SCERA COLA History

Retirement Board Meeting
December 15, 2022

COLA History

Article 16.5
Added in 1965

- Creates ongoing COLA program tied to CPI changes
- Funded with contributions and/or excess earnings
- 19 of 20 CERL systems adopt an ongoing COLA

Article 16.6
Added in 1965

- Creates flexibility in adopting ongoing or one time COLA's
- Added ability to retroactively apply a COLA

COLA Statutory History

19 CERL Systems

- Art. 16.5 & 16.6 COLA program
  - Adopted once for an ongoing COLA program
  - At time of adoption if granted retroactively, retroactive portion funded with *excess earnings or employer contributions
  - Prospective and ongoing COLA funded through 50:50 sharing of contributions (employer and employee)

SCERA

- Art. 16.5 & 16.6 COLA program
  - Adopted when funding source available
  - Used to grant one-time across the board and purchasing power COLAs funded with a combination of *excess earnings and employer contributions
- Gov. Code 31874.6
  - Added 2004, adopted 2005 for Purchasing Power COLA w/out across the board requirement

*excess earnings defined differently than present

COLA History

- 1946 – SCERA administered as part of the County Treasurer's office by County employees throughout various County departments and remained essentially the same until 1998
  - County and SCERA personnel worked together to develop and implement policies and methods to provide some level of consistent COLAs
- 1940's to early 1960's – Legislature had been enacting piecemeal COLA measures applied to members who retired prior to effective date of new sections of the CERL
- 1961 – A specific COLA section added to CERL
  - 31681.5 was added to the service retirement article of the CERL
    - COLA section only for those who were retired as of 1961
    - Differing amounts depending on retirement date
    - Funded with county appropriations

COLA History

- 1966 through 1976
  - Art. 16.5 and 16.6 used for one time across the Board COLAs
  - In 1970 Retirement Board secured actuarial study of an ongoing COLA program and concluded that the cost (0.91% of payroll for both employee and employer) was too high. Recommendation to keep funding from excess earnings until reserve dropped below the statutory 1% of total assets requirement
- 1977
  - County wanted to provide purchasing power type COLA but did not have statutory authority
  - Used 31681.52 and 31739.32 to provide variable amounts depending on date of retirement
  - Funded with excess earnings
  - 1978 and 1979 used Art. 16.5 and 16.6 for across the board COLAs funded with both excess earnings and a county contribution

COLA History

- 1980 – COLA program examined
  - SCOPE/SEIU requested either a supplemental ongoing or one-time 2% COLA on top of 3% already approved
  - County Administrative Officer Whorton spearheaded COLA study
  - Considerations included:
    - Social Security integration - SS is fully indexed to CPI
    - General Fund payments to provide retiree health insurance
    - Benefit formula increase in 1974 to 2% at 57 for general members
    - County appropriations the only funding source examined
  - Conclusion – one-time supplemental 2% approved
    - County determined purchasing power COLAs provided best solution for most needy retirees, but legislation limited available options
    - Original 3% COLA paid with excess earnings
    - 2% one-time supplemental COLA paid with county contributions over a ten-year amortization period
    - 1981 and 1982 same COLAs granted with same funding sources

COLA History

- 1983 through 1991
  - Used Art. 16.5 and 16.6 to provide various across the Board and purchasing power COLAs funded either from SCERA reserves, realization of investment gains, or County appropriations
- 1992 – Retirement Board discussion
  - Decision to recommend 2% COLA for those retired before February, 1991 and
  - 1% COLA for those retired before April, 1992
  - Up to 10% additional COLA for those who had lost at least 25% purchasing power
  - All funded by realizing investment gains
  - Policy goal to avoid an increase in Employer contribution rate

COLA History

- 1996
  - Actuarial Funding Policy adopted by SCERA
  - One of the policy funding objectives was to "maintain reserves sufficient to provide consistent ad-hoc cost-of-living payments at a level determined by the Retirement Board"
  - Amortization of Unfunded Actuarial Accrued Liability was set to 10-year declining periods
  - Five year smoothing of investment gains/losses was implemented
  - Discussion of drafting a COLA policy but no records found
- 1997
  - Provided the first true purchasing power COLA in 1997 to bring retirees/beneficiaries up to 75% purchasing power – Plan was 100% funded in part due to change in earnings assumption from 8% to 8.25%. The policy goal was to keep retirees at 75% as long as excess earnings available to do so

COLA History

- 1999
  - COLA policy adopted by SCERA
  - The four COLA objectives were:
    - Maintain reserves sufficient to pay all COLAs that have been promised
    - Provide a consistent level of ad-hoc cost-of-living benefit increases paid over the lifetime of the annuitants
    - Maintain the purchasing power of retirement benefits to the extent allowable under the CERL
    - Minimize Employer contribution rate increases
  - COLA could be across the board, or across the board with targeted purchasing power
  - Must be able to be fully funded from Unapportioned Earnings (Excess Earnings)
  - Unapportioned Earnings were not cumulative
  - The purchasing power target was 75% with a long-term goal of increasing to 100%

