



Public Pension COLA Designs

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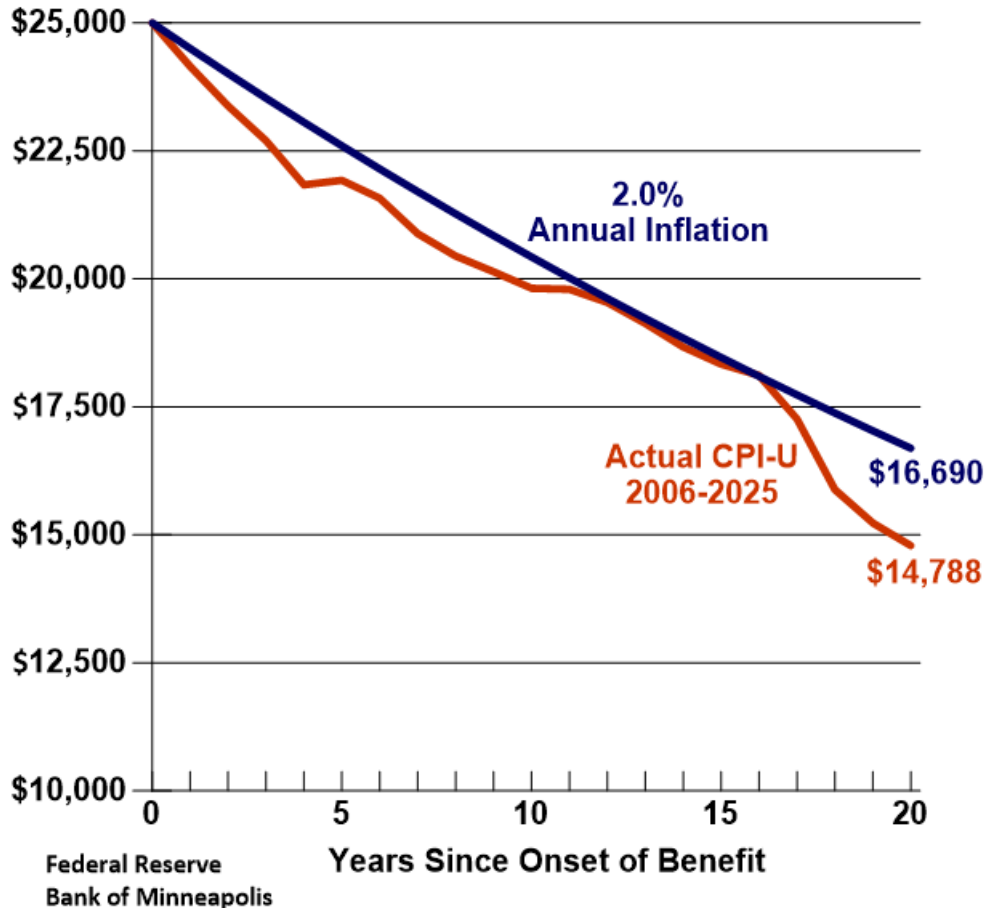
NASRA

**New Mexico Legislature
Investments and Pensions Oversight Committee
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COLA Purpose

- A COLA is intended to offset the effects of inflation on a pension benefit
- A COLA adds value – and cost – to the plan
 - More inflation protection generally means greater plan cost
 - Less inflation protection exposes retirees to more inflation risk
 - Conditional COLAs can distribute risk between the two parties
- It has been estimated that a COLA of one-half an assumed CPI of three percent will add 11 percent to the cost of the benefit (26 percent for an automatic COLA of three percent)

**Impact of 20 years of inflation on
purchasing power of \$25,000
(assuming no COLA)**



**67% of original purchasing
power remains after 20
years at steady 2.0%
inflation**

**59% remains under actual
CPI-U inflation from 2006-
2025**

COLA policy must balance three objectives

- Adequacy
 - Protecting the purchasing power of retirees' income
- Sustainability
 - Keeping the plan's funding on a sound long-term path
- Affordability
 - Keeping costs manageable for employers and taxpayers

No COLA design eliminates the tradeoffs among these objectives. Policy choices determine how those tradeoffs are managed and how the associated risks are distributed.

Key COLA distinctions

Automatic vs. ad hoc

Automatic: paid without further action, under a set rate or formula.

Ad hoc: a governing body must approve each increase, sometimes only if funding or amortization thresholds are met.

Predictability for retirees vs. year-to-year control for sponsors

Simple vs. compound

Simple: each increase is based on the original benefit, producing a smaller benefit at lower cost.

