



## Unfunded Actuarial Accrued Liability - What Does It Really Mean?

HMEPS annual contribution to retirement costs are based on two factors - Normal Cost or the employer and employee contributions to pay for the long-term costs of the plan and 2) Actuarial Accrued Liability or costs on an amortization basis with primary emphasis given to anticipated HMEPS earning on investments. Achieving performance exactly equal to the assumptions made on both factors provides a fully funded fund.

**What is Unfunded Actuarial Accrued Liability (UAAL)?** The UAAL is an actuarial term that refers to the difference between the actuarial values of assets (AVA) and the actuarial accrued liabilities (AAL) of a plan.

Essentially, the UAAL is the amount of retirement that is owed to an employee in future years that exceed current assets and their projected growth. HMEPS has experienced an UAAL for the past 12 years.

Public pensions UAAL have historically ranged from 50% in the mid-70s, 20% in the mid 90s to 0% in 2000.

**Why do we use the UAAL as a measurement?** It gives one measurement of how the plan is meeting its funding obligations.

A UAAL is an estimated based on many assumptions, including demographic, economic and financial projections that are subject to change. As a result, the UAAL is not an absolute number like the par amount of a fixed rate bond but an estimate that is revised annually based upon the five most recent years of experience.

If a plan has no UAAL then the plan is considered fully funded and the required contribution to the plan will be equal or less than the plan's normal cost (this is the ultimate goal of every pension plan). The normal cost for HMEPS is 5.6 percent of payroll.

**What is the danger of focusing primarily on the UAAL?** An actuarial valuation is a snapshot measurement of the AAL and AVA at a specific point in time.

Due to the fluctuation of the assets it can be misleading to focus on one particular valuation (or any measurement from that valuation).

**The primary funding question.** The primary funding question is not the size of the Unfunded Actuarial Accrued Liability (UAAL), but whether the contributions to the plan are expected to eliminate the UAAL over some reasonable period of time.