Negative COLA
Initial Consideration

LEOFF Plan 2 Retirement Board

June 16, 2010

Overview

- Issue
- Current Practice
- Examples of Negative COLA

Issue

- Negative inflation or deflation could cause retiree’s pension benefits to decline.

Current Practice

- Retirees entitled to a COLA on July 1 each year provided they have been retired one year
- COLA based on change, up or down in CPI-W for Seattle/Tacoma/Bremerton
- Benefit cannot fall below original calculated amount

Negative Inflation of 0.5% for 2010

- Member retired 7/1/2009 with a $5000 monthly benefit.

Calendar Year	Monthly Benefit	Change in CPI-W	COLA (%)	COLA ($)	Benefit after COLA
2009	$5000.00	0.44%	0.44%	$22.00	$5022.00
2010	$5022.00	(0.50%)	(0.50%)	($25.11)	$5000.00*

- *Benefit can not fall below original benefit

Negative Inflation of 0.5% for 2010

- Member retired 1/1/2008 with a $5000 monthly benefit.

Calendar Year	Monthly Benefit	Change in CPI-W	COLA (%)	COLA ($)	Benefit after COLA
2008	$5000.00	4.48%	3.00%	$150.00	$5150.00
2009	$5150.00	0.44%	1.89%*	$97.34	$5247.34
2010	$5022.00	(0.50%)	(0.50%)	($26.24)	$5221.10

- *COLA is greater than change due to "banking"

Historical Inflation Data

YEAR	CPI-W, Seattle, Tacoma, Bremerton
2009	0.44%
2008	4.48%
2007	3.79%
2006	3.73%
2005	3.02%
2004	1.57%
2003	1.41%
2002	1.81%

Summary

- The potential exists for a retired member's monthly pension to be reduced if there is deflation
- Benefit can not fall below original calculated amount

Negative COLA

QUESTIONS?

LAW ENFORCEMENT OFFICERS' AND FIRE FIGHTERS' PLAN 2 RETIREMENT BOARD

Negative COLA

Initial Consideration

June 16, 2010

1. Issue

The potential exists for a retired member's monthly pension to be reduced if there is negative inflation (deflation).

2. Staff

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3. Members Impacted

As of June 30, 2008 there were 16,626 active members and 1,134 retirees as reported in the Office of the State Actuary's *2008 Actuarial Valuation Report*.

4. Current Situation

Under the current law, a retired member is entitled to a cost of living adjustment (COLA) effective July 1, after they have been retired for one year.

5. Background Information and Policy Issues

Background Information

One of the key features with all of the plan 2 retirement plans is a guaranteed COLA. The COLA is indexed to changes in the consumer price index for Urban Wage Earners and Clerical Workers (CPI-W) in the Seattle, Tacoma and Bremerton area. The COLA is limited to the lesser of the change in the index or three percent.

What would happen if a retiree encounters a time of negative inflation or deflation? The following examples show the impact to a retiree's pension benefit if in the 2010 calendar year there was a change in the CPI-W of negative 0.50 percent.

Example 1: Member A retired 7/1/2009 with a $5000.00 monthly pension benefit

Calendar Year	Monthly Benefit	Change in CPI-W	COLA	COLA (in dollars)	Benefit after COLA
2009	$5000.00	0.44%	0.44%	$22.00	$5022.00
2010	$5022.00	(0.50%)	(0.50%)	($25.11)	$5000.00[1]

[1]The retiree's benefit cannot ever go below the original amount.

Example 2: Member B retired 1/1/2008 with a $5000 monthly pension benefit.

Calendar Year	Monthly Benefit	Change in CPI-W	COLA	COLA (in dollars)	Benefit after COLA
2008	$5000.00	4.48%	3.00%	$150.00	$5150.00
2009	$5000.00	0.44%	1.89%[2]	$97.34	$5247.34
2010	$5150.00	(0.50%)	(0.50%)	($26.24)	$5221.10

[2]Due to "banking" the retiree's COLA was greater than the rate of inflation.

A key feature of the COLA what is known as "banking". If the rate of inflation is greater than three percent, the amount over three percent is carried forward to the next year or "banked". "Banked" amounts are used to increase the member's COLA when inflation is less than three percent.

The amount a retiree has in their "bank" is dependent upon when they retire. In the example above, member B had some COLA "banked" because the 2008 change in CPI-W was greater than three percent so they were able to receive a COLA in 2009 that exceeded the change in the CPI-W.

Since the beginning of LEOFF Plan 2 in October of 1977 there has been only one year in which the rate of inflation was negative and that was in 1983. The percentage change for that year was negative 0.27%. However, since the preceding year was 6.48% there was no negative impact to any LEOFF Plan 2 retiree's pension benefit amount.

There have been situations where negative inflation has had a negative effect on a retiree's pension benefit. In LEOFF Plan 1 the retiree's pension is adjusted according to the index without limitations up or down nor is there any "banking" provision. LEOFF Plan 1 pension benefits are adjusted for the Consumer Price Index – Seattle, Washington area for urban wage earners and clerical workers, all items (1957 – 1959 = 100) compiled by the Bureau of Labor Statistics, United States Department of Labor. In 1983 when the change in the Consumer Price Index was negative, LEOFF Plan 1 retirees received an actual decrease in their pensions in April of 1984.

Another example of the potential for a negative COLA occurred this year in Maryland in the Maryland Retirement and Pension System. Retirees were scheduled to have a negative COLA applied to their benefits in July 2010, but legislation was passed that will keep their pensions at the current level and will instead deduct the negative inflation from the positive COLA expected in the following year.

