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Office of the President

TO MEMBERS OF THE FINANCE AND CAPITAL STRATEGIES COMMITTEE:

ACTION ITEM

For Meeting of July 20, 2022

AMENDMENT OF THE UNIVERSITY OF CALIFORNIA RETIREMENT PLAN FOR AD HOC COST-OF-LIVING ADJUSTMENT FOR ANNUITANTS

EXECUTIVE SUMMARY

The University of California Retirement Plan ("UCRP" or "Plan") provides annuitants with an annual cost-of-living adjustment (COLA) to their monthly retirement income (i.e., benefit) based on a formula tied to increases in the Consumer Price Index (CPI). This annual COLA is intended to protect annuitant purchasing power from being eroded to some extent by inflation over time. However, based on the UCRP COLA formula, for any years in which the increase in the CPI (i.e., measurement of inflation) is greater than two percent, annuitant purchasing power will decrease. This has especially been the case in the most recent year where the measurement of inflation for UCRP was over six percent resulting in purchasing power falling below 75 percent for about 900 annuitants and below 85 percent for around 4,800 annuitants as of July 1, 2022.

Historically, the University has striven to protect annuitants' benefits from being significantly eroded by inflation. This has been achieved by the Regents' adoption of various one-time "ad hoc" COLAs over the years that have restored annuitants' purchasing power to at least 75 percent. The most recent ad hoc COLA adjustment in 2001 restored annuitant purchasing power to 85 percent at that time.

Based on the erosion of purchasing power for UCRP annuitants over time in part by significant levels of recent inflation, it is recommended that UCRP be amended to provide for an ad hoc COLA effective July 1, 2022 for annuitants to restore purchasing power to an 85 percent minimum level. The 85 percent level is recommended so that it will not be necessary to provide additional ad hoc COLAs as frequently to maintain annuitants at the 75 percent purchasing power level.

RECOMMENDATION

The President of the University recommends that the Finance and Capital Strategies Committee recommend to the Regents that the University of California Retirement Plan ("UCRP" or "Plan") be amended to provide a one-time ad hoc cost-of-living adjustment (COLA) to restore purchasing power to an 85 percent minimum level, effective July 1, 2022.

BACKGROUND

UCRP provides annuitants with an annual COLA based on a formula tied to increases in the CPI. This annual COLA is based on the change in the average CPI for both the Northern (including San Francisco) and Southern California (including Los Angeles) metropolitan areas from February of the preceding year to February of the current year as prepared by the Bureau of Labor Statistics of the United States Department of Labor. These particular metropolitan areas are used because most of the annuitants of the Plan live in these regions.

July 1, 2022 Annual Annuitant COLA

For the July 1, 2022 UCRP annual COLA, the percentage change in the average CPI from February 2021 to February 2022 was calculated as follows:

	February 2021	**February 2022**
CPI All Urban Consumers Northern California	304.387	320.195
CPI All Urban Consumers Southern California	281.347	302.164
Average: Northern and Southern California	292.867	311.180
Percentage Increase		6.25%

UCRP provides an annual COLA equal to 100 percent of the first two percent of CPI change plus 75 percent of the change in average CPI above four percent. The maximum annual COLA is six percent. Based on this formula and the change in the average CPI of 6.25 percent, the July 1, 2022 COLA is 3.69 percent before any adjustments from COLA and/or inflation banks.

Generally speaking, the UCRP annual COLA has been designed to provide a two-percent annual COLA, if actual inflation (i.e., change in the average CPI) is sufficient to warrant such an adjustment. For years in which inflation is greater than two percent (such as this year), an inflation bank accumulates. The inflation bank can then be used to increase the annual COLA for future years in which inflation is less than two percent.

Conversely, for years in which inflation is less than two percent, certain annuitants accumulate a COLA bank. The COLA bank is the portion of the annual COLA below two percent that the annuitant has not yet received due to insufficient inflation. The COLA bank can be used to increase the annual COLA for future years in which inflation is greater than two percent.

After applying the inflation and COLA banks, the final July 1, 2022 annual COLA for annuitants varies by retirement date and is as follows:

Retirement Date	COLA
On or before July 1, 2019	3.69%
July 2, 2019 to July 1, 2020	4.41%
July 2, 2020 to July 1, 2021	3.69%

Measurement of Retained Purchasing Power

The first step in determining whether purchasing power has eroded is to measure the current level of retained purchasing power. This calculation compares the ratio of the annuitants' current monthly benefit (with COLAs) to the original monthly benefit against the ratio of the current CPI to the CPI when benefits began.

If the retained purchasing power has eroded below 85 percent, for example, the adjustment necessary to increase the purchasing power to 85 percent is determined by comparing the target 85 percent purchasing power to the actual retained purchasing power for the annuitant.

The table below shows the retained purchasing power for UCRP annuitants as of July 1, 2022. It shows that purchasing power has fallen below 75 percent for about 900 annuitants and below 85 percent for around 4,800 annuitants.

