

HOUSTON MUNICIPAL EMPLOYEES PENSION SYSTEM
FUNDING POLICY
(pursuant to §802.2011, Tex. Gov't Code)

I. Introduction

Texas Government Code §802.2011, as added by S.B. 2224 of the 2019 86th Texas Legislative Session, requires the governing body of a covered public retirement system to “adopt a written funding policy that details the governing body’s plan for achieving a funded ratio of the system that is equal to or greater than 100 percent.”

The Houston Municipal Employees Pension System (“HMEPS”), a public retirement system covered by §802.2011, is a governmental defined benefit plan governed by Article 6243h, Tex. Rev. Civ. Stats. (“Statute”). Article 6243h was amended in the 2017 85th Texas Legislative Session by S.B. 2190, which made significant changes to the Statute by reducing certain benefits, increasing required employee contributions, establishing a prescribed process for calculating required city contributions, codifying certain actuarial assumptions, and establishing mechanisms for addressing situations in which city contribution rates fall below or exceed a prescribed range.

II. Funding Objectives

The HMEPS Statute was amended by S.B. 2190 to accomplish the following legislative objectives:

- Systematically decrease the unfunded liability to \$0 over a closed 30-year period
- Reduce certain benefits to lower current liabilities
- Increase employee contributions and strengthen employer contributions to better fund the system
- Establish clear funding policies with a mechanism for sharing risk and controlling costs in the future
- Codify more conservative actuarial assumptions to improve the transparency of obligations owed

A brief discussion of the objectives are outlined below. All citations are to the Statute.

III. Mechanisms for Achieving Objectives

A. Decrease the Unfunded Liability

Section 8C required the actuary for HMEPS and the actuary for the City of Houston (“City”) to separately perform an Initial Risk Sharing Valuation Study (“RSVS”) as of July 1, 2016. As provided by the Statute, the rates and amounts in the HMEPS actuary’s Initial RSVS are the applicable rates and amounts for a 30-year period beginning July 1, 2017 because the calculated rates and amounts in each actuary’s Initial RSVS were within two percentage points of each other.

The Initial RSVS established the HMEPS unfunded actuarial accrued liability (“UAAL”) as of July 1, 2016, which is defined as the “legacy liability.” In December 2017, HMEPS received from the City \$250 million in pension obligation bond proceeds, which were taken into account in calculating the legacy liability in the July 1, 2016 Initial RSVS.

**Houston Municipal Employees Pension System Pension Plan
Funding Policy (§802.2011, Tex. Gov't Code)**

The Initial RSVS created a schedule of City contribution amounts to pay down the legacy liability over a closed 30-year period beginning July 1, 2017. As the Statute requires, the City pays HMEPS the contribution amounts for the amortized legacy liability in bi-weekly payments.

B. Increase in member contributions and reduction of benefits

With the 2017 amendments to the Statute, employee contributions were increased and benefits were adjusted. The following is a brief summary of changed provisions.

Employee Contributions

After 7/1/17	Group A: 7.00% for FY 2018 Group B: 2.00% for FY 2018 Group D: 3.00% (2.00% for service benefit; 1.00% for cash balance benefit)
After 7/1/18	Group A: 8.00% Group B: 4.00% Group D: 3.00% (2.00% for service benefit; 1.00% for cash balance benefit)

Survivor Benefits

After 7/1/17 For active participants and Group A and B retirees who die on or after July 1, 2017, the spousal survivor benefit percentage changed from 100% to 80%, if the surviving spouse was married to the participant at the time of death and for at least one continuous year as of the date of separation from service (the marriage requirement applies for separations from service on or after July 1, 2017), and from 100% to 50% if the surviving spouse was married less than one continuous year as of the date of separation from service (the marriage requirement applies for separations from service on or after July 1, 2017).

For deferred Group A and B participants (not yet receiving a pension benefit) who die on or after July 1, 2017, the spousal survivor benefit percentage changed from 100%, payable immediately, to 50%, payable at the participant's eligibility date; however, the surviving spouse can elect an earlier actuarially equivalent benefit.

Cost of Living Adjustment (COLA)

After 7/1/17 The COLA is equal to 50% of the rolling 5-year net investment return minus an amount that is 2.00% less than the assumed rate of return, but the COLA is not less than 0.00% nor greater than 2.00%. The COLA applies to all retirees and survivor benefit recipients other than Group D participants who terminated service prior to July 1, 2017 and the survivors of pre-July 1, 2017 Group D participants.

For active DROP participants, a COLA is only credited if the DROP participant is at least 62 years of age as of January 1 of the year in which the COLA applies.

