Glossary

This glossary contains common definitions of terms used in this report and in Appendices A and B.

Actuarial Assumptions: The factors actuaries use to estimate 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 or other reasons.

Actuary: A financial professional who evaluates and advises pensions, taking into account factors such as investments, contribution levels, risks, plan benefits, mortality rates and life expectancy.

Actuarial Accrued Liability (AAL): The portion of the present value of future benefits that can be attributed to previous service.[2]

Actuarial Value of Assets (AVA): The value of assets used to determine a pension plan's recommended funding level. The AVA might be adjusted to smooth the effect of short-term market volatility.[3]

Amortization: The paying off of an interest-bearing liability through a series of installments, as opposed to paying it off in one lump sum payment.

Amortization Period: The number of years in the future that will be required to amortize, or pay off, a pension system's unfunded accrued liability, based on the employer's contribution rate and the assumption that there aren't future actuarial gains or losses. The amortization period is used to calculate the ARC's amortization payment.[4]

Closed Period: An amortization period based on specific number of years, counted down annually, during which a liability is expected to be fully amortized.

Open Period: An amortization period that is regularly recalculated. Because the amortization period is regularly reset, the liability may take much longer to fully amortize.[5]

2 http://www.osc.state.ny.us/retire/employers/gasb/glossary.php

3 https://www.soa.org/Files/Research/Projects/2015-10-pension-glossary.pdf

4 http://www.retirement.state.wy.us/home/actuarialglossary.html

5 http://www.cde.ca.gov/fg/ac/co/documents/gasb45attha.doc

Amortization Payment: The portion of the pension plan contribution or ARC that is designated to pay interest on and to amortize the present value of earned benefits *not* covered by current assets. The amortization payment is used to pay the Unfunded Actuarial Accrued Liability.

Annual Required Contribution (ARC): The amount of funding that employers must contribute each year to adequately fund a pension system. The ARC includes the cost of pension benefits accrued in the current year, as well as the cost of paying off the pension system's previously accrued unfunded liabilities. The ARC is calculated after accounting for other revenue, such as investment returns and employees' contributions. [6]

Annuity: A series of periodic payments, usually for life, payable monthly or at 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.

Actuarial Assumed Rate of Return: An actuarial assumption regarding the expected annual return on assets held in the pension fund.[7]

Cost of Living Adjustment (COLA): A periodic increase in benefits to compensate for loss in purchasing power of money due to inflation. The COLA is commonly pegged to an index such as consumer price index (CPI).[8] There is debate nationwide as to whether employees' COLA increases have the same legal protections as the pensions themselves.[9]

Decrements: The probability that a plan participant enters a new status, such as deceased, terminated, disabled or retired.

6 http://www.nasra.org/files/JointPublications/NASRA_ARC_Spotlight.pdf

7 http://www.mersofmich.com/Portals/0/Assets/PageResources/WorkScenarios/ual-evip-gasb/GlossaryOfTerms.pdf

8 http://www.businessdictionary.com/definition/cost-of-living-adjustment-COLA.html

9 http://www.ncsl.org/documents/fiscal/MonahanNCSL81011.pdf

Deferred Retirement Option (DROP): A program that allows retirement-eligible employees to claim pension benefits while continuing to work. When the employee retires, he or she receives money in the DROP account as a lump sum and annual pension benefits. The program is a way to keep employees working that would otherwise retire in order to receive pension benefits.[10]

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, age or a combination of those factors. The risks associated with the plan—namely that investment returns are insufficient to pay the benefit—are taken on solely by the employer. Historically, it has been the typical plan offered by public employers.

Defined Contribution (DC) Plan: A retirement plan in which contributions are made to an individual account for each employee. The retirement benefit is not predetermined, and employees take on all of the risk in these plans. For employers, the benefit of a DC plan is it makes planning and budgeting for retirement benefits much easier. In the private sector, 401(k) plans are the most common type of DC plan.[11]

Discount Rate: The rate a pension plan uses to calculate the present value of its future benefit promises—i.e. the liability. If the discount rate is lowered, the present value increases. For state and local pension plans, the discount rate and the assumed investment return on assets are usually the same number.[12]

Experience Study: An actuarial study conducted regularly to evaluate the accuracy of assumptions used to produce annual actuarial valuations.[13] Actual rates of death, retirement, disability, termination and salary increases are compared to the assumed values and modified as appropriate by the actuary.

Funded Ratio: The ratio of the actuarial value of assets (AVA) to the actuarial accrued liability (AAL). The figure is often used by observers as a barometer of a pension system's fiscal health.

Legacy Costs: The costs involved with an employer paying increased healthcare fees and other benefit-related costs for its current employees and retired pensioners.[14]

Net Pension Liability (NPL): The difference between the current value of market assets and the total pension liability.

Normal Cost: The portion of the cost of projected benefits allocated to the current year.[15] The employer normal cost equals the total normal cost of the plan reduced by employee contributions.[16]

Pension Obligation Bond (POB): A debt instrument issued by a state or local government to pay its obligation to the pension fund or system in which its employees are members.[17]

Portability: The ability of an employee who changes jobs and joins a different retirement system to bring his or her retirement assets with him without penalty. Generally, defined contribution plans are considered more portable than defined benefit plans.

Present Value: The current worth of an amount payable in the future, after discounting for interest and the probability of its payment.

Unfunded Actuarial Accrued Liability (UAAL): The difference between the actuarial assets and actuarially accrued liability. This is also described often in more simple terms as a pension system's unfunded liability. The UAAL and NPL are very similar conceptually and are generally close in value. However they differ in the way assets and liabilities are valued.

Valuation Date: A point in time at which an asset is assigned a dollar value. It is a term often used in reference to a periodic determination of worth for reporting purposes.[18]

Vesting: The 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, even if employment under the plan is terminated.

401(k), 403(b), and 457 Plans: A few examples of 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 in 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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10 http://www.trs.state.tx.us/global.jsp?page_id=/global/glossary

11 http://www.governing.com/finance101/gov-finance-101-glossary-items.html

12 http://www.ft.com/cms/s/0/b5e7a3bc-e133-11e1-9c72-00144feab49a.html#ixzz4AMNuoCLw

13 https://www.minnesotatra.org/images/pdf/glossary.pdf

14 http://www.investopedia.com/terms/l/legacycosts.asp

15 http://www.prb.state.tx.us/files/education/terminologyfinal.pdf

16 http://www.texastransparency.org/Special_Features/Reports/Pension_Obligations/pdf/finalbasicsofactmethod.pdf pg. 18

17 https://www.orrick.com/Events-and-Publications/Documents/247.pdf

18 http://definitions.uslegal.com/v/valuation-date/