Compound: each increase builds on the original benefit plus all prior increases.

Some plans are simple until a set age or year of retirement, then compound

COLA designs vary widely



Inflation-based

Tied to CPI, usually a fraction of the change or subject to a cap (e.g., “not to exceed 3%”).



Funding- or performance-based

The COLA rises or falls with plan funding or investment returns.



Delayed onset or minimum age

Retirees must wait a set period of time, or reach a certain age, before the first COLA.



Limited or targeted

The COLA covers part of the benefit or select groups (e.g., first \$13,000).



Most plans provide an automatic COLA

Plans (101)	Linked to inflation	Investment or funding	CPI + investment or funding	Fixed % or other	Total
Automatic	40	6	11	15	74
Ad hoc	3	8	0	18	27
Total	43	14	11	33	101

Excludes plans where COLAs are left to individual local employers and plans whose COLAs are eliminated for the foreseeable future.

Trade-offs between COLA types

Inflation-linked

Advantages

- Directly targets retiree purchasing power
- Predictable and easy for retirees to understand
- Pays more when inflation is high and retirees need it most

Disadvantages

- Cost rises with inflation
- Caps and partial indexing shift high-inflation risk back to retirees
- Inflation above the assumed rate produces actuarial losses

Funding- or performance-linked

Advantages

- Adjusts automatically to what the plan can afford
- Protects plan funding and limits employer cost
- Can pay more when returns and funding are strong

Disadvantages

- Weak link to inflation: can pay little when prices rise fast
- Retirees bear investment risk
- Less predictable; an underfunded plan may stay at the floor for years
- Puts pressure on the investment function

Hybrid designs (e.g., South Dakota, Rhode Island, Colorado FPPA) combine features of both.

New Mexico PERA COLA

- Before 2013: automatic 3% compounded COLA for those retired at least two full years
- 2013: COLA reduced from 3% to 2% and delayed depending on retirement date
- 2020 legislation created a shared-risk COLA, effective FY 24:
 - COLA = (smoothed investment return – hurdle rate) × funded ratio
 - Hurdle rate: the investment return needed to fund a COLA above 0.5%
 - Minimum 0.5%; maximum 3.0% if under 100% funded, 5.0% if at or above 100%

Recent PERA COLAs

Paid to most retirees

COLA year	COLA paid	Inflation*
FY 25	0.50%	4.1%
FY 26	0.63%	3.0%
FY 27	0.50%	2.9%**

FY 25–27 combined: COLAs 1.6% vs. inflation 10.3%

A fixed 2.5% COLA applies to retirees with 25+ years of service (and disability retirees) with benefits of \$25,000 or less, and to those age 75+ as of 7/1/20.

