

Key Pension Terms

Actuarial Accrued Liability - Generally represents the portion of the present value of fully projected benefits attributable to service credit earned (or accrued) as of the valuation date.

Actuarial Assumptions - Factors which actuaries use in estimating the cost of funding a defined benefit pension plan. Examples include: the rate of return on plan investments; mortality rates; and the rates at which plan participants are expected to leave the system because of retirement, disability, termination, etc.

Annual Required Contribution (ARC) - The employer's periodic required contributions, expressed as a dollar amount or a percentage of covered plan compensation, determined under GASB 25. The ARC consists of the Employer Normal Cost and the Amortization Payment.

Actuarial Valuation - The determination, as of a valuation date, of the Normal Cost, Actuarial Accrued Liability, Actuarial Value of Assets, and related Actuarial Present Values for a plan. An Actuarial valuation for a governmental retirement system typically also includes calculations of items needed for compliance with GASB 25, such as the funded ratio and the ARC.

Actuarial Value of Assets - The value of pension plan investments and other property used by the actuary for the purpose of an actuarial valuation (sometimes referred to as valuation assets). Actuaries often select an asset valuation method that smoothes the effects of short-term volatility in the market value of assets.

Amortization - Paying off an interest bearing liability by gradual reduction through a series of installments, as opposed to paying it off by one lump sum payment.

Funded Ratio - The ratio of the actuarial value of assets (AVA) to the actuarial accrued liability (AAL). Plans sometimes calculate a market funded ratio, using the market value of assets (MVA), rather than the AVA, although GASB 25 reporting requires the use of the AVA.

Amortization Payment - That portion of the pension plan contribution or ARC which is designed to pay interest on and to amortize the Unfunded Actuarial Accrued Liability.

Annuity - A series of periodic payments, usually for life, payable monthly or other specified intervals. The term is often used to describe the part of a retirement allowance derived from a participant's contributions. A deferred annuity is one in which payments do not commence until a designated time in the future.

Cash Balance Plan - A defined benefit pension plan that looks like and expresses its benefits like a defined contribution plan (i.e., accounts and account balances, contributions, and interest credits). However, the investment risk is borne by the plan sponsor, not the participant.

Defined Benefit (DB) Plan - A pension plan that is designed to provide participants with a predefined, predictable and guaranteed benefit based on a formula that takes into account an employee's compensation, years of service, and age, or a combination thereof.

Defined Contribution (DC) Plan - A pension plan in which contributions are made to an individual account for each employee. The retirement benefit is not pre-determined and is entirely dependent upon the account balance at retirement, and is based on the money that accumulates in an employee's account, reflecting any employer contributions and employee contributions and any investment gains or losses.

ERISA: Employee Retirement Income Security Act - This federal legislation sets minimum standards for pension design to increase the security of private sector employees' benefits.

Experience Study - A periodic review and analysis of the actual experience of the Retirement Fund which may lead to a revision of some actuarial assumptions. Actual rates of death, retirement, disability, or termination and salary increases are compared to the assumed values and modified as appropriate by the actuary.

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Integrated Pension Plan - Defined benefit plans often provide that part of the Social Security pension be subtracted from the member's annuity.

Normal Cost - The normal cost generally represents the portion of the cost of projected benefits allocated to the current plan year. The employer normal cost equals the total normal cost of the plan less employee contributions.

Normal Retirement Age - Participants are not required to retire when they reach retirement age. Participants generally continue to earn benefits if they work past retirement age.

Portability - The ability of an employee who changes jobs and joins a different retirement system to bring his or her retirement assets with them without penalty.

Present Value - The current worth of an amount or series of amounts payable in the future, after discounting each amount at an assumed rate of interest and adjusting for the probability of its payment or receipt.

Post Retirement Benefit Increase - Often referred to as cost of living adjustments (COLAs), these are increases to the initial benefit received upon retirement and can be a percentage based on an index such as inflation or a fixed dollar amount.

Rate of Return - This is the gain or loss of an investment over a specific period of time. The Real Rate of Return is return on an investment after adjusting for inflation. Actuarial gains or losses represent the difference between the actual rate of return and that expected based on the actuarial assumptions.

Social Security Retirement Age - The age, used as the normal retirement age under the Social Security Act, to pay unreduced benefits, that depends on the calendar year of birth.

Unfunded Actuarial Accrued Liability (UAAL) - The excess, if any, of the Actuarial Accrued Liability over the Actuarial Value of Assets. In other words, the present value of benefits earned to date that are not covered by current plan assets.

Vesting - Determination that an employee has reached a defined number of years of service to be eligible to receive a pension benefit based on the benefits he or she has accrued, or some portion of them, even if employment under the plan is terminated.

401(k), 403(b), and 457 Plans - These are defined contribution plans which permit employees to save for retirement on a tax-deferred basis. 401(k) plans are found in the private sector and the public sector in some states. 403(b) plans are for employees of public educational institutions and certain non-profit tax-exempt organization. 457 plans (also known as deferred compensation plans) are for governmental employees and non-church-controlled tax-exempt organizations.

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