Pension Terminology

Actuarial Accrued Liability
Computed differently under different funding methods, the actuarial accrued liability generally represents the portion of the Present Value of Future 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.

Actuarial Cost Methods
An actuarial method which defines the allocation of pension costs (and contributions) over a member's working career. All standard actuarial cost methods are comprised of two components: normal cost and the actuarial accrued liability. An actuarial cost method determines the incidence of pension costs, not the ultimate cost of a pension plan; that cost is determined by the actual benefits paid less the actual investment income.

Actuarial Equivalent
A benefit having the same present value as the benefit it replaces. Also, the amount of annuity that can be provided at the same present value cost as a specified annuity of a different type or a specified annuity payable from a different age.

Actuarial Gain or Loss
Experience of the plan, from one year to the next, which differs from that assumed results in an actuarial gain or loss. For example, an actuarial gain would occur if assets earned 10 percent for a given year since the assumed interest rate in the valuation is 8 percent.

Actuarial Present Value
The value of an amount or series of amounts payable or receivable at various times, determined as of a given date by the application of a particular set of actuarial assumptions (i.e. interest rate, rate of salary increases, mortality, etc).

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.

Actuarially Reduced
The method of adjusting a benefit received at an early date so that the expected total cost to the retirement system is equivalent to the cost if the benefit did not begin until later.

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Actuary
A business professional who analyzes the financial consequences of risk. Actuaries use mathematics, statistics and financial theory to study uncertain future events, especially those of concern to insurance and pension programs. They evaluate the likelihood of those events, design creative ways to reduce the likelihood and decrease the impact of adverse events that actually do occur.

Age (Retirement)
Normal retirement dependent upon attainment of a specified age.

Aggregate Funding Method
The aggregate funding method is a standard actuarial funding method. The annual cost of benefits under the aggregate method is equal to the normal cost. The method does not produce an unfunded liability. The normal cost is determined for the entire group rather than on an individual basis.

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.

Annuitant
One who receives periodic payments from the retirement system. This term includes service and disability retirees, and their survivors.

Annuity
A series of periodic payments, usually for life, payable monthly or at other specified intervals. The term is frequently used to describe the part of a retirement allowance derived from a participant's contributions. Compare with "pension".

Beneficiary
The person designated to receive benefits under an employee benefit plan in the event of the death of the person covered by the plan.

Cash-Out
A lump sum payment of the member's contributions prior to retirement.

Credited Service
A period of employment which is recognized as service for purposes of determining eligibility to receive pension payments and/or determining the amount of such payments.

Death Benefit
A benefit payable by reason of a member's death. The benefit can be in the form of a lump sum, an annuity or a refund of the member's contributions.

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Deferred Annuity
An annuity for which payments do not commence until a designated time in the future.

Deferred Compensation
Considerations for employment that are not payable until after the regular pay period. The most common form of deferred compensation are pension plans, but private employers may also offer bonuses, incentive clauses, etc.

Defined Benefit Plan (DB)
A pension plan providing a definite benefit formula for calculating benefit amounts - such as a flat amount per year of service; a percentage of salary; or a percentage of salary, times years of service.

Defined Contribution Plan (DC)
A pension plan in which the contributions are made to an individual account for each employee. The retirement benefit is dependent upon the account balance at retirement. The balance depends upon amounts contributed during the employee's participation in the plan and the investment experience on those contributions.

Disability Retirement
A termination of employment involving the payment of a retirement allowance as a result of an accident or sickness occurring before a participant is eligible for normal retirement.

Early Retirement
A termination of employment involving the payment of a retirement allowance before a participant is eligible for normal retirement. The retirement allowance payable in the event of early retirement is often lower than the accrued portion of the normal retirement allowance.

Entry Age Normal Cost Method (EANC)
The EANC method is a standard actuarial funding method. The annual cost of benefits under EANC is comprised of two components:

- Normal cost
- Amortization of the unfunded liability

The normal cost is determined on an individual basis, from a member's age at plan entry, and is designed to be a level percentage of pay throughout a member's career.

Equities
Ownership of a company (as opposed to debt). Examples include stocks, venture capital, and leveraged buy-outs.

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ERISA

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

401(k), 403(b), and 457 Plans

These defined contribution plans allow 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.

Fiduciary

(1) Indicates the relationship of trust and confidence where one person (the fiduciary) holds or controls property for the benefit of another person; (2) anyone who exercises power and control, management or disposition with regard to a fund's assets, or who has authority to do so or who has authority or responsibility in the plan's administration. Fiduciaries must discharge their duties solely in the interest of the participants and their beneficiaries, and are accountable for any actions which may be construed by the courts as breaching that trust.

Funded Ratio

The ratio of a plan's current assets to the present value of earned pensions. There are several acceptable methods of measuring a plan's assets and liabilities. In financial reporting of public pension plans, funded status is reported using consistent measures by all governmental entities. According to the Government Accounting Standards Board (GASB), the funded ratio equals the actuarial value of assets divided by the actuarial accrued liability calculated under the Projected Unit Credit cost method.

General Accounting Standards Board (GASB)

This governmental agency sets the accounting standards for state and local government operations.

Individual Retirement Account (IRA)

A retirement account to which an individual can make annual tax-deductible contributions according to annual limits that are specified by the Internal Revenue Service.

