THE CITY OF NORFOLK

NORFOLK EMPLOYEES' RETIREMENT SYSTEM

# A Guide to Understanding the "Unfunded Liability"

Audience: Norfolk Employees' Retirement System (NERS) Members and Citizens

Description: Explains the "unfunded liability" of the Norfolk Employees' Retirement System (NERS) - the difference between the assets and the value of benefits already accrued.

**<u>DISCLAIMER</u>: This pamphlet summarizes parts of Chapter 37 of the Code of the City of Norfolk. The summaries are intended to provide simplified and meaningful information that is relevant to the member. Any information that is inconsistent with, or contradicts, Chapter 37, must be disregarded.**

KNOW 2 ASK©

The NERS "Know 2 Ask" series provides basic information needed to empower you to ask important retirement-related questions. Knowing who and what to ask is key.

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## Overview

One measure of a pension fund's health is its funded status. To determine the funded status the Norfolk Employees' Retirement System (NERS or the System) we compare the assets available to the benefits we must pay now, or at some point in the future. This difference is referred to as the "unfunded liability".

## System Funding—"Money In Must Equal Money Out"

Each year, as the local government system sponsor, the City is required to fund both benefits currently being accrued and to eliminate any shortfall called unfunded accrued liability. To ensure responsible financing of benefits, the NERS is constantly evaluating the System's assets relative to the value of the liabilities, so that when the pension benefits become payable, there will be sufficient funds to pay the benefits.

Funding for NERS, like other retirement plans, is based on a "Money In Must Equal Money Out" formula, where the "left side" (System income) must balance with the "right side" (System benefits and expenses):

$$C + I = B + E$$

Left Side = Right Side

| Left Side | Right Side |
|---|---|
| C = Contributions (Employer and Employee) | B = Benefits Paid |
| I = Investment Income (Return) | E = Expenses (Administrative) |

**Contributions** Each year, the NERS hires an actuary to estimate the true cost of the System and determine the contributions needed to meet that cost. The City makes contributions to the NERS' Pension Fund based on the actuary's report. The City of Norfolk's employer contribution rates are calculated to reflect the cost of benefits as they accrue, as well as pay down existing unfunded liabilities.

The NERS members' mandatory five percent (5%) contributions (City Code Sec. 37-103.1) are calculated based upon a member's individual earnable compensation.

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| **Investment Income** Return on investments is the money (return) that NERS earns from an investment during a certain timeframe. Return on investments is a percentage that identifies the amount of money earned (return) related to total value of the assets (money) that was | |
| **Benefits Paid** The actuary also estimates each member's individual pension benefit, making certain assumptions about life expectancy, wage increases, System investment returns, years of life after retirement, inflation, and many other factors.<br><br>Simply put, there is no way for these assumptions to be completely accurate. The unfunded pension liability, which is more formally referred to as the unfunded actuarial accrued liability (UAAL) in financial statements, results from past assumptions not being met. | |
| **Expenses** The administrative expenses of the NERS is another liability considered by the actuary when analyzing the financial outlook of the Pension Fund. The administrative expenses represent the amount of money needed to run the day to day operations of the NERS. | |

## Unfunded Liability Facts

- An unfunded pension liability is not an absolute dollar figure; it is an estimate based on a number of assumptions – demographic and economic – and is, therefore, subject to fluctuation.
- Having an unfunded liability does not mean that a pension plan is unable to pay the benefits for which it is presently obligated or to meet current cash flow requirements.
- The City does not have to take drastic and immediate actions to reduce or pay off the System's unfunded actuarial liability. It is being "paid down" in the same way you pay down your home mortgage. The annual contributions contain a payment toward this unfunded liability.
- The health of a public retirement plan is not determined by the unfunded liability. The health of the plan has more to do with the City's ability and willingness to make the minimum required contribution on an annual basis. The funded ratio is a better measure of a plan's financial status.

## What is the funded ratio?

The NERS' funded ratio as of June 30, 2023, was 84.5%. This means that the actuarial value of the retirement system's assets was 84.5% of the projected amount needed to pay for current or future benefits for the NERS' retirees, beneficiaries and members.

Despite the unfunded liability, retirement benefits for the NERS' members, retirees and beneficiaries are secure and cashflow is available to pay the NERS' current liabilities.

## Key Takeaways

- An unfunded pension liability is the difference between the NERS assets and the value of benefits currently due, or due at some point in the future.
- The unfunded liability represents the actuarial value of the NERS benefits that have been earned in the past, but are not yet funded.
- The fact that a retirement system has an unfunded liability does **not** mean the system is underfunded.
- An unfunded liability does not mean that the NERS is not able to pay its current or future retirees and beneficiaries.
- The NERS' is financially sound and its assets are secure and safe.

### Finance Retirement Office

Key Areas:

- Retirement Benefits
- Retirement Plan Summary
- City Code Chapter 37

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