributed to past service is the actuarial liability, calculated by subtracting the present value of future normal costs from the total present value of future benefits. Alternatively, actuarial liability can be viewed as accumulating all past normal costs, including interest.

Mr. Boorack explained that the actuarial value of assets for the state, teachers' and Commonwealth plans is determined using a smoothing methodology. This method phases in actuarial gains or losses on a market value basis over five years, recognizing 20% of a gain or loss each year until it is fully recognized. This approach helps reduce market volatility while still reflecting overall market movements.

A plan's funded status is determined by comparing liabilities to assets. The unfunded actuarial liability (UAL) and the funded ratio are two ways to show this status. The UAL represents the dollar difference between the plan's total liabilities and assets, while the funded ratio is the portion of the liability covered by plan assets.

A comparison between the UAL and the funded ratio was presented with examples. Although the result shows that the funded ratio is a more accurate measure of funding status, both were used in the process. It was emphasized that a fully funded plan is not static; it can move in and out of fully funded status. Factors like actuarial losses, changes in assumptions, or plan provisions that increase liabilities can cause a plan to shift away from being fully funded.

The funding schedule includes the normal cost (accrued benefits for the year) and the past service cost (amortization of the unfunded liability).

- *The Commonwealth financial schedule and liabilities*

Normal cost payments continue when a pension system is fully funded, but past service costs are reduced to zero. According to Chapter 32, Section 22C, the Commonwealth must achieve full funding by June 30, 2040. After that, it will only make normal cost payments. The funding schedule is updated every three years, with the next revision due in early 2026 based on the January 1, 2025 valuation.

The previous funding schedule, adopted in early 2020, called for a 9.63% annual increase in total appropriation payments until FY 2035. A more minor increase is due in FY 2036, when the plan will be fully funded.

The current schedule, adopted in early 2023 based on the January 1, 2022 valuation, continues the 9.63% increase through FY 2028. Starting in FY 2029, the remaining unfunded liability will be amortized on an annual increasing basis of 4% through FY 2036. There is a 5% increase in FY 2029. The lower payments beyond FY 2028 show that between the 2019 and 2022 valuation, significant gains lowered the future costs and the funding schedule from increasing approximately 10% down to 4%.

The appropriation payment for FY 2025 is $4.5 billion, with $4.93 billion scheduled for FY 2026. The state system's actuarial valuation is as of January 1, 2024.

PERAC's quarterly report on funded ratios shows that as of January 1, 2025: 4 systems are fully funded; 16 are funded between 90-100%; 20 are funded between 80-90%; 30 are funded between 70-80%; and 24 are funded between 60-70%. In total: 4 systems are fully funded; 20 have a funded ratio better than 90% (which includes the four that are fully funded); 40 are 80% funded or better; 70 are 70% funded or better, and 94 are 60% funded or better. There are only 10 systems that are less than 60% funded at this time. The state's funded ratio was about 72.5% as of January 1, 2024, which falls into the category of the 70 systems that are more than 70% funded. There are about 65 systems that are better funded than the state. The teachers are 60.4% funded, and there are about 90 systems that are better funded than the teachers.

- *The analysis of asset returns and funding scenarios*

The impact of COLA Base increases, and potential funding from actuarial gains were discussed as follows:

COLA (Cost of Living Adjustment) increases are typically achieved by raising the COLA base. In general, for each $1,000 increase in the COLA base, the total liability increases by approximately 0.5%.

Based on the January 1, 2024, actuarial valuation:

- Increasing the COLA base to $14,000 would cost $579 million.
- Increasing the COLA base to $16,000 would cost $1.74 billion.
- Increasing the COLA base to $18,000 would cost approximately $2.9 billion.

These amounts represent a lump-sum payment, not an amortized cost over several years.

One possibility for increasing the COLA base is for the Legislature to consider it if the plan experiences actuarial gains that could offset the increased liability. A likely source of these gains would be from planned investments. For example, if the fund's performance equals 10%, this would generate a 3% gain in the fund's value. Since 1990, there have been seven instances of two consecutive years with double-digit returns and three instances of three consecutive years with such returns. Based on the current asset value as of January 1, 2024, a 10% return over two years could result in an actuarial gain of $4.6 billion. This gain would cover the $2.9 billion cost of increasing the COLA base to $18,000.