Joint and Survivor Annuity

A provision that enables a plan participant to take annuity payments with continuing payments of all or part of the benefits after his or her death going to a designated beneficiary. The survivor annuity will automatically be provided to a married participant if he or she does not choose against it. The annual pension benefits of the participant electing to have such a survivor annuity are generally reduced to provide for the survivor.

Life Annuity

A monthly benefit payable as long as the annuitant is alive. There are no residual payments to survivors.

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Life Expectancy
The average number of years a person of a given age might be expected to live.

Lump Sum Distribution
Payment within one taxable year of the entire balance payable to the participant from a qualified pension or employee annuity plan.

Money Purchase Plan
A type of pension plan where the employer agrees to make a fixed contribution each year for each eligible employee. The contribution is typically expressed as a percentage of the employee's pay and the contribution constitutes a non-discretionary commitment on the part of the employer. The contribution must be made each year, regardless of employer profits, and can only be varied by plan amendment. Although treated differently under federal tax law, money purchase plans are fundamentally defined contribution plans.

Non-Contributory Plan
A retirement system in which no contributions are required of its members to aid in its financing.

Normal Cost
Computed differently under different funding methods, 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 reduced by employee contributions.

Normal Retirement Age
The age, as established by a plan, when unreduced benefits can be received.

Offset Plan
A pension plan in which the employer's participation in Social Security is used as "credit" against members' benefits.

Pay-As-You-Go
A method of recognizing the costs of a retirement system only as benefits are paid. Also known as the current disbursement cost method.

Pension
A series of periodic payments, usually for life, payable monthly or at other specified intervals. The term is frequently used to describe the part of a retirement allowance financed by employer contributions. Compare with "annuity".

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Portability
The ability of an employee who changes jobs and joins a different retirement system to become a dual member, maintaining membership in both systems. Dual members may combine service for benefit eligibility. They may also use their highest salary from either system for benefit calculation.

Pre-Funding
To accumulate a reserve fund in advance of paying benefits. This is the opposite of "pay-as-you-go."

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.

Present Value of Future Projected Benefits (PVFB)
Computed by projecting the total future benefit payments from the plan, using actuarial assumptions (i.e. probability of death or retirement, salary increase, etc.), and discounting the payments to the valuation date using the valuation interest rate to determine the present value (today's value).

Projected Benefits
Pension benefit amounts which are expected to be paid in the future taking into account such items as the effect of advancement in age as well as past and anticipated future compensation and service credits.

Projected Unit Credit (PUC) Funding Method
The PUC funding method is a standard actuarial funding method. The annual cost of benefits under PUC is comprised of two components:

- Normal cost
- Amortization of the unfunded actuarial accrued liability

The PUC normal cost equals the difference between the accrued liability at the beginning and end of the year.

Projected Unit Credit (PUC) Liability
The portion of the Actuarial Present Value of future benefits attributable to service credit that has been earned to date (past service).

Prudent Man Rule
A requirement imposed by the Employee Retirement Income Security Act (ERISA) that plan fiduciaries carry out their duties with the care, skill prudence and diligence which a prudent man, acting in a like capacity and familiar with such matters, would use under conditions prevailing at the time.

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Qualified Plan
An employee benefit plan approved by the Internal Revenue Service, meeting requirements set forth in IRS Code Section 401. Contributions to such plans are subject to favorable tax treatment.

Replacement Ratio
A calculation of the degree to which retirement income supplants a pre-retirement member's "take home" pay, less working expenses. To determine this ratio, several factors must be taken into account: a retiree's pre-retirement earnings; changes in tax liabilities after retirement; changes in Social Security tax liability; the elimination of work-related expenses - including contributions to the retirement system; and savings.

Reserve
A collection of assets set aside to meet future liabilities.

Roth IRA
A retirement account which an individual can make after-tax contributions according to annual limits that are specified by the IRS.

Service Retirement
Retirement dependent upon completion of a specified period of service. In some usages, the term has the same meaning as "normal retirement".

Supplemental Cost
A separate element of actuarial cost which results from future normal costs having a present value less than the present value of the total prospective benefits of the system. Such supplemental cost is generally the result of assuming actuarial costs accrued before the establishment of the retirement system. A supplemental cost may also arise after inception of the system because of benefit changes, changes in actuarial assumptions, actuarial losses, or failure to fund or otherwise recognize normal cost accruals or interest.

Thirteenth Check
An annual supplemental retirement payment arising from earnings on investments of the system in excess of those determined as needed.

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.

Unfunded Liability *or* Unfunded PBO
The excess, if any, of the pension benefit obligation over the valuation assets. This is the portion of all benefits earned to date that are not covered by plan assets.

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Variable Annuity
A benefit whose payments vary from year to year depending upon the value of a portfolio of securities (usually common stocks).

Vesting
The right of an employee to the benefits he or she has accrued, or some portion of them, even if employment under the plan is terminated. An employee who has met the vesting requirements of a pension plan is said to have a vested right. Voluntary and mandatory employee contributions are always fully vested.

Withdrawal
The termination of employment prior to becoming eligible for any benefits. The term sometimes refers to subsequent termination of membership in a system by withdrawal of the employee's accumulated contributions from the system.