



# DEFERRED RETIREMENT OPTION PLAN (DROP) OVERVIEW

*The following brief overview is intended to provide general information regarding the Deferred Retirement Option Plan (DROP) of the Houston Municipal Employees Pension System (HMEPS), and is not intended to be a summary plan description. In the event of any conflict between this brief overview and Art. 6243h, Tex. Rev. Civ. Stats. Ann., as amended by the Meet and Confer Agreement between HMEPS and the City of Houston, as amended (“Statute”), including the rules and regulations promulgated thereunder, the Statute will prevail.*

The Deferred Retirement Option Plan (DROP) is an optional retirement method that allows an actively employed HMEPS Group A or Group B member (eligible member) to elect to enter the DROP (DROP Election) and to request that an amount determined pursuant to the provisions of the DROP (monthly DROP credit) be credited to a notional account (DROP Account) effective on a date prior to retirement or separation from active employment (termination) with the City of Houston or HMEPS. The monthly DROP credit will NOT be paid directly to the member while the member is actively employed, but will be credited to a DROP Account in that member’s name. When the member’s employment has ended, DROP participation will end, and after all requirements of HMEPS have been satisfied, the DROP Account balance (DROP benefit) will be paid to the retired member according to the distribution option the retired member elects.

## **DROP Definitions:**

DROP participant: A HMEPS Group A or Group B member who is participating in the DROP and, unless required otherwise by the context, a person who participated in DROP and is receiving a DROP benefit or is eligible to elect a distribution of a DROP benefit.

DROP Entry Date: The date a member ceases to earn service credit and begins earning credit for the member’s DROP account, which is the later of the date the member is first eligible to participate in the DROP or the DROP Entry Date requested by the member, as approved by the Board of Trustees (Board). The DROP Entry Date must be the first day of a month. A member cannot have a DROP Entry Date that precedes his or her date of eligibility for membership in HMEPS or that occurs prior to the date of HMEPS’s receipt of the member’s request to participate in DROP.

DROP Election Date: The date HMEPS receives in the HMEPS office a member’s duly completed and executed “DROP Election.” The DROP Election can only be obtained from an authorized HMEPS representative upon the member’s timely submission to HMEPS of a completed application and required documents and information.

Monthly DROP Credit (MDC): An amount based on a DROP participant’s credited service and average monthly salary as of DROP Entry Date and the benefit accrual rate(s) of the applicable pension group in effect on the earlier of the member’s last day of credited service or DROP Election Date. Any changes in the benefit accrual rates after the member’s last day of credited service or DROP Election Date will not apply to the DROP member’s monthly DROP credit or retirement pension benefit.

## **Eligibility**

In order to be eligible to elect to participate in the DROP, you must meet or exceed the minimum qualification requirements for normal retirement pursuant to the provisions of the applicable pension group in effect on your DROP Entry Date, and be in active service with the City or HMEPS (or, in extremely limited circumstances, have been separated from service no more than thirty (30) calendar days), and not otherwise have been approved for a pension benefit. You must also meet all other requirements for DROP participation of the Statute and policies and procedures adopted by the Board.

You must meet one of the following age and credited service requirements as of the DROP Entry Date:

- (i) At least age 62 with at least 5 years of credited service, or
- (ii) At least age 50 with at least 5 years of credited service and the sum of your age and years of credited service, including parts of years, equals 75 or more.

## **Group Change and Service Purchase Obligations**

After you execute a DROP Election, you cannot enter into an obligation with HMEPS to: (i) purchase service credit other than service credit for missed contributions during the DROP period as approved by the Board, (ii) purchase pension credit for military service, or (iii) change pension group participation. However, if you entered into an obligation described by (i) through (iii) prior to executing a DROP Election, and all terms and conditions of the obligation have not been met as of DROP Election Date, you are eligible to participate in the DROP provided any service credit purchased under such obligation is not used to meet minimum service requirements for eligibility to participate in the DROP, and provided all other requirements for DROP participation are met. At least one biweekly paycheck stub (advice) showing appropriate deductions must be presented as evidence that such obligation was in effect at the time the DROP Election was executed. Your DROP benefit will be contingent upon your fulfilling all of the terms and conditions of any and all applicable obligations. If all terms, conditions and requirements under such obligation(s) are not completed and fulfilled, your DROP Benefit will be determined as if such obligation(s) had never existed.