*CPI-U, prior calendar year. Sources: NM PERA; LFC; BLS

**preliminary



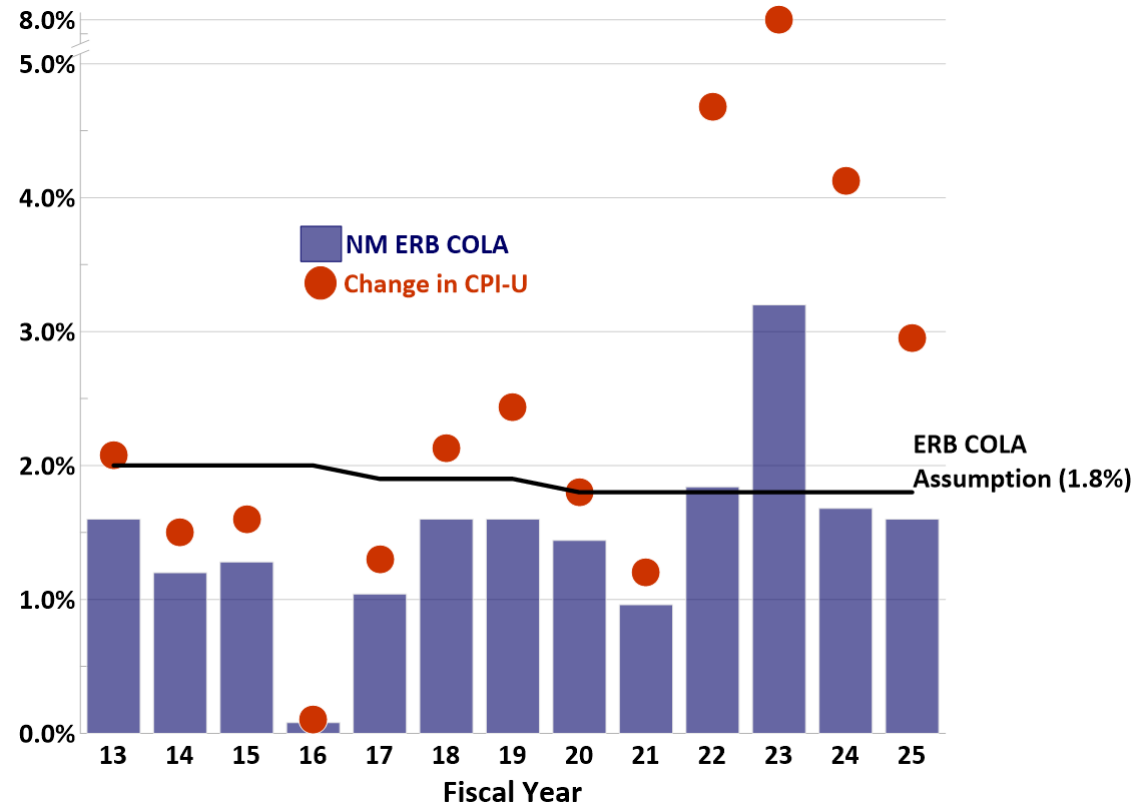
New Mexico ERB COLA

- COLA is based on the change in CPI: if CPI is less than 2%, COLA is equal to the full change. If CPI is greater than 2%, COLA is equal to one-half of the change, but not less than 2% nor more than 4%
- 2013 legislation implemented percentage reductions based on plan funded status:

Reduction to the ERB COLA, by funded ratio

Funded ratio	25+ years, benefit at or below median	All other retirees
90% or less	10%	20%
Over 90%, under 100%	5%	10%
100% or more	None	None

New Mexico ERB COLA Experience FY 2013 to FY 2025



- Prior to FY 22 the ERB COLA replaced ~65 to 80 percent of inflation per year
- ~40 to 54 percent since FY 22
- In all but two years the ERB COLA has been below the COLA assumption



Where should additional funding go?

ERB example: FY 13 - FY 25
Cumulative change, compounded

Inflation (CPI-U)



Full ERB formula (no reduction)



ERB COLA paid (20% reduction)



Purchasing power retained

90.9%

with full formula

86.7%

as actually paid

71.7%

with no COLA

A \$25,000 benefit in FY 13 is about **\$1,450 a year lower** today because of the reduction (\$30,220 vs. \$31,670).

Fund COLAs or payments directly

- Provides immediate relief, especially for the oldest retirees who have lost the most purchasing power
- One-time payments end; permanent increases add to long-term liabilities and cost

