Retirement News Highlights

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Inflation Raises Expenses for Pension Funds

By Heather Gillers
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Rising inflation is driving up expenses for many large U.S. pension funds that have promised retirees cost-of-living raises.

About half of states link pension benefits for some or all of their retired workers to changes in the consumer-price index, according to the National Association of State Retirement Administrators. With inflation reaching 7% in December, some retirement funds are now looking at increasing pension checks by 3% or more for the first time in a decade. At others, board members or state officials are approving one-time cost-of-living raises.

“It’s a hot topic,” said Keith Brainard, the association’s research director. “A cost-of-living adjustment can be an expensive plan provision.”

Pension funds are confronting a challenge shared by institutions and household savers alike: Just as expectations for public market investment returns are dimming, everyday costs are going up. This year, many retirement systems will book a loss on cost-of-living adjustments, rather than the annual windfall they have been seeing for years when those inflation-linked increases came in below expectations.

The $28 billion Los Angeles Fire and Police Pension System, for example, got an unexpected gain of $264 million last year when cost-of-living adjustments for pensioners came in well below the actuaries’ assumption of 2.75%.

This year, with the fund’s cost-of-living adjustment likely to approach 7% for many beneficiaries, the system is likely to pay out tens of millions dollars more than anticipated. Pensions range from 50% to 90% of final salary.

Pension funds “have been used to coming in ahead; now all of a sudden they’re going to be behind,” said Joe Newton, pension market leader with Gabriel, Roeder, Smith & Co., an actuarial and benefits consulting firm. Russia’s attack on Ukraine is further stoking inflation concerns.

In the roughly 30,000-person town of Windsor, Conn., an $84 million local pension fund is paying out about $410,000 a month in pension benefits to its roughly 250 retirees this year, said Finance Director James Bourke. About $63,000 of that is due to cost-of-living increases made over the years, with $5,000 coming from this year’s cost-of-living increase of 1.3%.

Next year, the cost-of-living increase will rise to 5.9%, tacking on about $25,000 a month. The pension fund has taken several measures over the past decade that help keep costs down, Mr. Bourke said, including closing the plan to new hires and increasing worker contributions.

Inflation also can add to pension costs down the road if it drives up workers' final salaries, which are used to calculate their pensions.

To be sure, cost-of-living increases are only one component of the pension obligations many funds face, and some states limit costs by approving payouts on a one-time basis. More than 430,000 beneficiaries of the Teacher Retirement System of Texas received up to $2,400 from the state's general fund in January after the Texas legislature approved the measure.

But many other state pensions offer yearly increases of up to 2% or 3%, sometimes more, according to a National Association of State Retirement Administrators survey of plans' cost-of-living provisions. Those raises can add up, particularly if they compound, meaning that one year's increase becomes part of the base on which the next year's increase is calculated.

Indeed, since the 2007-09 financial crisis, more than 30 state pension systems have modified cost-of-living adjustments in an effort to reduce costs, the National Association of State Retirement Administrators survey shows.

State pension funds still have $740 billion less than they need to cover future benefit promises, according to a fiscal 2021 estimate from Pew Charitable Trusts, even after a decade of stock gains has swelled public pension coffers. Funding shortfalls have led public officials to invest retirement savings in illiquid private markets and weighed down some states' and cities' creditworthiness in the eyes of ratings firms, driving up their borrowing costs.

Some pension funds that lowered or eliminated cost-of-living increases in an effort to control expenses are now experiencing pushback.

Retired Cincinnati teacher Elizabeth Jones hasn't received a cost-of-living increase since 2017 after the State Teachers Retirement System of Ohio suspended the increases in the face of a funding shortfall. She is now running for a seat on the board on a platform that includes restoring annual cost-of-living increases.

"Everyone's bills are going up, grocery bills, gas, you name it," said Ms. Jones, the president of the retiree chapter of Cincinnati Federation of Teachers and a former high school English teacher and guidance counselor.

As of June 30, the pension fund had about $90 billion in assets and $105 billion in liabilities. Teachers retiring over the past year had an average annual pension of $55,476 and an average age of 62, according to the fund.

Board members are expected to vote in March on proposals for one-time or two-time cost-of-living adjustments for some retirees, a spokesman said. The retirement system's actuary, Cheiron, advised members to proceed with caution, according to a board publication. The firm projects that a one-time 2% cost-of-living increase would cost the fund roughly $1 billion.

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