March 15, 2016

Item Name: Update on Retiree Cost-of-Living Adjustment

Program: Benefit Program Services

Item Type: Information Consent

Executive Summary

The annual rate of inflation as measured by the percentage change in the Consumer Price Index (CPI-U) was .120 percent through the 12 months ending December 2015. The impact of the .120 percent inflation for the Cost-of-Living-Adjustments (COLA) is reflected in the chart on page 2 for retirees by COLA provision and year of retirement. Due to the applicable inflation rate being less than 1 percent, additional government codes apply that impact COLA this year.

Strategic Plan

This item supports the California Public Employees' Retirement System (CalPERS) Strategic Plan Goal B: "Cultivate a high-performing, risk-intelligent, and innovative organization," as well as, our objective to "deliver superior, end-to-end customer service that is adaptive to customer needs."

Background

The basic structure of the retirement COLA increases at CalPERS includes: annually scheduled cost-of-living increases and Purchasing Power Protection Allowance (PPPA) benefit increases.

The Retirement Law provides for the payment of an annual COLA to be paid each May. However, the COLA is limited to the lesser of two compounded numbers – the rate of inflation or the COLA contracted by the employer. In addition, if a member's COLA increase is less than one percent in a given year, no COLA increase is applied for that year. Currently 95 percent of CalPERS retirees are subject to a 2 percent COLA provision. Less than 5 percent of all CalPERS retirees are currently subject to a 3, 4 or 5 percent COLA.

Government Code sections 21329 and 21335 state in whole or in part, "a) No adjustment shall be made for any year for which the adjustment is less than one (1) percent of the base allowance, and the adjustment for any year shall not exceed 6 percent of the base allowance." This year, due to a low inflation rate (0.12 percent), approximately 45 percent of retirees will not receive a 2016 increase. In the future, when the inflation rate exceeds one percent, the 0.12 percent increase retirees did not receive in 2016 will be factored in to that year's adjustment. Because of the reduced number of retirees receiving a COLA this year, the amount of benefit increases for 2016 will be less than in previous years. The reduction in benefit increases will be recognized as an actuarial gain in future Actuarial Valuation reports for our employers, marginally reducing employer rates for a future year.

The PPPA is an automatic equity adjustment added to a monthly benefit as a protection against inflation and works together with the COLA. PPPA was designed to be a supplementary benefit distributed to retirees (and their survivors or beneficiaries) when the original purchasing power of their monthly benefit falls below a certain level. The levels are established by statute and are as follows:

- 75 percent of original purchasing power for State and Schools
- 80 percent of original purchasing power for Public Agencies

Typically PPPA does not apply until a member has been retired for 25-30 years.

Analysis
The United States (US) inflation rate as measured by the percentage change in the CPI-U for the 12 months ending in December 2015 was .120 percent. This measure will be used in calculating the 2016 regular COLAs for CalPERS retirees. The US inflation rate one year ago was 1.62 percent. Over the last 20 years (1995-2015), the inflation rate has averaged 2.2 percent and the long term (1965-2015) inflation rate has averaged 4.1 percent.

The impacts of the .120 percent inflation for the COLA are reflected in the chart below for retirees by COLA provision and year of retirement.

COLA Increases in May 2016 for Retirees by Year of Retirement

COLA Provision	Year of Retirement	% COLA Increase Effective May 1, 2016
2% COLA	2004 & Earlier	2%
	2005	1.555%
	2006-2014	No Increase to COLA
	2015	Not Eligible
3% COLA	1980 & Earlier	3%
	1981-2014	No Increase to COLA
	2015	Not Eligible
4% COLA	1973 & Earlier	4%
	1974-2014	No Increase to COLA
	2015	Not Eligible
5% COLA	2014 & Earlier	No Increase to COLA
	2015	Not Eligible

Budget and Fiscal Impacts
No budget impacts. See analysis section for financial impacts.

Benefits and Risks
The annual COLA is a statutory requirement. There are no identified risks associated to this informational item.

Attachments
Not Applicable.

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