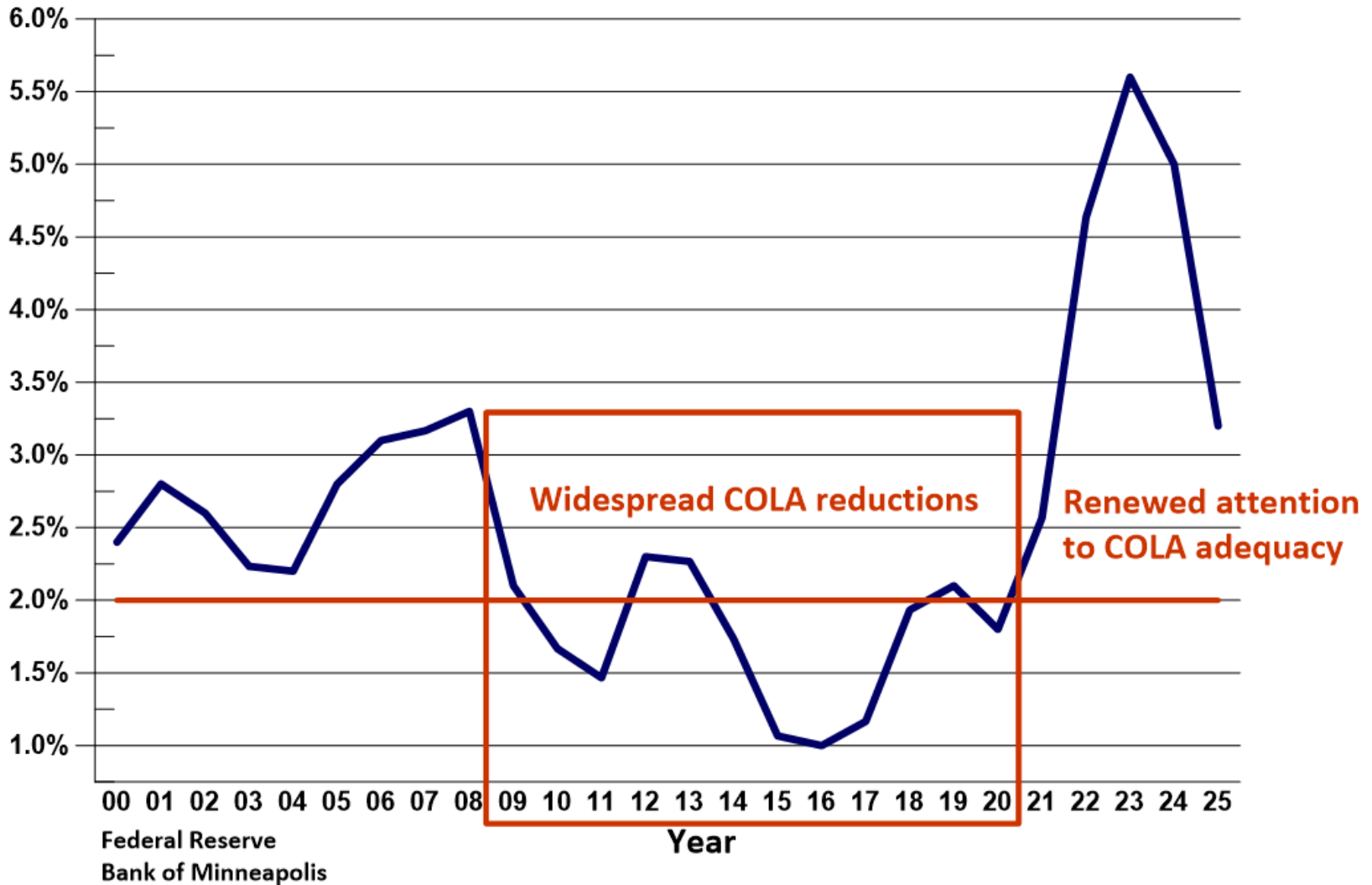
Improve the funded ratio

- Also lowers long-term cost and risk, but the benefit to retirees builds slowly
- ERB reductions decline at 90% funded and end at 100%, restoring the full formula for all retirees
- For most PERA retirees, the payoff is largest at 100% funded, where the COLA cap rises from 3% to 5%

Sources: NM ERB COLA history; BLS CPI-U, prior calendar year; NASRA calculations.



3-year rolling average change in CPI-U, 2000-2025



Higher inflation has renewed COLA activity

Ad hoc grants after long gaps

Alabama, Georgia, New Hampshire, Oklahoma, Pennsylvania, Texas, and others granted COLAs after several years without one.

Increases to automatic COLAs

Minnesota: state employee COLA raised from 1.5% to 1.75%.

Rhode Island: from a COLA every four years while under 80% funded to an annual 0.25% adjustment until 80% is reached.

Key challenges

- 1) Maintaining purchasing power when COLAs are discretionary or infrequent
- 2) Designing automatic COLAs that remain affordable through different economic conditions



Toward more reliable and predictable COLAs

State	Approach
Georgia ERS (2023)	Board model ties COLAs to funded ratio and returns above a hurdle (5.5% since 2026); capped at lesser of inflation or 3%; board keeps final say
Colorado FPPA (2023)	Board grants an affordable compounding COLA, plus a one-time payment up to CPI-W when funding and return triggers are met
Louisiana (2023)	Moves COLA funding into the employer contribution rate, aiming for larger, more dependable increases by FY 2030
Indiana (2025)	1% COLAs for those retiring after 7/1/29, funded by a surcharge that can rise up to 0.1% of payroll a year
Alabama (2025)	Any increase requires a matching employer contribution increase; allowed at most once every four years
North Carolina (2026)	Board may recommend a COLA or one-time payment when five-year investment gains exceed its cost
Massachusetts (2026)	Reserve fund banks 7.5% of excess investment returns to prefund an Enhanced COLA (\$100–\$300 a year) and future COLA base increases



Colorado Fire & Police Pension Association

Board policy adopted April 2023

1 Affordable base COLA

Each year the board grants a compounded COLA *at the level the plan can afford while remaining fully funded.*

