Glossary

Accrual rate. The rate at which pension entitlement is built up relative to earnings per year of service in earnings-related schemes—for example, one-sixtieth of final salary.

Accrued pension. The value of the pension to a member at any point prior to retirement, which can be calculated on the basis of current earnings or also include projections of future increases in earnings.

Actuarial fairness. A method of setting insurance premiums according to the true risks involved.

Additional voluntary contributions. Contributions to an occupational pension scheme over and above the employee's normal contribution rate.

Adverse selection. A problem stemming from an insurer's inability to distinguish between high- and low-risk individuals. The price for insurance then reflects the average risk level, which leads low-risk individuals to opt out and drives the price of insurance still higher until insurance markets break down.

Agency slack. A situation in which individuals are unable to monitor the efforts of their agents comprehensively. Agency slack occurs when the agent is averse to effort and so underperforms. In the case of pensions, for example, investors may not be able to monitor fund managers, who, as a consequence, may not do their best for the investors. See also moral hazard.

Annuity. A stream of payments at a specified rate, which may have some provision for inflation proofing, payable until some contingency occurs, usually the death of the beneficiary or a surviving dependent.

Annuity factor. The net present value of a stream of pension or annuity benefits.

Annuity rate. The value of the annuity payment relative to its lump-sum cost.

Average effective retirement age. The actual average retirement age, taking into account early retirement and special regimes.

Basic state pension. The flat-rate state pension paid to all persons of pensionable age meeting the national insurance contribution test and their surviving dependents.

Benefit rate. The ratio of the average pension to the average wage, which could be expressed as relative to the economywide average wage or to the individual's specific average or final wage.

Ceiling. A limit on the amount of earnings subject to contributions.

Commutation. Exchange of part of the annuity component of a pension for an immediate lump sum.

Comprehensive income tax. A tax on all incomes, whether from earnings or investments and whether used for savings or consumption. A pure comprehensive income tax allows the component of investment returns compensating for inflation and so only taxes real returns.

Contracting out. The right of employers or employees to use private pension fund managers instead of participating in the publicly managed scheme.

Contracting-out rebate. The amount by which employers' and employees' national insurance contributions are reduced for contracting out of the state earnings-related pension scheme and the minimum contribution to a personal pension plan.

Deferred annuity. A stream of benefits commencing at some future date.

Defined benefit. A pension plan with a guarantee by the insurer or pension agency that a benefit based on a prescribed formula will be paid. Can be fully funded or unfunded and notional.

Defined contribution. A pension plan in which the periodic contribution is prescribed and the benefit depends on the contribution plus the investment return. Can be fully funded or notional and nonfinancial.

Demogrant. Same as a universal flat benefit, where individuals receive an amount of money based solely on age and residency.

Demographic transition. The historical process of changing demographic structure that takes place as fertility and mortality rates decline, resulting in an increasing ratio of older to younger persons.

Disclosure. Statutory regulations requiring the communication of information regarding pension schemes, funds, and benefits to pensioners and employees.

Discretionary increase. An increase in a pension payment not specified by the pension scheme rules.

Early leaver. A person who leaves an occupational pension scheme without receiving an immediate benefit.

Early retirement. Retirement before reaching an occupational scheme's normal retirement age or, in the state scheme, before reaching the state's pensionable age.

Earnings cap (ceiling). A limit on the amount of earnings subject to contributions.

Full funding. The accumulation of pension reserves that total 100 percent of the present value of all pension liabilities owed to current members.

Funding. Accumulation of assets in advance to meet future pension liabilities.

Implicit pension debt (net). The value of outstanding pension claims on the public sector minus accumulated pension reserves.

Indexation (uprating). Increases in benefits by reference to an index, usually of prices, although in some cases of average earnings.

Intergenerational distribution. Income transfers between different age cohorts of persons.

Intragenerational distribution. Income transfers within a certain age cohort of persons.

Legal retirement age. The normal retirement age written into pension statutes.

Marginal pension. The change in the accrued pension between two periods.

Means-tested benefit. A benefit that is paid only if the recipient's income falls below a certain level.