If all terms and conditions of a service purchase obligation and all requirements of DROP have been met as of the DROP Election Date, you are eligible to participate in the DROP even if the service purchased under such obligation is used to establish eligibility.

## **The DROP Application Process**

The following procedure is applied to all member requests to participate in the DROP:

- (i) You must submit a request for an application to participate in the DROP. (You should notify HMEPS that you intend to make a DROP Election no earlier than sixty (60) calendar days prior to the date you are eligible to participate in DROP). The request must be submitted in a manner and on a form approved by HMEPS. A request may be faxed, mailed or delivered to the HMEPS office. (Fax number: (713) 650-1961). The request is not a commitment to participate in the DROP, and therefore is not binding on you or HMEPS.

(ii) In response to a request, HMEPS will make a preliminary determination as to whether you are eligible to participate in the DROP based on records available to HMEPS at that time. This preliminary determination may change when certified employment and personnel records are reviewed. If preliminary eligibility is determined, a DROP application packet will be provided to you. A DROP application packet includes information about DROP participation, an application to participate in the DROP, a listing of the documents you must submit to HMEPS before executing a DROP Election, and instructions regarding how to complete an application and meet other requirements for DROP participation. If eligibility cannot be determined based on information available to HMEPS, you will be notified by HMEPS.

After eligibility has been preliminarily determined, HMEPS will review data required to establish your eligibility to participate in the DROP and to determine the amount of the monthly DROP credit you are eligible to receive

(iii) When the DROP application and documents for which you are responsible for submitting are received in the HMEPS office, HMEPS will provide you with a DROP Election form, and may require you to attend a DROP pre-entry meeting with an authorized HMEPS representative. The completed application and documents must be received in the HMEPS office, and all deficiencies corrected before you can execute a DROP Election. Your DROP Election must be executed in the presence of a notary public. The signature of an authorized HMEPS representative, or the presence of a date/time stamp as normally affixed to HMEPS mail, will evidence HMEPS's receipt of your DROP Election. If you are retiring or otherwise terminating employment and wish to participate in the DROP, you must execute a DROP Election no later than thirty (30) calendar days after your separation from service and before any other application for pension benefits has been approved by the Board, or you will not be eligible to participate in the DROP.

If you do not provide the completed application and requested documents within a reasonable period of time as determined by HMEPS, HMEPS may determine that your application is deficient and may administratively withdraw your DROP application. If withdrawn, no further action will be taken with respect to the DROP application, and you will be required to resubmit a request to apply for DROP under the rules then in effect in order to reinitiate the DROP process. A deficiency notice will not waive or extend required time periods.

If a DROP pre-entry meeting is required, and you fail to attend the meeting when scheduled, your DROP application may be administratively withdrawn, and you will be required to resubmit a request to apply for DROP under the rules then in effect in order to reinitiate the DROP process.

(iv) When all information and completed documents for which the City or HMEPS is responsible for submitting are received in the HMEPS office, your eligibility to participate in the DROP can be established and the monthly DROP credit can be determined. HMEPS will then prepare your DROP Election for presentation to the Board for approval at a regularly scheduled monthly Board meeting. You may withdraw your DROP Election any time prior to the Board meeting in which it is presented for approval. Withdrawal of a DROP Election does not waive or alter the requirement that you must make a DROP Election no later than thirty (30) calendar days after your separation from service in order to participate in DROP. Upon approval by the Board, a DROP Election is irrevocable except as specifically provided by the Statute.

