



COLA VS. 13TH CHECK— WHAT ARE THE TRADE OFFS?

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COLA/13th Check – The Basics

- What is a cost of living adjustment (COLA)?
 - *Permanent increase in retirees' monthly pension benefit*
 - *Usually calculated as a % of the pension benefit*
 - *Example: 1% COLA on \$1,000 benefit increases benefit to \$1,010 forever*
 - *Effective if applied regularly to keep up with inflation*

COLA/13th Check – The Basics (cont'd)

■ What is a 13th check?

- *One-time extra check paid at end of year, in lieu of a COLA*
- *In Indiana, current amount based strictly on service years:*

Service Years	5-10 disabled	10-20	20-30	30+
13 th Chk amt	\$150	\$275	\$375	\$450

- *No effect on future benefits – must be granted each year*
- *Example: retiree with 15 years of service receives one-time \$275 check*

COLA/13th Check – The Basics (cont'd)

- Either benefit applies to current retirees only – no effect on benefit formula for active members
- COLA vs. 13th check amounts
 - *On average: 13th check \Leftrightarrow 0.4% COLA*
 - *13th check lump sum vs. COLA spread over time*
 - *13th check favors older retirees, those with lower benefits*

COLA/13th Check – The History

- COLA/13th check history before SB373
 - *PERF retirees have not received a COLA since 2009*
 - *13th check each year since then – looks permanent, but not really*
 - *13th check funded from general revenue –re-approved by legislature each budget cycle*

Senate Bill 373 – Overview

- Passed 2018
- Created Supplemental Allowance Reserve Accounts (SARAs) to pre-fund COLA or 13th check benefits
 - *Funded from employer contributions, not general revenue*
 - *Benefits not granted until sufficient funding in SARA*

Senate Bill 373 – Overview (cont'd)

- Law applies to 5 separate pension funds, including PERF
 - *PERF, 2 teachers funds, legislator's fund, excise/conservation officer fund*
 - *Establishes Separate SARA maintained for each fund*
- Equivalence required among funds
 - *All funds must provide same form of benefit (13th check vs. COLA)*
 - *SARA funding must be equivalent for all funds*

Senate Bill 373 – Funding

- Funding level for supplemental benefits under SB373
 - *Set by INPRS trustees*
 - *Limited by fund with least capacity (pre-1996 Teacher's Fund)*
 - *Funding limit sets ceiling for the benefits*
- Annual funding capacity
 - *Roughly equal to current 13th check ⇔ 0.4% COLA*

Senate Bill 373 – Benefits

- Future benefit determination under SB373
 - *Legislature approve benefits bi-annually, based on available SARA balances*
 - *Form of benefit must be the same for all funds*
 - *Could replace 13th check with COLA*
- For 2019 and 2020, legislature approved continuation of 13th check payments from general revenue
 - *SARAs not yet funded*
 - *No guarantee of this after 2021*

COLA vs 13th Check Trade-offs

- In a perfect world:
 - *COLA would be granted every year and would match the inflation rate, ~2%*
 - *Benefits would keep up with inflation for all retirees*
 - *No need for 13th check*

COLA vs 13th Check Trade-offs

■ In the real world:

- *Monthly benefits missing 10 years of inflation*
- *0.4% COLA would not keep up with inflation*
- *Retirees reliant on annual 13th check*
- *Replacing 13th check with 0.4% COLA would benefit some in long run, but would reduce current benefits*
- *Example: Retiree with \$1000 monthly benefit and 25 years of service*
 - *13th check = \$375*
 - *Annual impact of COLA = \$48*
 - *8 years for COLA to catch up*

COLA vs 13th Check Trade-offs

- Who benefits more from a 13th check vs. a COLA?

Characteristic	13 th Check	COLA
Monthly benefit	Lower benefit – 13 th check is higher % of base benefit	Higher benefit – increases dollar amount of COLA
Current age	Older ages – fewer years to receive COLA benefits; lower monthly benefits	Younger ages – more years to receive COLA benefits
Years of service	Longer service period – 13 th check increases w service	Shorter service period – COLA indifferent to service period

- Think of trade-off in terms of a break-even period – how many years of COLA benefits are equivalent to the 13th check lump sum?

Summary

- SB373 will change the form and funding of PERF supplemental benefits
 - *13th check may be replaced by a COLA, in whole or in part*
- Benefits of COLA vs. 13th check depends on individual circumstances
 - *Key factors are age, years of service and monthly benefit amount*
- 13th check is funded through 2020
 - *Uncertain beyond that*