2 Catch-up trigger

If that COLA is below 1% and five-year investment returns are at least 6.5%, *the board may add a one-time payment.*

3 Inflation make-up

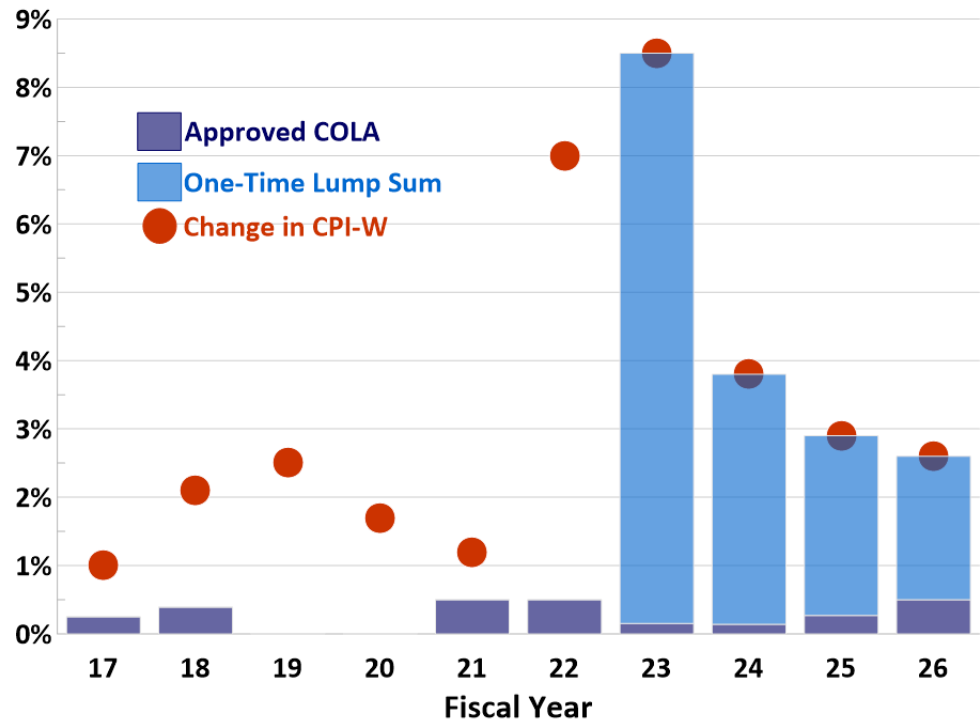
The one-time, non-compounding payment equals CPI-W inflation minus the compounding COLA.

FY 2026 result

0.50% + 2.10%

compounding COLA + one-time lump sum, about 3.8% of annual benefit in total

Colorado FPPA
Historical COLAs vs. CPI-W



The Colorado FPPA policy combines the COLA the plan can permanently afford with temporary inflation relief when investment returns are favorable



Employees' Retirement System of Georgia

Board funding policy adopted 2022, revised April 2026

Example: how the FY 27 COLA was set

Actuarial investment return	9.90%
– Hurdle rate	5.50%
= Excess return	4.40%
× Shareable factor (81.8% funded)	0.50
= Shareable portion, rounded to 0.25%	2.25%
Inflation (Social Security COLA, max 3%)	2.80%
FY 27 COLA: lesser of the two	2.25%

The shareable factor rises with funding: it was 0.25 at 75.9% funded in FY 26.

Recent ERS benefit adjustments

Year	COLA	One-time payment
FY 27	2.25%	5%, max \$555.36
FY 26	0.50%	5%, max \$837.72
FY 25	0.25%	4.5%, max \$572.64
FY 24	0.50%	4.75%, max \$568.92
FY 23	1.50%	Lesser of \$531.27 or one monthly benefit

One-time payments are a percentage of the annual benefit, up to the maximum shown.

Similar to New Mexico PERA: the same return-minus-hurdle structure, but Georgia caps the COLA at inflation and pairs it with one-time payments.