Houston Municipal Employees Pension System Pension Plan Funding Policy (§802.2011, Tex. Gov't Code)

Deferred Retirement Option Plan (DROP) (Groups A & B only)

After 7/1/17 The credited interest rate is 50% of the rolling 5-year net investment return, but not less than 2.5% nor greater than 7.5%.

Group D Cash Balance Benefit

After 1/1/18 A cash balance account is established for each Group D member beginning the later of the first full pay period after January 1, 2018 or the Group D member's hire date. Each Group D member makes required bi-weekly contributions of 1% of salary to the account, and interest is credited to the account after one year of participation. The interest rate is the DROP interest rate converted to a bi-weekly percentage.

C. City Contributions and the Corridor

The Statute, with the implementation of S.B. 2190, has a funding policy that establishes a "target" contribution rate for the City, develops a minimum and maximum corridor around the City's target contribution rate, and defines steps to be taken should the annual calculated contribution rate move outside the corridor. The corridor mid-points for each of the 30 fiscal years beginning July 1, 2017 were established in the HMEPS actuary's Initial RSVS. The mid-points are the sum of the projected employer normal cost plus assumed administrative expenses for each of the corresponding fiscal years. The minimum and maximum contribution "corridor" then becomes the rates equal to +/-5 percentage points of the mid-points.

Every year the HMEPS actuary and the City actuary are to separately produce a RSVS and present the findings to each other no later than 150 days after the end of the fiscal year. The RSVS process calculates the unfunded actuarial accrued liability and the applicable city contribution rate for the following fiscal year that begins one year after the RSVS July 1 date.

If the HMEPS actuary's and City actuary's city contribution rates in their respective RSVS vary by more than two percent, there is a resolution process and any resulting difference in the rates sets the city contribution rate at the average of the two rates.

In a falling-cost environment, gains are used to reduce the city contribution rate. Alternatively, if the city contribution rate exceeds the corridor maximum, adjustments are made to the amortization period, employee contributions, or benefits in order to reduce the city contribution rate as prescribed by the Statute and not otherwise prohibited by applicable federal law or regulations.

The City contributes to HMEPS at least bi-weekly an amount equal to the city contribution rate multiplied by the pensionable payroll for the bi-weekly period.

D. Actuarial Assumptions

The Statute requires:

- the use of the Ultimate Entry Age Normal (UEAN) actuarial method
- a maximum 7.00% assumed rate of investment return

Houston Municipal Employees Pension System Pension Plan Funding Policy (§802.2011, Tex. Gov't Code)

- a five-year smoothing method beginning July 1, 2017
- a specific process for amortization and funding of liability gain/loss layers arising from unanticipated changes in the legacy liability
- a maximum payroll growth rate assumption of 3%
- additional limitations on the price inflation assumption, projected salary increases and payroll growth rate

The Statute also requires that at least once every four years the HMEPS actuary conduct an Actuarial Experience Study ("AES"). The City's actuary reviews the HMEPS actuary's AES and may identify assumptions and methods that differ from those of the HMEPS actuary provided they are consistent with standards adopted by the Actuarial Standards Board and the City actuary provides its rationale for how each proposed assumption or method is consistent with those standards. If the HMEPS actuary does not accept the City actuary's proposed assumption or method, there is a statutory process for an independent actuary to be selected to address the use of the assumption or method.

IV. Funding Policy Adoption

This funding policy is adopted pursuant to §802.2011, Tex. Gov't Code, in conformity with the prescribed funding provisions of the Statute as added by S.B. 2190. The HMEPS Board of Trustees administers and makes determinations regarding the HMEPS plan as authorized by the Statute and in accordance with the Statute and other applicable laws.

Nothing contained herein may be construed to convey any right or privilege not otherwise provided by the Statute. In the event this policy conflicts with any statutory provision, the Statute prevails.

**Houston Municipal Employees Pension System Pension Plan
Funding Policy (§802.2011, Tex. Gov't Code)**

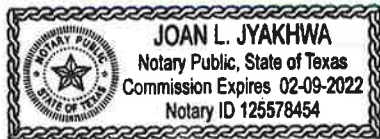
IN WITNESS WHEREOF, the Board of Trustees has caused these presents to be executed by its duly authorized officer in a number of copies each of which shall be deemed an original but all of which shall constitute but one and the same instrument, effective December 19, 2019.

HOUSTON MUNICIPAL EMPLOYEES
PENSION SYSTEM

By: 
Sherry Mose, Chairman

THE STATE OF TEXAS §
 §
COUNTY OF HARRIS §

This instrument was acknowledged before me on December 19, 2019, by Sherry Mose of the Board of Trustees of the HOUSTON MUNICIPAL EMPLOYEES PENSION SYSTEM, on behalf of the Board of Trustees.




Notary Public, State of Texas