The presentation then moves to three scenarios analyzed in 2019 based on a request from the Massachusetts Retirees and the Legislature for PERAC to evaluate cost scenarios for long-service and long-retired retirees with below-average benefits. The analysis focused on the costs associated with COLA increases for these retirees, and the data below also included the latest updated analysis from January 1, 2024:

- A $100 annual increase for retirees with at least 20 years of service and 15 years of retirement, resulting in a cost of $96 million(slightly less than the previous $97 million).
- A $200 annual increase for retirees with at least 20 years of service and below-average benefits would cost $126 million, up from $94 million in the prior analysis.
- A $100 annual increase for retirees with 15-20 years of retirement, increasing to $200 once reaching 20 years. The updated cost was $174 million, slightly higher than the previous $166 million.

Mr. Boorack concluded that these costs represent lump-sum payments. If amortized over the current schedule (ending FY 2036), the payments would begin in FY 2026. The first group would add $11.4 million to the schedule, increasing by 4% annually. The second group would add $15 million, and the third group would add nearly $21 million, increasing by 4% annually. The total appropriation schedule for FY 2026 is $4.9 billion.

Commission members made the following comments after the presentation:

Rep. Gordon asked if the COLA base has ever increased based on plan performance or if it was based on timing. Mr. Boorack confirmed that it was based on timing.

Mr. Valeri asked if a triennial funding review would be part of the proposed process and when it would occur. Mr. Boorack confirmed that the funding schedule is based on an actuarial valuation every few years and that a review will occur if the plan shows two consecutive years of 10% returns. Mr. Boorack then further explained the plan's performance would be reviewed, and if this approach were implemented, it would coincide with a triennial review. Specifically, if there are two consecutive years of 10% returns, it could align with the timing of the review or occur in between. Under this proposal, having two consecutive years of double-digit returns would be a good opportunity for the Legislature to consider increasing the COLA base.

Mr. Howgate asked if implementing a COLA increase during the next triennial pension funding schedule would impact the process. He clarified that since the COLA increase would only occur if performance exceeded expectations, it would not affect the current funding schedule. However, the increase would indirectly affect the scheduling of the subsequent triennial evaluation because higher pensions would be factored into the actuarial valuation. He sought confirmation on whether this was the correct way to understand the potential impact.

Mr. Boorack responded that the extra money earned from two consecutive years of double-digit returns would be enough to absorb the increased liability from a COLA base increase. Once the COLA base is raised, the resulting liabilities will be included in all future actuarial valuations as the benefits increase.

Mr. Howgate asked for clarification, elaborating that the first COLA increase would be speculative, relying on performance exceeding the assumptions in the triennial pension funding schedule. Since future performance is uncertain, it would not need to be reflected in contributions during the first three-year period. Mr. Boorack confirmed that this was correct.

Mrs. Glaster followed up on Mr. Valeri's point, noting that in the past, investment gains typically reduced employer contributions without a corresponding increase in benefits. She suggested that some of these gains could be identified and used to adjust the cost of future schedules. However, she also cautioned that investment losses must be considered, as they can pressure PRIM. She emphasized that the margin over the assumed rate of return should be carefully considered.

The inflationary impact on COLA adjustments for state and teacher Retirees

In response to Mr. Valeri's point from the last meeting about retirement benefits for state and teacher retirees lagging inflation, Mr. Boorack presented a series of graphs comparing three initial retirement benefit levels—$15,000, $30,000, and $60,000—across two scenarios: one for retirees in 2013 and another for retirees in 2020. The first graph showed the impact of a 3% COLA (with a one-time 5% increase in FY 2023) versus inflation. For retirees starting in 2013, the graph demonstrated that inflation was lower than the 3% COLA for the first six to eight years, causing the capped COLA benefit to outpace inflation. However, by 2025, the difference was minimal, with a $15,000 pension showing only about a $600 gap between the two. This suggests that for retirees in 2013, the impact of COLA adjustments was relatively small.

After Mr. Boorack presented the analysis, commission members provided comments:

Mr. Valeri asked why Mr. Boorack used the $15,000 retirement benefit level as the starting point, noting that the average in 2013 was around $28,000. He suggested using the 2013 average would make a difference when considering the COLA base.