Sources: ERS of Georgia, Post-Retirement Benefit Adjustment History and FY 26–27 COLA calculations

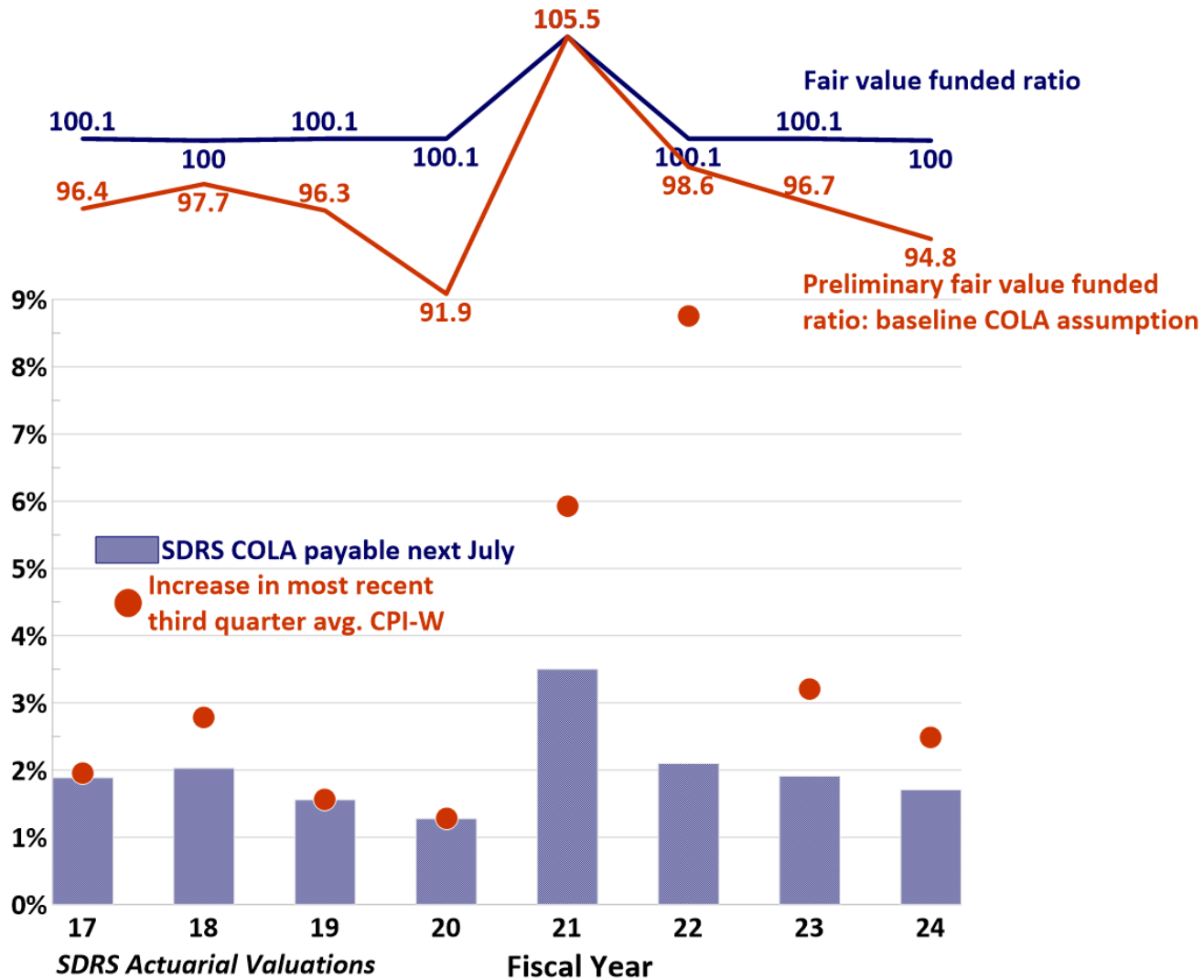


South Dakota Retirement System

- General member and employer contribution rates are fixed in statute at 6.0 percent of pay since FY 03
 - 5.0 percent from FY 74 to FY 02
- State law requires recommendation to the legislature and governor for corrective action if:
 - Funded ratio falls below 100 percent on a market value basis, or;
 - Fixed statutory contribution rate does not meet the actuarial requirement
- COLA automatically varies with inflation and long-term affordability
 - COLA equals inflation up to 3.5 percent if affordable
 - When not affordable, COLA maximum is reduced to the level that keeps the plan funded at 100 percent if paid for the lifetime of all members



SDRS COLA and Funding Level



SDRS Actuarial Valuations
FY 17 to FY 24, compiled
by NASRA

Questions for policymakers

- How much purchasing power should the COLA protect?
- Who should bear the risk of high inflation: retirees, employers, or both?
- How is the COLA funded?
- What triggers should raise or reduce the COLA?
- If additional funding is available, what mix of immediate inflation relief and reduction of plan unfunded liabilities best serves participants and the state?



Thank you

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NASRA Issue Brief: Cost-of-Living Adjustments

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