Retained Purchasing Power	Number of Annuitants[1] by Purchasing Power as of July 1, 2022
Less than 75%	876
75% up to 80%	1,307
80% up to 85%	2,660
85% and above	78,052

Historical Protection of Purchasing Power

Historically, the University has striven to protect annuitants' benefits from being significantly eroded by inflation even though this is not a guaranteed contractual benefit. UCRP does not contain a specific provision regarding maintaining a set percentage of purchasing power. This means that purchasing power protection has been achieved by the Regents' adoption of various ad hoc COLA over the years that have restored annuitants' purchasing power.

[1] Number of annuitants shown is based on data as of the last actuarial valuation as of July 1, 2021.

The table below contains information regarding the last four ad hoc COLAs that were adopted by the Regents. It includes the date when the ad hoc COLA was effective and the minimum level of purchasing power that was restored.

Ad Hoc COLA Effective Date	Minimum Level of Purchasing Power Restored
January 1986	75%
July 1988	75%
January 1991	80%
January 2001	85%

The January 2001 ad hoc COLA restored purchasing power to the 85 percent minimum level so that it would not be necessary to provide additional ad hoc COLAs as frequently to maintain annuitants at the 75 percent minimum purchasing power level.

The advantage of a periodic ad hoc COLA over a guaranteed COLA that protects purchasing power to a minimum level is that the funding costs for an ad hoc COLA are lower. A guaranteed purchasing power protection COLA can result in significant actuarial liabilities that may require the accumulation of additional financial resources within the Plan which may or may not be needed depending on actual levels of future inflation. In addition, a guaranteed purchasing power provision can have significant costs that were not anticipated if inflation remains high over a significant period of time. Alternatively, a periodic ad hoc COLA requires no advance funding and does not increase actuarial liabilities until the ad hoc COLA is actually granted.

The California Public Employees' Retirement System (CalPERS) provides for a guaranteed purchasing power protection COLA. The purchasing power protection is at a 75 percent minimum threshold for State and school members and 80 percent for local and public agencies.

Restoring Purchasing Power to the 85 Percent Level

It is recommended that UCRP be amended to provide an ad hoc COLA to restore purchasing power to an 85 percent minimum level, effective July 1, 2022, for annuitants with retirement dates on July 1, 1991 and earlier.

The table below contains the number of annuitants that would be eligible for the ad hoc COLA by retirement date along with their average age and average monthly UCRP benefit. At the rightmost column of the table, the ad hoc COLAs (i.e., percentage increase in UCRP benefit) necessary to restore purchasing power to the 85 percent level are also shown for each of the retirement date groups. The ad hoc COLA percentage ranges from 1.38 percent to 13.64 percent depending on retirement date.

Retirement Date	Number of Annuitants	Average Age	Average Monthly UCRP Benefit	Ad Hoc COLA to Restore Purchasing Power to 85% Level
Before July 2, 1985	876	89	$1,243	13.64%
July 2, 1985 to July 1, 1986	217	87	$1,660	13.12%
July 2, 1986 to July 1, 1987	298	88	$1,549	12.04%
July 2, 1987 to July 1, 1988	369	88	$1,815	9.76%
July 2, 1988 to July 1, 1989	423	87	$1,794	6.97%
July 2, 1989 to July 1, 1990	712	86	$1,798	4.04%
July 2, 1990 to July 1, 1991	1,948	87	$3,177	1.38%

Data shown is based on the last actuarial valuation as of July 1, 2021.

Cost Impact of Ad Hoc COLA

The Regents' consulting pension actuary, Segal, has expressed the opinion that the recommended ad hoc COLA to restore purchasing power to the 85 percent level would not materially alter the funding status of the Plan.

The estimated cost to UCRP to restore purchasing power to the 85 percent level would be an increase in the Plan's Actuarial Accrued Liability (AAL) of approximately $32.6 million; there would be no increase to the Plan's Normal Cost. The increase in AAL represents approximately 0.03 percent of the Plan's total AAL of $97.2 billion based on the latest actuarial valuation as of July 1, 2021.

The Plan's funded ratio would decrease by 0.03 percent. As of the latest actuarial valuation as of July 1, 2021, the Plan's funded ratio was approximately 83 percent on an actuarial value basis and 94 percent on a market value basis.

The total funding policy contribution for the campus and medical center segment, which is an actuarially determined contribution, would increase by 0.02 percent of compensation. The employer contribution schedule approved by the Regents in November 2021 would remain unchanged.

If adopted, the actual cost impact of the ad hoc COLA will be reflected in the upcoming July 1, 2022 actuarial valuation that will be presented to the Regents in November 2022.

Notice

The University will take appropriate action concerning proposed changes that may trigger notice, consultation, and meeting and conferring obligations under the Higher Education Employer-Employee Relations Act, if any such action is required.

Key to Acronyms

AAL	Actuarial Accrued Liability
CalPERS	California Public Employees' Retirement System
COLA	Cost-of-living adjustment
CPI	Consumer Price Index
UCRP or Plan	University of California Retirement Plan