American Academy *of* Actuaries

September 4, 2009

Representative Anthony Weiner
2104 Rayburn House Office Building
Washington, DC 20515
(202) 226-7253

VIA FACSIMILE - w/Copy to Neil Cavuto

Dear Congressman Weiner:

On behalf of the American Academy of Actuaries[1], I would like to correct some inaccuracies expressed during your interview last week with Mr. Cavuto on "Your World with Neil Cavuto" (Aug. 24, 2009) regarding Social Security's annual cost-of-living increases (COLAs).

To begin with, the process for determining each COLA is not discretionary. Rather, the process is prescribed by law and regulations under the Social Security Act as amended in 1973. Since 1984, Social Security Administration (SSA)'s actuaries have performed the COLA calculation each October, based on the increase in the Consumer Price Index (CPI-W) through September (the CPI is updated monthly by the Department of Labor's Bureau of Labor Statistics). Full details of the formula can be found at the SSA's website:

http://www.ssa.gov/OACT/COLA/latestCOLA.html

The formula used to calculate the COLAs appears in the *Code of Federal Regulations*, and is available at the following link:

http://www.ssa.gov/OP_Home/cfr20/404/404-0275.htm

We have attached, in Q&A format, some additional information on the determination of Social Security COLAs and the outlook for increases for 2009 and 2010.

We hope you'll find these materials helpful. We'd be pleased to meet with you or your staff to discuss this issue, as well as the wider range of current retirement security issues for which actuaries can offer their expertise.

Sincerely,

Frank Todisco, FSA, MAA, EA
Senior Pension Fellow
American Academy of Actuaries

[1] The American Academy of Actuaries is a professional association with over 16,000 members, whose mission is to assist public policymakers by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

Some Questions and Answers on the Social Security Cost of Living Allowances (COLAs)

Q: How is the annual COLA for Social Security benefits determined?

A: The process for determining each annual COLA is prescribed by law and regulations under the Social Security Act as amended in 1973; it is not discretionary. Since 1984, Social Security Administration actuaries have performed the COLA calculation each October, based on the increase in the Consumer Price Index (CPI-W) through September (the CPI is updated monthly by the Department of Labor's Bureau of Labor Statistics).

The formula uses the increase in the Consumer Price Index from the third quarter of the previous year to the third quarter of the current year. Full details of the formula are at this website:
http://www.ssa.gov/OACT/COLA/latestCOLA.html

Q: Are the reports of zero Social Security COLAs for the next two years definitive?

A: No. Current news reports indicating there will be no COLAs effective in December 2009 and December 2010 reflect estimates, not final determinations. Final determinations cannot be known until the Bureau of Labor Statistics measures inflation through the end of September 2009 (for any December 2009 increase) and through the end of September 2010 (for any December 2010 increase).

Q: What is the outlook for a COLA for December 2009?

A: A zero COLA for December 2009 is highly likely, although not certain.

The 2009 Social Security trustees' report, published May 12, 2009, included projection of the COLA for December 2009, estimating it to be zero. The subsequent passage of nearly four months without any resurgence of inflation makes a zero COLA for December 2009 even more likely. However, no one can be completely sure about this result until the September CPI figure becomes available in October.

Q: Why would the COLA for December 2009 fall to zero?

A: Briefly, the CPI reached a peak in the third quarter of 2008, then fell precipitously in the fourth quarter (falling at a 13% annualized rate) and stayed below that peak. As a result, the December 2008 COLA (based on third-quarter 2008 CPI) was unusually large, at 5.8 percent. The current year's CPI continues to show deflation relative to that third-quarter 2008 peak, which is why no COLA is expected for this year.

Remember that the impact of the 5.8-percent COLA effective with December 2008 benefits will continue to be felt for all future years, even though the inflation that triggered it has largely subsided.

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Q: What is the outlook for a COLA for December 2010?

A: The data that will determine the December 2010 COLA will be available no sooner than October 2010. So, at this time, one can only speculate as to the size of a December 2010 COLA (if any) – and that speculation will be shaped by inflation expectations going forward.

The intermediate assumptions used by the Social Security trustees include inflation of negative 1.0% for 2009 and positive 1.7% for 2010 – reflecting the potential impact of the recession – before gradually reverting to more normal levels. If inflation were to follow this trajectory, there would indeed be a zero COLA in December 2010. (See http://www.ssa.gov/OACT/TR/2009/V_economic.html#131314, fifth paragraph)

However, our calculations show that if the annual rate of inflation experienced over the 14 months from August 2009 to September 2010 turns out to be approximately 2.5% or higher, then there would be a non-zero COLA in December 2010. So a positive COLA at that time is well within the realm of possibility.