Mr. Boorack explained that focusing on individual benefit levels rather than averages provides a clearer picture. He noted that the average benefit has increased due to higher salaries among new retirees. Since 2020, inflation has significantly outpaced the 3% COLA. To illustrate this, he provided an example:

- A retiree in 2020 with a $30,000 benefit has experienced a $5,000 loss in purchasing power, a 13% reduction, due to inflation outpacing the COLA. A retiree from 2013 with a $60,000 benefit will see a $17,000 loss in purchasing power, or over 20%, by 2025. Similarly, a 2020 retiree with a $60,000 benefit has a $12,000 loss, about 16%. He emphasized that high inflation rapidly erodes pension value compared to benefits that increase with inflation

Mr. Trotsky suggested that the commission consider examining the number of people negatively impacted by the current COLA at the median pension benefit. While recognizing that not many people have a $15,000 benefit, he emphasized the need to understand how many beneficiaries struggle to keep up with inflation. He stressed that the goal should be to highlight the number of people affected by this issue.

Mr. Boorack explained that individuals with benefits over $13,000 will not keep up with inflation. However, those with benefits below $13,000 will keep up with inflation until their benefit surpasses that threshold. Once the benefits reach the COLA cap, inflation's impact becomes more noticeable.

Mr. Trotsky inquired about the specific number or percentage of beneficiaries not keeping up with inflation. Mr. Boorack estimated that 90% or more are affected. Mr. Keefe suggested that determining the exact percentage would be helpful and proposed including this topic in the next meeting. Mr. Trotsky agreed and suggested breaking the numbers down even more would be useful.

Mr. Boorack noted that half the population has benefits greater than $13,000, meaning they are missing out on that amount or more. He explained that higher benefit levels are more affected by inflation and mentioned that he would provide the number of retirees with benefits below the COLA cap at the next meeting.

Historical Cost-of-Living Adjustments Summary for State and Teacher Retirees

Mrs. Glaster presented four key topics: historical COLAs for state and teacher retirees, the COLA base as a percentage of the average pension, the impact of inflation and the low COLA base on the oldest retirees, and supplemental COLA options and potential funding strategies.

- *Historical COLAs for state and teacher retirees*

An example covering the historical COLA bases was presented and discussed. It highlighted that the $6,000 base in 1971 would be equivalent to $45,000 today, and the $7,000 base in 1981 would be $23,000 today. The $13,000 base in 2012 would now be about $17,300, showing that COLAs haven't kept up with inflation.

- *COLA base as a percentage of average pension*

A 2009 special commission on Chapter 32 pensions recommended raising the COLA base to $18,000 in $1,000 annual increments by 2015, representing 43% of the average teacher pension at that time. Comparing Massachusetts' 104 retirement systems today, two systems have a $12,000 COLA base representing 40 to 42 percent of their average benefit. 17 have a $13,000 base, including the state and teacher retirees. A vast majority of systems (over 80%) have a COLA base above $13,000, and on average, these systems protect about 50% of their average pension with the COLA base. For state and teacher retirees, the $13,000 COLA base represents only 26.5% of the average teacher pension ($59,100) and 30.9% of the average state pension ($42,000). If the retirees of the teachers and state systems could receive COLA on 50% of their pension, the COLA base would be between $21,000 and $24,000.

- *The impact of inflation and the low COLA base on the oldest retirees*

Mrs. Glaster discussed the impact of inflation and the low COLA base on teacher retirees, particularly the oldest ones, who began with lower benefits due to a $30,000 salary cap before 1979. She highlighted that many of the oldest retirees are living on reduced pensions, with retirees over 90 averaging $31,582 for MTRS retirees and $28,474 for state retirees. This issue has sparked discussions about implementing supplemental COLAs to assist those most affected.

- ❖ *Supplemental COLA options and potential funding strategies.*

Mrs. Glaster also raised several questions regarding the eligibility for a supplemental COLA, such as minimum years of service and retirement, the maximum benefit level to receive this supplement, and how to treat various retirement categories, such as ERI retirees, survivors, and disability retirees.

Mrs. Glaster then presented a model the Ohio State Teachers Retirement System uses, which pays a one-time "13th check" based on a portion of investment gains that exceeds expectations. This model involves establishing a budget, calculating total service units, and applying a unit value to determine the bonus amount for each eligible retiree. She demonstrated how this could work using MTRS data, showing varying one-time bonus amounts based on years of service and retirement. The bonus examples ranged from $390 to $1,053, with an average of $646, and the recipients' average age was 80. Those who were retired longer and had more years of service received larger amounts.

The discussion concluded with Mrs. Glaster suggesting further consideration of the potential funding strategies and the best way to implement supplemental COLAs.

After the presentation, Mr. Valeri asked whether this supplemental benefit is issued annually or only during periods of high inflation or high gains. Mrs. Glaster explained that Ohio issues the 13th check when its asset earnings exceed the assumed rate for a certain period, along with other economic conditions. She stated that it's not an annual occurrence and that the provided materials include the details.