## **DROP Operation and Reporting**

Upon approval of your DROP Election by the Board, a notional DROP account will be established in your name. The sole purpose of a DROP account is to facilitate accounting for your DROP credits on an individual basis. There will be no physical separation of any specific HMEPS assets in association with your notional DROP account. After you separate from service, the DROP Benefit will be paid from HMEPS's net assets held in trust for pension benefits according to the authorized disbursement option you elect.

HMEPS will provide periodic DROP account statements. Statements will be mailed to your address of record, or if you registered for online access, your DROP account statements are available on the HMEPS website on your password-protected page. The statement will include: 1) the account balance at the beginning of the period reported by that statement, 2) debits and credits posted to the account during the period, and 3) the account balance at the end of the period.

## **DROP Credits**

For each month of the period from your DROP Entry Date to termination of employment, HMEPS will credit the following amounts to your notional DROP account (including credit of certain prorated amounts for partial months of service):

- i. Your Monthly DROP Credit (MDC), which is a monthly amount equal to what would have been your monthly retirement benefit if you had retired on your DROP Entry Date, except that the benefit accrual rate(s) in effect on the earlier of your last day of credited service or DROP Election Date will be used to compute the monthly benefit. Prior to January 1, 2018, the MDC is adjusted each year in February for the applicable annual Cost of Living Adjustment (COLA) paid by HMEPS on pension benefits. Beginning February 1, 2018, for future credit only, an annual COLA that increases the amount of the monthly retirement benefit will be paid in February of the year only if you are at least age 62 as of January 1 of that year. No COLA will be paid, however, if the applicable COLA amount that year is \$0. The MDC is credited to the DROP account at the end of the last day of each month, except that prorated amounts are calculated and credited on the date used for prorating.

You must pay required employee contributions to HMEPS for all the time in DROP that would otherwise constitute service in order to receive allowable credits to your DROP account.

You cease to accrue credited service the day prior to your DROP Entry Date. Credits will not be made to your DROP account for any period that would not constitute service. Your participation in DROP ends upon your termination of employment with the City or HMEPS.

Beginning January 1, 2018, the DROP interest rate will be equal to half of the percent return on HMEPS's investments for the prior rolling five fiscal years net of investment expenses, with a minimum rate of 2.5% and a maximum rate of 7.5%, currently compounding at daily intervals.

## **Surviving Spouse/Designated Beneficiary DROP Election**

If you made your current DROP Election prior to May 11, 2001, then in the event you die before the full distribution of your DROP account balance, the undistributed DROP account balance will be distributed to your designated beneficiary, if any, as designated in the manner and form established by the Board. The distribution will be made in a lump-sum payment within a reasonable time after the Board has approved the distribution. If you are **married**, you may designate a beneficiary other than your spouse; however, your spouse must sign a written consent to such designation in the presence of a Notary Public.

If you made your current DROP Election on or after May 11, 2001, then in the event you die before the full distribution of your DROP account balance, the undistributed DROP account balance will be distributed to your **surviving spouse**, if any, in a lump-sum payment within a reasonable time after the Board has determined that your surviving spouse is eligible for the distribution. If you leave no surviving spouse, each designated beneficiary, as designated in a manner and form established by the Board, is eligible to receive your undistributed DROP account balance in a lump-sum payment within a reasonable time after the Board has determined that the beneficiary is eligible for the distribution. For all DROP participants, if no beneficiary is designated, the undistributed DROP account balance will be distributed to your estate. If HMEPS determines that a beneficiary designation does not comply with HMEPS' requirements, the non-complying designation is void. If there is no complying designation, the undistributed DROP account balance, if any, will be distributed to your estate under applicable law.

**Please contact HMEPS regarding further eligibility requirements for DROP beneficiary elections.**

### **DROP Termination**

Any termination of your employment with the City will simultaneously terminate your DROP participation.

