M E M O R A N D U M

TO: All Retirement Boards

FROM: Bill Keefe, Executive Director

RE: COLA Reserve Fund and Enhanced COLA

DATE: August 27, 2026

On July 9, 2026, Governor Healey signed the Fiscal Year 2027 (FY 27) budget, Chapter 137 of the Acts of 2026, which included a number of items related to the pension system. This memo will address the new Cost of Living Adjustment (COLA) provisions in Sections 22-27 and 32-38 of the FY 27 budget.

Included in the FY 27 budget are provisions that mandate, for the State and Teachers' Retirement Systems, the creation of a Cost of Living Reserve Fund (COLA Reserve Fund) and an Enhanced COLA. The COLA Reserve Fund is an account which is established to provide a mechanism for setting aside a portion of excess investment gains to fund an Enhanced COLA benefit for eligible members and future COLA base increases in $1,000 increments. For purposes of this memo, references to the "state level" refer to both the State and Teachers' Retirement Systems.

There are local options for the adoption of the Enhanced COLA benefits and the establishment of a COLA Reserve Fund for the local retirement systems, which are any system other than State and Teachers. For local systems, the COLA Reserve Fund can only be adopted with the Enhanced COLA local option, and the Reserve Fund can only be used to fund the Enhanced COLA. This was a late change in the legislation; previous iterations allowed for the local option Reserve Fund to be used for COLA base increases.

This memo will explain the COLA Reserve Fund and Enhanced COLA and detail how each provision is to be adopted and implemented. There is also an attachment that spells out the timeline and cycle of events related to the use of the COLA Reserve Fund and Enhanced COLA at both the state and local levels.

Enhanced COLA

The Enhanced COLA provision provides the same benefit for superannuation and disability retirees with one difference in eligibility.

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Eligibility

- The member retired prior to July 1, 2020.

- The member has a retirement allowance that is *below 80 percent of the average salary* in the respective system as determined by the most recent actuarial valuation.

- **Superannuation** retirees must have had at least 20 years of creditable service while **disability** retirees have no minimum creditable service requirement.

Repeating from above, please note **the earnings threshold is 80 percent of the average salary in the system**; not 80 percent of the average retirement allowance.

Benefits

All Enhanced COLA payments are annual, in addition to the regular COLA, paid in the same manner as the regular COLA (monthly throughout the year) and become part of the member's permanent base. The statute does not make reference to tiers when describing the different levels of the Enhanced COLA. However, for purposes of this memo, we will call them tiers for clarity.

Years Retired	Amount
10-14	$100
15-19	$200
20-plus	$300

The years retired calculation is as of June 30, in line with the payment of the July COLA. The law does not allow for any rounding. For example, nine years and 360 days retired as of June 30 is not 10 years retired.

A surviving beneficiary, receiving benefits as the Option C survivor of a member or receiving benefits under Sections 9, 12, 100 or 101, shall receive the additional Enhanced COLA if the deceased member would have been eligible. However, the retirement allowance considered for eligibility is the survivor's allowance amount, not the member's.

It is possible that members' and beneficiaries' eligibility will change over time, by becoming newly eligible or by becoming ineligible. A person's allowance could drop below the 80 percent of the average salary threshold or, less likely, a person on the cusp of the threshold could rise above the 80 percent of the average salary threshold.

For local systems, each tier of the Enhanced COLA is a separate provision and must be adopted by the retirement board and then by the local legislative body. Each tier may be adopted separately, in any order, or all three may be adopted at the same time. However, if two or three tiers are adopted at once, the full amount of the actuarial present value of the increase in liabilities for those two or three tiers must be accrued before a transfer happens and the benefits can be paid. (Throughout the rest of this memo, we will refer to the "actuarial present value of the increase in liabilities" attributable to a COLA enhancement as the "cost" of the COLA.) Once any of the tiers is adopted, then the system must vote in conjunction to establish a COLA Reserve Fund. The Enhanced COLA is not authorized without the COLA Reserve Fund.