Mr. Valeri highlighted the significant drop in benefits for retirees aged 80 or older and noted that the enhanced COLA proposal targets long-serving retirees, especially those with 20 years of service. He compared it to Ohio’s 13th check approach, suggesting a more straightforward proposal with potential adjustments like eligibility criteria or implementation after 10 years of retirement. Mr. Valeri emphasized the need to address the concerns of older retirees while considering broader solutions for all retirees.

Mr. Keefe acknowledged Mr. Valeri’s point, noting that the longer retirees are out of the workforce, the more their buying power decreases. He suggested that this group, which may require the most support, should be a focus.

Senator Brady highlighted that many older retirees face financial struggles, often choosing between essentials like medication and food. He stressed the importance of supporting this vulnerable group.

Mrs. Kougias noted that retirees in the 75-79 age group, representing 39% of the population, earn below the average benefit and should not be overlooked. She also highlighted that post-retirement issues prevent retirees with valuable institutional knowledge from contributing to the system, stressing the need to consider all retirees, not just the older ones.

Mr. Valeri highlighted the significant increase in Medicare premiums since 2013, with premiums rising 84% from $100 to $184 monthly. He emphasized that healthcare costs are a significant concern for retirees, especially the older generation, who struggle to keep up with these rising expenses due to the lack of increases in their COLA base.

Mr. Howgate highlighted that the annual state contribution to the pension fund, growing by 9.6% each year, is unsustainable and puts pressure on other parts of the budget. He emphasized the importance of balancing pension sustainability with affordability.

Mr. Keefe acknowledged the above discussions, noting that only a small portion of excess returns would be used for a potential bonus or 13th check for retirees. At the same time, the majority (about 90%) of the excess returns would go toward the pension liability. He suggested this could help balance the dual goals of addressing pension liabilities and retirees' needs.

Mrs. Kougias acknowledged Mr. Howgate's concerns about sustainability and raised practical considerations, such as the implementation costs of a bonus or 13th check. She emphasized assessing the labor and system modifications required and their impact on the workforce.

Mr. Valeri asked Mrs. Glaster how easily systems could accommodate a process similar to the Ohio model. He expressed concern about the limitations of the software packages they use and sought clarification on what would be required to implement such a process.

Topic Suggestions for Next Meeting Agenda

Mr. Keefe confirmed that the next meeting would be held on March 10th. He suggested following up on Mr. Trotsky's point on determining the number of state and teacher retirees with pensions above $13,000 and refining some of the numbers presented. He also asked if there were other topics that the commission members would like to include in the next meeting.

Mrs. Glaster proposed identifying key topics for Mr. Boorack to price out, particularly a separate funding schedule for a COLA base increase. She referenced the projected $6.5 billion savings by 2036 when transitioning to paying only normal costs. Mrs. Glaster also highlighted potential changes to service purchase rules, pointing out discrepancies that could create unfunded liabilities. She recommended normalizing service purchases across both systems to generate liability savings, which could be leveraged to improve COLA funding.

Mr. Valeri supported the need for discussions on funding options, stressing that while the current COLA base is insufficient to keep up with inflation, solutions should balance fiscal sustainability and minimize the impact on the state budget. He suggested using excess investment gains, especially given the 64% asset growth since 2013, to fund COLA base increases. Mr. Valeri also noted that by 2036, as appropriations decrease by over $6 billion, there will be more opportunities to address COLA funding, including potentially enhanced COLAs.

Rep. Gordon proposed exploring the structural costs of the MTRS and MSRB systems, specifically whether technology could be leveraged to reduce operational costs. He suggested that adopting more efficient processes could help offset the costs of COLA increases and emphasized the importance of finding creative solutions to minimize unnecessary expenses and ensure the long-term sustainability of the pension system.

As the meeting concluded, Rep. Gorden moved to adjourn, Frank Valeri seconded the motion, and a roll call vote was taken:

Michael Brady YES, Erika Glaster YES, Ken Gorden YES, Doug Howgate YES, Bill Keefe YES, Kathryn Kougias YES, Amelia Marceau YES, Michael Trotsky YES, Frank Valeri YES. The meeting was adjourned at 11:57 AM.

Special Cost of Living Adjustment (COLA) Commission Meeting Documents

COLA Commission 020425 Agenda.pdf

Erika Glaster Feb 4 Presentation COLA Comm Material (3).pptx

PERAC COLA Base Increase Report 2005.pdf

Approved,

Bill Keefe, Chairman