On termination of employment, and before any benefit or DROP payment, if you are an option-eligible participant, you must make the required election whether to have a normal benefit or a J&S Annuity. If you elect a J&S Annuity, your notional DROP account, including all DROP credits, will be recalculated from your DROP Entry Date to your termination of employment as if the J&S Annuity was selected to be effective as of your DROP Entry Date.

Prior to receiving a DROP benefit, you must contact the HMEPS office to request a DROP Termination Set (Termination Set). The Termination Set will include required notices and forms, explanations of DROP benefit payment options, and other related election and designation forms. All required forms and documents must be submitted to, and accepted by, HMEPS before a DROP benefit distribution election can be presented to the Board for approval. You also may schedule and attend a DROP exit meeting with a HMEPS representative for further explanation of the DROP termination process.

If you die while participating in DROP, your surviving spouse, or all of your designated beneficiary(ies), as applicable, may elect to revoke your DROP election, and receive survivor's benefits, if eligible, as if DROP participation had not occurred. Otherwise, such surviving spouse or designated beneficiary(ies) will receive a lump-sum payment in the amount of the undistributed balance of your DROP benefit less applicable taxes, if any, and survivor's benefits, if any, will be determined with consideration given to your DROP participation. After you have retired, neither your surviving spouse nor designated beneficiary(ies) may revoke your election to participate in the DROP.

Effective January 1, 2005, upon separation from service with the City, your average monthly salary for purposes of your retirement pension benefit will be your average monthly salary as of the later of January 1, 2005 or DROP Entry Date. Your final retirement pension benefit is the average monthly salary times the benefit percentage you accrued as of DROP Entry Date (determined as of the earlier of your last day of credited service or DROP Election Date). Your initial retirement pension will be your final retirement pension benefit plus any cost of living adjustments (COLAs) you received while participating in DROP. COLAs attributable to periods after retirement will be based on your final retirement pension benefit.

If you die while employed and your DROP election is not revoked, the survivor benefit payable to your eligible survivor(s) will be computed as a percentage of the monthly ordinary disability pension that you would have been eligible to receive had you become disabled the day before your DROP entry date, except that the ordinary disability pension is computed based on your credited service as of the day before your DROP Entry Date, the benefit accrual rate(s) applicable to the credited service as of your DROP Election Date, and your average monthly salary as of the later of January 1, 2005 or DROP Entry Date. If you suffer a service-related death, your surviving spouse, if any, is ineligible to receive a service-related survivor benefit unless your DROP election is revoked.

## **DROP Account Balance Distribution**

To the extent allowed by applicable law, you may make an irrevocable election to receive payment of a DROP benefit in a lump sum, in periodic payments, or in a combination of a lump sum and the remainder of the DROP benefit, after the lump sum, in periodic payments. Also, you may defer making a distribution election until a future date; however, distribution must commence no later than the first day of April following the later of the calendar year in which you have (a) terminated service (b) attained age 70 1/2 (you will be subject to IRS Required Minimum Distributions after you have terminated service and reached age 70 1/2). All payment options and amounts are subject to approval by the Board. The Board may require that a DROP account balance be paid in a lump-sum disbursement based on criteria specified by the Board and applied on a uniform and non-discriminatory basis. The Board, in its sole discretion, may authorize a participant to elect to receive partial payments from the participant's DROP account in a manner and form determined by the Board. The Board may establish procedures concerning partial payments, including limitations on the timing and frequency of such payments. A participant who elects partial payments may elect to receive such participant's entire remaining DROP account balance in a single lump-sum payment. All distributions and changes in form of distribution must be made in a manner and at a time that comply with Section 401(a)(9) of the Internal Revenue Code of 1986, as amended. You are advised to consult your personal tax advisor concerning the applicable tax rules prior to electing a DROP distribution option.

## **Revocation of an Election to Participate in DROP**

Except for the following specific provisions, your DROP Election is irrevocable.