COLA Reserve Fund

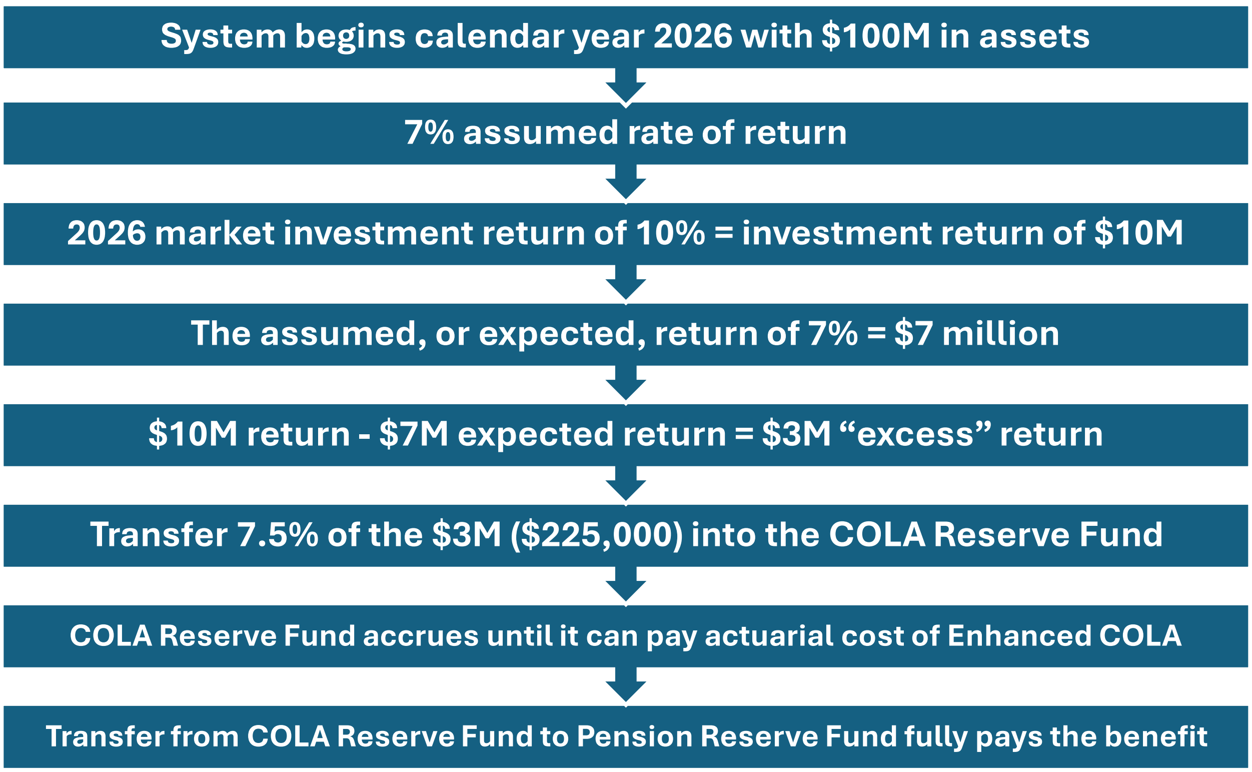
The COLA Reserve Fund is a fund established to hold assets to cover the cost of pre-funding COLA benefits. In the near future, the COLA Reserve Fund will be assigned a General Ledger (GL) account number and added to PERAC's Chart of Accounts and Annual Statement template. At the state level, it will first fund the Enhanced COLA and then be used to fund COLA base increases. At the local level, it is only used to fund the Enhanced COLA which cannot be adopted without adopting the COLA Reserve Fund. The COLA Reserve Fund is an accounting mechanism; all funds continue to be invested in the same manner as all other assets of the system.

In a year in which the investment returns exceed the assumed rate of return, 7.5% of that "excess investment income" is transferred to the COLA Reserve Fund annually. More specifically, excess investment income is defined as:

> the amount in any calendar year where all gains from invested funds of a retirement system results in earnings in excess of the investment return assumption set in the system's most recent actuarial valuation. Such amount, in excess of said investment return assumption, shall be based on the market rate of return during a calendar year on the balance of total assets of the system at the close of business on December 31 of the prior calendar year, less the amount required to be derived by the investment return assumptions set in said valuation.

The statute states that within 90 days of the start of a calendar year, the actuary of the system must certify the total gross investment income on a market value basis of the system for the prior calendar year. It is understood that may not always be possible as there can be lags in investment reporting. It should be done as soon as possible and needs to be done in time to make sure any potential benefit increase can be paid in July. If the investment return exceeds the system's actuarially assumed rate of return, then 7.5% of the excess investment income will be transferred to the COLA Reserve Fund. If the investment return does not exceed the rate of return, no funds are transferred.[1]

Sample Calculation Steps



Cost and transfer from the Reserve Fund

The assets in the COLA Reserve Fund accrue over time while continuing to be invested with all the other system assets and remain assets of the system. As such, the balance grows or reduces by the same year-end investment return as the rest of the system's assets. For example, if the system has a 3% investment return, no new transfer of "excess investment income" would be made as that

