Policy Brief
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Fair and Affordable COLAs

A PAR review of Act 399 and cost-of-living adjustments

During the 2014 session the Legislature made changes in the way cost-of-living adjustments (COLAs) are granted for retirees of the four major state retirement systems. Act 399 (House Bill 1225) by Rep. Joel Robideaux and Sen. Elbert Guillory sets conditions on how and when COLAs will be given over time. This change offers a more consistent and fiscally sound approach to COLAs. It addresses the legitimate needs of retirees, who have not received a cost-of-living increase since 2009. It also provides a responsible financing mechanism that is better geared to the realities of the deeply indebted retirement systems. The new COLA method under Act 399 will be more sustainable, more favorable for taxpayers and less of a contributing factor to the unfunded accrued liability (UAL) of each system.

The current situation

Cost-of-Living Adjustments are permanent retirement benefit increases designed to combat the effect of inflation on a retiree's check. The current method of funding COLAs is through a mechanism created in 1992 known as the Experience Account. When the retirement systems have particularly good returns on their investments, some of those investment earnings (or the "experience") is credited to a separate account. When these funds build up to a certain level in the Experience Account, the Legislature may decide to give a COLA. Thus, COLAs are funded through the positive investment returns of the retirement system portfolios. Only four other states have a similar mechanism. Each of the major state retirement systems – LASERS (for state employees), Teachers, LSERS (for school employees) and State Police – has a designated Experience Account.

The problem

The Experience Account siphons off portfolio funds in strong investment years to pay for future cost-of-living adjustments. But portfolio losses or shortages in negative or weak investment years are not fully offset. The investment gains and losses of the system do not balance out, but instead there is an increasing accumulation of more retirement system debt over time. In short, the Experience Account reroutes retirement system earnings to a treasure chest that can be used for retiree raises, but it does not actually add funding to the retirement systems to help pay for the COLAs.

The fix

Act 399 combines a series of improvements to the existing approach of the Experience Account. For example, it provides a schedule of escalating benefit increases that would occur only as the level of funding in a retirement system grows healthier. Also, the rate of increase would apply to the first $60,000 of a retiree's income, whereas previously the percentage is applied to approximately the first $92,000 of income. These and other changes would place less of a strain on the long-term financial obligations and liabilities of the retirement systems. This reform is not as advantageous as PAR's long-standing recommendation to replace the Experience Account with a prefunded system that collects money during the working life of the employee to pay for future COLAs. But the Robideaux-Guillory reform is a significant step forward.

Summary of Act 399 provisions:

◆As the retirement systems reduce their UALs over time, the size of the benefit increases can go up. For example, the LASERS and Teachers systems' portfolios currently are funded at between 55% and 60% of what they ultimately need to meet their long-term obligations to retirees, a situation that ranks Louisiana among the worst-funded retirement systems in the nation. Under Act 399, as each state system portfolio reaches a new threshold of healthier funding, the maximum possible COLA increases also. Below is the schedule. Assuming funds in the Experience Account are sufficient to pay for a COLA, the benefit increase shall be the lesser of the Consumer Price Index or the amount in the column "Maximum COLA":

System Funding Level	Maximum COLA	Maximum Frequency
> 80%	3%	Every year
75% to 80%	2.5%	Every other year
65% to 75%	2%	Every other year
55% to 65%	1.5%	Every other year
< 55%	No COLA can be given	

◆Currently, LASERS has to have an investment return of at least $100 million and Teachers $200 million before flowing money to the Experience Accounts. Act 399 created thresholds for LSERS ($15 million) and State Police ($5 million).

◆Previously, once the state finally has paid off a system's major unfunded liabilities, there is no longer a requirement to meet those $100 million and $200 million thresholds before moving additional earnings into the Experience Accounts. Act 399 will keep those thresholds, thereby providing more financial security for the retirement systems. The thresholds will increase over time.

◆Previously, when a portfolio exceeded its investment target, the "excess gains" were applied to the UAL but the payment schedule was reamortized. This practice lowered the upfront payment for the state but did not save as much in the long term. Under Act 399, the excess gains applied to the UAL will not be reamortized.

◆Previously, a COLA, in the form of a percentage pay increase, would apply to all the benefit income of a retiree up to approximately $92,000 per year. (Originally the cap was $70,000 but it has been rising because it is indexed for inflation.) Act 399 resets the income cap upon which COLAs are calculated to $60,000, with an index for inflation. With this change, a COLA will be less costly.

◆Under Act 399, if a retirement system is less than 80% funded, the Experience Account cannot hold funds in excess of the amount needed to pay for a single COLA. In years with strong investment gains, that means a larger portion of the returns will be applied more directly to the system's liabilities rather than to the COLA account.

For more information contact: Robert Travis Scott, President, 225-926-8414 ext.221 robertscott@parlouisiana.org
P O Box 14776 Baton Rouge, LA 70898-4776 Phone: (225) 926-8414 Fax: (225) 926-8417 Web Site:www.parlouisiana.org