Minimum pension guarantee. A guarantee provided by the government to bring pensions to some minimum level, possibly by "topping up" the capital accumulation needed to fund the pensions.

Moral hazard. A situation in which insured people do not protect themselves from risk as much as they would have if they were not insured. For example, in the case of old-age risk, people might not save sufficiently for themselves if they expect the public system to come to their aid.

Nonfinancial (or notional) defined-benefit (plan). A defined-benefit pension plan that is unfunded (except for a potential reserve fund).

Nonfinancial (or notional) defined-contribution (plan). A defined-benefit pension plan that mimics the structure of (funded) defined-contribution plans but remains unfunded (except for a potential reserve fund).

Normal retirement age. The usual age at which employees become eligible for occupational pension benefits, excluding early-retirement provisions.

Notional (or nonfinancial) accounts. Individual accounts where the notional contributions plus interest rates accrued are credited and determine the notional capital (that is, the liability to society).

Notional (or nonfinancial) capital. The value of an individual account at a given moment that determines the value of annuity at retirement or the transfer value in case of mobility to another scheme or country.

Notional or nonfinancial interest rate. The rate at which the notional accounts of notional defined-contribution plans are annually credited. It should be consistent with the financial sustainability of the unfunded scheme (potentially the growth rate of the contribution base).

Occupational pension scheme. An arrangement by which an employer provides retirement benefits to employees.

Old-age dependency ratio. The ratio of older persons to working-age individuals. The old-age dependency ratio may refer to the number of persons over 60 divided by, for example, the number of persons ages 15–59, the number of persons over 60 divided by the number of persons ages 20–59, and so forth.

Overannuitization. A situation in which a compulsory pension forces an individual to save more in pension than he or she would in the absence of the compulsory provision.

Pay-as-you-go. In its strictest sense, a method of financing whereby current outlays on pension benefits are paid out of current revenues from an earmarked tax, often a payroll tax.

Pension coverage rate. The number of workers actively contributing to a publicly mandated contributory or retirement scheme, divided by the estimated labor force or by the working-age population.

Pension lump sum. A cash withdrawal from a pension plan, which in the case of some occupational pension schemes is provided in addition to an annuity. Also available from personal pension plans.

Pension spending. Usually defined as old-age retirement, survivor, death, and invalidity-disability payments based on past contribution records plus noncontributory, flat universal, or means-tested programs specifically targeting the old.

Pensionable earnings. The portion of remuneration on which pension benefits and contributions are calculated.

Portability. The ability to transfer accrued pension rights between plans.

Provident fund. A fully funded, defined-contribution scheme in which funds are managed by the public sector.

Replacement rate. The value of a pension as a proportion of a worker's wage during a base period, such as the last year or two before retirement or the entire lifetime average wage. Also denotes the average pension of a group of pensioners as a proportion of the average wage of the group.

Supplementary pensions. Pension provision beyond the basic state pension on a voluntary basis.

Support ratio. The opposite of the system dependency ratio: the number of workers required to support each pensioner.

System dependency ratio. The ratio of persons receiving pensions from a certain pension scheme divided by the number of workers contributing to the same scheme in the same period.

System maturation. The process by which a pension system moves from being immature, with young workers contributing to the system, but with few benefits being paid out since the initial elderly have not contributed and thus are not eligible for benefits, to being mature, with the proportion of elderly receiving pensions relatively equivalent to their proportion of the population.

Universal flat benefit. Pensions paid solely on the basis of age and citizenship, without regard to work or contribution records.

Valorization of earnings. A method of revaluing earnings by predetermined factors such as total or average wage growth to adjust for changes in prices, wage levels, or economic growth. In pay-as-you-go systems, pensions are usually based on some percentage of average wage. This average wage is calculated over some period of time, ranging from full-career average to last salary. If the period for which earnings history enters into the benefit formula is longer than the last salary, the actual wages earned are usually revalued to adjust for these types of changes.

Vesting period. The minimum amount of time required to qualify for full and irrevocable ownership of pension benefits.