[1] For the purpose of this calculation, if the investment return assumption of a retirement system is net of investment related expenses, the actual return should be determined net of investment related expenses. Note that the return shown in the PERAC Investment Report is a *gross* return, not a net return.

would be below the assumed rate of return, however, the fund balance would grow by 3%. Conversely, following the same example, if the system had a negative 3% investment return, the COLA Reserve Fund would lose 3% of its value. However, the COLA Reserve Fund's lowest balance is zero. The details of debiting and crediting will come in the near future when the COLA Reserve Fund is assigned a GL number and added to PERAC's Chart of Accounts and the Annual Statement template.

Assets in the COLA Reserve Fund will not be used by the actuary of the system when calculating the system's funded status until such time as there are sufficient funds to transfer to the system's Pension Reserve Fund to fully pay the actuarial cost of all locally-adopted Enhanced COLAs, whether that is one, two or three tiers, or at the state level, to pay for the Enhanced COLA or COLA base increase.

The actuary of the system must annually certify the actuarial present value of the total increase in the liabilities of a system attributable to the Enhanced COLA benefits. An annual valuation is not required to make this certification. The Enhanced COLA does not get paid to any members until sufficient funds necessary to cover the actuarially determined liability of the state Enhanced COLA or locally-adopted Enhanced COLA tier(s) have been set aside in the COLA Reserve Fund. Once the actuary of the system determines that there are sufficient funds in the COLA Reserve Fund to cover the actuarial cost of the approved Enhanced COLA, then those funds are transferred from the COLA Reserve Fund to the Pension Reserve Fund to pay the Enhanced COLA benefit along with the regular COLA increase on July 1.

If there is more money in the COLA Reserve Fund than needed to pay for a tier, or tiers, of the locally-adopted Enhanced COLA, the entire balance of the COLA Reserve Fund is transferred to the Pension Reserve Fund. For local systems, after a transfer to the Pension Reserve Fund to pay an Enhanced COLA benefit, the COLA Reserve Fund should have a zero balance and is dormant unless there is an Enhanced COLA tier locally adopted in the future.

At the state level, if there is more money in the COLA Reserve Fund than needed to pay for the Enhanced COLA, the balance shall remain in the COLA Reserve Fund as the COLA Reserve Fund remains active and switches to accrue funds to pay for COLA base increases in perpetuity. When that happens, the same processes that were in place to determine the cost of the Enhanced COLA, the annual investment return and possible excess investment income, and the balance of the COLA Reserve Fund will be used to accrue funds toward a $1,000 COLA base increase. When the actuary determines there are sufficient funds for a base increase, that will trigger an automatic base increase for that July's COLA payment.

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For local systems, the COLA Reserve Fund is only active while "saving" for a locally approved tier of the Enhanced COLA. After a transfer is made from the COLA Reserve Fund to the Pension Reserve Fund to pay for an Enhanced COLA tier, and there is no other tier to "save" for, the COLA Reserve Fund is no longer active. No funds should be transferred to the COLA Reserve Fund except to fund the actuarially determined liability for the Enhanced COLA provisions that were adopted by the board and the local legislative body.

How to adopt the Enhanced COLA and the COLA Reserve Fund

To adopt any or all of the three tiers of the Enhanced COLA, the local retirement board must vote to adopt. Chapter 32 Section 103 has been amended to add paragraphs (k), (l) and (m) which correspond to the $100, $200 and $300 tiers, respectively, of the Enhanced COLA. Each of these paragraphs require a separate vote by the board and the local legislative body to approve. The board and the local legislative body must also vote to establish the COLA Reserve Fund if they have adopted any of the Enhanced COLA paragraphs. Once the board has voted then the local legislative body votes to approve each provision.

The "local legislative body" shall mean: (i) in the case of a city, the city council in accordance with its charter; (ii) in the case of a town, the town meeting; (iii) in the case of a district, the district members; and (iv) in the case of an authority, the governing body. In the case of a county or regional retirement system, this subdivision shall take effect upon its acceptance by the county or regional retirement board advisory council at a meeting called for that purpose by the county or regional retirement board. Acceptance of each of the provisions shall be deemed to have occurred upon the filing of the certification of such vote with the commission.

As with all other local options, the decision to adopt any of the three Enhanced COLA tiers and the establishment of the COLA Reserve Fund may not be revoked.

Please contact Assistant Deputy Director Patrick M. Charles at Patrick.m.charles@mass.gov with any questions.

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Attachments