

# Projected Unit Credit

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# Funding Method Basics

- Normal cost
- Actuarial accrued liability
- Unfunded actuarial accrued liability (UAAL)
- Amortization of UAAL
- Individual or aggregate basis?

# Normal Cost

- Represents the portion of the cost of projected benefits allocated to the **current year**
- Computed differently under different funding methods

# Actuarial Accrued Liability

- Represents the portion of the cost of projected benefits allocated to **past service credit**
- Computed differently under different funding methods

# Unfunded Accrued Liability

- The excess, if any, of the actuarial accrued liability over assets
- $UAAL = AAL - Assets$
- Typically this is positive, but can be negative (surplus or “reserve”)
- Sources of UAAL
  - under funding, benefit improvements for past service, experience losses

# Amortization of UAAL

- **Immediate gain** method:
  - UAAL amortized separately from the normal cost
  - Amortization period typically extends beyond working lifetimes of current actives
- **Spread gain** method:
  - UAAL amortized under the normal cost
  - Does not extend beyond working lifetimes of current actives

# Individual or Aggregate Basis?

- **Individual** methods calculate a normal cost for each individual active member
- **Aggregate** methods calculate an average normal cost that is applied to all active members

# Projected Unit Credit

- Immediate gain method
- Individual basis
- Annual contribution comprised of:
  - normal cost (service prorate of projected benefit); plus
  - amortization of UAAL
- Normal cost tends to increase over time
- Method is suitable in plans with high turnover rates

# Aggregate

- Spread gain method
- Aggregate basis
- Annual contribution comprised of:
  - normal cost only
  - UAAL included in normal cost
- Calculations are relatively simple
- Not suitable for small plans with a wide range of ages
- Supports intergenerational equity

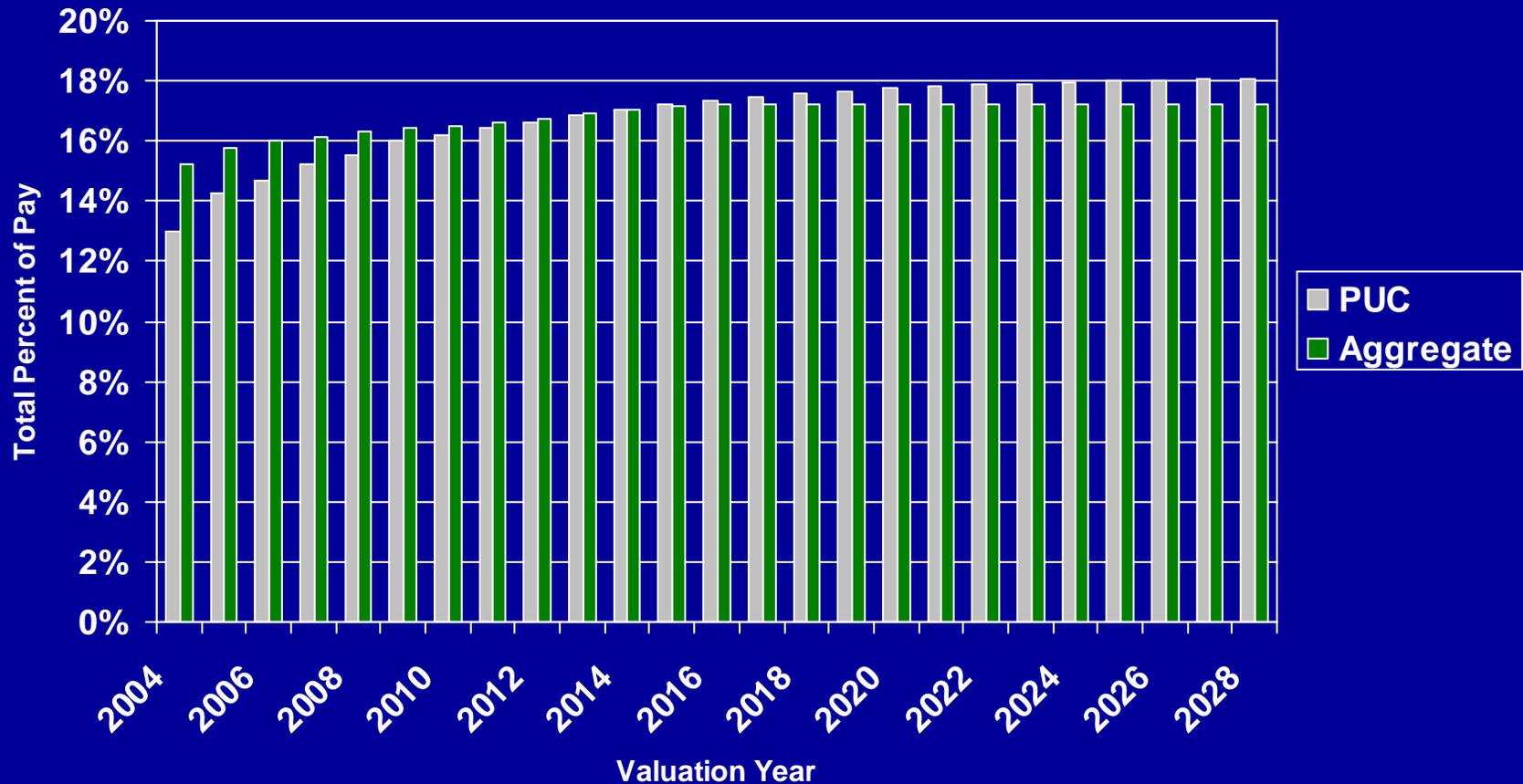
# Aggregate vs. PUC

LEOFF Plan 2 at  
9/30/2004\*

	Aggregate	PUC
Normal Cost Rate	15.20%	17.23%
UAAL Rate	N/A	-4.21%
Total Rate	15.20%	13.02%

\* Estimate based on preliminary 9/30/2004 valuation results

# Projected Contribution Rates\*



*\* Projections based on preliminary 9/30/2004 valuation results. Provided for comparative purposes only and should not be used otherwise.*

# Selecting a Funding Method

- Initial selection should be consistent with the plan sponsor's goals (at plan inception):
  - desired pattern of costs or contributions
  - desired level of benefit security
  - desired level of intergenerational equity
  - desired funding levels
- Plan sponsor selects the funding method, after consultation with an actuary, to implement the funding policy

# Changing Funding Policy/Method

- Any subsequent funding method change is typically tied to a change in funding policy
- Typically occurs infrequently
- Influenced by many factors:
  - significant change in plan demographics
  - plan closure or freeze
  - significant benefit changes
  - budgetary issues

# Conclusions

- Funding methods address both past and future costs (UAAL and normal cost)
- A switch to PUC would lower short-term rates and increase long-term rates
- A funding method change is typically tied to a change in the overall funding policy
- Funding policy changes are typically infrequent and influenced by many factors