COLA History

- 2000
  - Across the Board plus purchasing power COLA to restore up to 75% purchasing power
  - Funded with Unapportioned Earnings
  - Unapportioned Earnings were measured annually not cumulatively
- 2001
  - Legislation effective 2001 changes purchasing power target from 75% to 80% (31874.3(c))
  - Across the Board plus purchasing power COLAs to restore up to 80% purchasing power
  - Funded with Unapportioned Earnings
  - Unapportioned Earnings were measured annually not cumulatively

COLA History

- 2002
  - Actuarial Funding Policy Changes
    - Amortization for Unfunded Actuarial Accrued Liability increased to 20 years
    - Excess earnings now evaluated cumulatively
    - Negative Contingency Reserve concept adopted
  - COLA Policy Changes
    - Added a "Determination of Unapportioned Earnings" section
    - Included a "Negative" employer reserve (We now call it the Negative Contingency Reserve)
    - Increased the statutory reserve requirement from 1% of system assets to 3% of system assets
  - Actuarial Valuation 12-31-02
    - Benefit formula changes – 3% at 55 and 3% at 60 addressed
    - Experience loss of $71.2 million including $49.4 million loss from investments
    - Assumption change loss of $44 million

COLA History

- 2003
  - Across the Board and Purchasing Power COLA granted
  - Funded with Unapportioned Earnings
- 2005 – Government Code 31874.6 effective
  - Established a standalone Purchasing Power COLA without an across the Board COLA requirement
    - Provided there are sufficient Unapportioned Earnings to fully fund the adjustment
    - The Contingency Reserve has a balance of 3% of system assets
    - Limited to those who lost at least 20% of their purchasing power
    - Based on annual Consumer Price Index changes for the CPI Index that covers Sonoma County
- 2005, 2007, 2008
  - Purchasing Power COLA's granted
  - Funded with Unapportioned Earnings

COLA History

- How does SCERA's COLA policy work
  - In order for SCERA to recommend a COLA to the Board of Supervisors several conditions must be met
    - There must be retiren members or beneficiaries who have lost more than 20% of the purchasing power of their benefit
    - There must be 3% of system assets in a contingency reserve
    - The full present value cost of the COLA must be available from Unapportioned earnings

COLA History

- What are Unapportioned Earnings:
  - SCERA is required to credit interest to certain valuation reserves
    - Investment earnings are calculated on an actuarial valuation basis. That means we use the smoothed investment return taking into account SCERA's five-year smoothing policy where 20% of each of the past five years' gains and losses are recognized
    - Administrative expenses are deducted from the actuarial (smoothed) value investment earnings then the amount left over is available for crediting interest to valuation reserves.
    - Anything left over after crediting reserves is "Unapportioned Earnings"

COLA History

- Sufficient Investment Earnings:
  - First SCERA credits interest on valuation reserves
    - Member and Employer Contribution reserves
    - Annuitant (retirees and beneficiaries) reserve
    - COLA reserve
  - Once the interest crediting is done if there are still Unapportioned Earnings they fill up any negative contingency reserve
  - If there are still Unapportioned Earnings remaining then 3% of total system assets must be placed in a Contingency reserve
  - After the above crediting and reserving, if the present value cost of a purchasing power COLA can be paid with remaining Unapportioned Earnings it can be recommended to the Board of Supervisors

COLA History

- If there are insufficient earnings to credit reserves
  - First, draw down the Future COLA reserve, if any
  - Then, draw down the Contingency reserve, if any
  - Then, track the balance in the Negative Contingency Reserve
  - No COLA can be recommended pursuant to the COLA policy

Policy Discussion

- There is a clear history of both the County and SCERA working together to provide a consistent COLA and to secure funding
- For example, in the 35-year period from 1970 to 2005, a COLA was granted nearly 75% of the time
- Many funding strategies were implemented including amortizing an unfunded COLA liability over 10 years, realizing investment gains, using excess or Unapportioned Earnings and county contributions
- Philosophies regarding prudent retirement plan funding shifted with the economic impacts of the time period but the COLA program was always supported
- In 2002 when the SCERA Board changed its funding policy and COLA policy to include a tracking reserve for interest crediting deficiencies there was a small deficiency being tracked
- This was managed with future gains until the Great Recession in 2008 where SCERA suffered a large investment loss. There was no discussion at the time about the impact of negative reserve tracking on the COLA program

Policy Discussion

- The SCERA Board established a working committee to consider the COLA issue. Committee members are:
  - Neil Baker, Travis Balzarini, Chris Coursey and Bob Williamson
- What is SCERA's objective
  - Committee to assemble and provide a comprehensive history of COLAs to the SCERA Board and County
    - Goal is to create a shared understanding of past actions including various forms of COLAs provided and related funding approaches
  - Engage with the County representatives with the ultimate goal of producing a decision by the County regarding future retiree COLAs
  - The nature of SCERA's involvement from the County decision forward will be determined by the substance of the County's policy decision