Policy Issues

Under current law there is no annual limit on far a member's benefit can reduced under negative inflation, other than the limitation of not falling below the original calculated pension benefit amount. During times of when inflation exceeds the annual three percent maximum allowed by law, the "banking" feature of the plan 2 COLA may help mitigate the impact of negative inflation.

6. Supporting Information

Historical Annual Inflation Data[1]

Year	CPI-W STB	Year	CPI-W STB	Year	CPI-W STB	Year	CPI-W STB
2009	0.44%	2001	3.55%	1993	2.98%	1985	2.08%
2008	4.48%	2000	3.75%	1992	3.54%	1984	3.27%
2007	3.79%	1999	3.10%	1991	5.53%	1983	**-0.27%**
2006	3.73%	1998	2.63%	1990	7.11%	1982	6.48%
2005	3.02%	1997	3.10%	1989	4.68%	1981	10.84%
2004	1.57%	1996	3.30%	1988	3.30%	1980	16.08%
2003	1.41%	1995	2.90%	1987	2.35%	1979	10.85%
2002	1.81%	1994	3.66%	1986	0.71%	1978	9.01%

[1]From the Office of the State Actuary's website.

RCW 41.26.440 Post-retirement cost-of-living (LEOFF Plan 2).

Beginning July 1, 1979, and every year thereafter, the department shall determine the following information for each retired member or beneficiary whose retirement allowance has been in effect for at least one year:

(1) The original dollar amount of the retirement allowance;

(2) The index for the calendar year prior to the effective date of the retirement allowance, to be known as "index A";

(3) The index for the calendar year prior to the date of determination, to be known as "index B"; and

(4) The ratio obtained when index B is divided by index A.

The value of the ratio obtained shall be the annual adjustment to the original retirement allowance and shall be applied beginning with the July payment. In no event, however, shall the annual adjustment:

(a) Produce a retirement allowance which is lower than the original retirement allowance;

(b) Exceed three percent in the initial annual adjustment; or

(c) Differ from the previous year's annual adjustment by more than three percent.

For the purposes of this section, "index" means, for any calendar year, that year's average consumer price index -- Seattle, Washington area for urban wage earners and clerical workers, all items, compiled by the bureau of labor statistics, United States department of labor.

WAC 415-02-350 What are cost-of-living adjustments and how are they calculated?

(1) **What is a cost-of-living adjustment (COLA)?** The value of a retiree's, beneficiary's, or ex-spouse's monthly allowance may change in the years after retirement because of inflation or other factors. A COLA automatically adjusts benefits based on the cost of living changes.

(2) **What retirement plans include COLAs?** With one exception, all retirement plans administered by the department provide one or more of the types of COLAs listed in subsection (3) of this section. The judges retirement fund (chapter 2.12 RCW) does not provide a COLA.

RETIREMENT SYSTEM	PLAN	COLA TYPE	STATUTE
JUDICIAL		Base	RCW 2.10.170
LEOFF	Plan 1	Base	RCW 41.26.240
LEOFF	Plan 2	Base	RCW 41.26.440
PSERS		Base	RCW

			41.37.160
PERS	Plan 1	Uniform	RCW 41.40.197
PERS	Plan 1	Optional Auto	RCW 41.40.188 (1)(c)
PERS	Plan 2	Base	RCW 41.40.640
PERS	Plan 3	Base	RCW 41.40.840
SERS	Plans 2 and 3	Base	RCW 41.35.210
TRS	Plan 1	Uniform	RCW 41.32.489
TRS	Plan 1	Optional Auto	RCW 41.32.530 (1)(d)
TRS	Plan 2	Base	RCW 41.32.770
TRS	Plan 3	Base	RCW 41.32.845
WSPRS	Plans 1 and 2	Base	RCW 43.43.260

(3) **What are the types of COLAs?**

(a) **Auto COLA**

The auto COLA, if offered under your plan, is an option you may select at retirement. If you choose this option, your monthly retirement allowance will be actuarially reduced at retirement, and you will receive an automatic adjustment in your monthly retirement allowance each year for the rest of your life. The auto COLA has no age requirement and is limited to a maximum of three percent of your monthly allowance.

(b) **Base COLA**

The base COLA is applied in July (April for LEOFF Plan 1) of each year and adjusts the benefit based on the change in the Consumer Price Index for the Seattle-Tacoma-Bremerton, Washington area. Base COLAs are limited to a maximum of three percent of the monthly allowance for all affected plans except LEOFF Plan 1. During a calendar year, the base COLA is payable to:

(i) Retirees who have been retired for at least one year by July 1st of each year (April 1st for LEOFF Plan 1); and

(ii) Beneficiaries or eligible ex-spouses who receive benefit payments from an account that, by July 1st, has paid a monthly benefit for at least one year (April 1st for LEOFF Plan 1).

(c) **Uniform COLA**

The uniform COLA is an annual adjustment to the benefit, based on years of service. The annual adjustment for the uniform COLA is independent from any other COLA. During a calendar year, it is payable to:

(i) Retirees who, by July 1st, have received a retirement benefit for at least one year and who, by December 31st, will have reached age sixty-six or older;

(ii) Beneficiaries and eligible ex-spouses who receive benefit payments from an account that, by July 1st, has paid a monthly benefit for at least one year and who, by December 31st, will have reached age sixty-six or older; and

(iii) Retirees, beneficiaries, or eligible ex-spouses of any age whose retirement benefit is calculated under the minimum formula.

(4) **Who is responsible for determining the amount of the COLA?** The office of the state actuary (OSA) bases the percentages of the COLAs on the Consumer Price Index. The Index is based on wages earned by urban wage earners and clerical workers in the Seattle-Tacoma-Bremerton, Washington area. OSA provides this information to the department annually.