- (i) If you incur a service disability, you may apply for a service disability retirement; however, if the Board approves a service disability for you, your election to participate in the DROP is automatically revoked and you will receive a service disability benefit as if your election to participate in the DROP had not occurred. In event of such a revocation, the balance of your DROP account will become zero (\$0.00) and the DROP account will be rescinded. You are not eligible to apply for an ordinary disability pension while participating in DROP.
- (ii) If you die while participating in the DROP, your surviving spouse, or if none, your designated beneficiary may elect to revoke your DROP election. In the event of such a revocation, the balance of your DROP account will become zero (\$0.00), the DROP account will be rescinded, and no distribution of DROP benefits will be made, but instead any applicable survivor benefits will be determined as if your DROP participation had not occurred.

## **Retirement Pension of a DROP Participant:**

Except as provided for option-eligible participants under DROP, upon termination of employment, you will receive a normal retirement pension on your effective retirement date calculated as provided under the Statute for normal retirement pensions, with the following exceptions:

- (i) the number of years of credited service will be the credited service you accrued through the day prior to your DROP Entry Date;
- (ii) the benefit accrual rate(s) will be the benefit accrual rate(s) that applied at the earlier of your last day of credited service or DROP Election Date; and
- (iii) Your average monthly salary will be the average monthly salary as of the later of January 1, 2005 or your DROP Entry Date.

In addition, your retirement pension will be increased by any cost of living adjustments applied during your participation in the DROP. COLAs applied after retirement will be based on the retirement pension calculated as described in i, ii, and iii above.

The following is an example of the monthly retirement benefit for a hypothetical member who enters DROP after 1/1/05 and retires after 1/1/05:

**EXAMPLE:** A member was originally hired in June 2008 and becomes eligible to participate in DROP in June 2029. The member makes a DROP election in June 2029. At DROP entry, the member has 21 years of credited service in Group B and an average monthly salary of \$4,000. The member participates in DROP for 4 years. At retirement, the monthly retirement pension is based on the credited service at DROP Entry (21 years as of June 2029), the benefit accrual rates in effect on DROP Election Date (Group B accrual rates as of June 2029 are 1.75% in Tier 1, 2.0% in Tier 2 and 2.5% in Tier 3), and the average monthly salary (AMS) as of June 1, 2029 (\$4,000). Accordingly, the member's monthly retirement benefit upon retirement is  $((10 \times 1.75\%) + (10 \times 2.0\%) + (1 \times 2.5\%)) \times \$4,000 = (17.5\% + 20\% + 2.5\%) \times \$4,000 = 40\% \times \$4,000 = \$1,600$ , plus any applicable COLAs applied during the DROP period.

### **DROP Participation after Re-employment**

If you are a former DROP participant who is subsequently rehired by the City or HMEPS, you are not eligible to again participate in the DROP, even if you have a remaining balance in your DROP account when rehired. In addition, you can not receive any DROP distributions while employed. If you are a deferred participant or retiree who is rehired into a covered position in Group A or Group B and you did not previously participate in DROP, you are eligible to participate in the DROP, provided you meet all of the requirements for DROP participation. Rehired members should contact the HMEPS office for more information.

### **Authorized Changes to the DROP**

If an unanticipated actuarial cost occurs in administering the DROP, the Board, on the advice of HMEPS's actuary, may take action necessary to mitigate the unanticipated cost, including refusal to accept additional elections to participate in the DROP, but the Board will continue to administer the DROP for the DROP participants participating in the DROP before the date of the mitigating action.

**This "DROP Overview" attempts to explain the major features of the DROP. It is not intended as a legal interpretation of the applicable laws, nor is it intended to be a summary plan description of the DROP. The HMEPS staff cannot provide legal, financial or tax advice to a pension plan member. Each prospective DROP participant is advised to consult his or her personal tax advisor and financial advisor prior to electing to participate in the DROP. Nothing contained herein shall be construed to convey any right or benefit not otherwise provided by the Statute.**