

# **HOUSTON FIREFIGHTERS' RELIEF AND RETIREMENT FUND PENSION BENEFITS POLICIES**

## **21.00 Post Retirement Option Plan (PROP) Policies and Procedures**

### **21.01 Introduction**

The purpose of this policy is to provide a coordinated and fully documented outline of the general rules for applicants electing to participate in the Post Retirement Option Plan ("PROP") of the Houston Firefighters' Retirement and Relief Fund ("Fund") as provided in Section 5A of the Statute. This policy is intended to provide those associated with the process (members of the Fund, members' surviving spouses, the Fund's Board of Trustees ["Board"], and the Fund's staff) with a detailed outline of the steps, time frames, and rules regarding PROP.

Participation in PROP involves complicated tax implications, therefore members (or surviving spouses) who elect to participate in PROP should seek professional advice concerning their participation in PROP from their personal tax advisor, financial planner, attorney, or other professional who is knowledgeable about the rules for required minimum distributions ("RMDs") at age 70-1/2, and taxation of distributions from tax qualified governmental plans. Failure to obtain competent legal and tax advice pertaining to your individual circumstances prior to the PROP election or during the period of PROP participation can lead to severe and adverse financial consequences.

### **21.02 PROP Eligibility**

The following persons may elect to participate in the PROP:

- A. A member who terminates active service after participating in the DROP and who is eligible to receive a service pension or other taxable benefits under Section 5 of the Statute; or
- B. A retired member, whether or not that member was a DROP participant, who is eligible to receive a service pension or other taxable benefits under Section 4 of the Statute (this includes a member who receives taxable disability benefits); or
- C. A surviving spouse of a member who elects and is eligible to participate in the PROP by continuing a deceased member's PROP account or by establishing a PROP account in which to receive credits from all or part of the surviving spouse's survivor benefits. This includes surviving spouses of members who received (or would have received) taxable benefits as defined in 21.02(A) and 21.02(B).

### **21.03 PROP Election Process**

- A. A member of the Fund (or a surviving spouse) who desires to participate in PROP must schedule an appointment with a Member Services Representative of the Fund forty-

five (45) calendar days or more prior to the individual's intended effective date of participation in PROP, which must be on the first of a month. (It is recommended that a member's spouse also attend the appointment.)

B. During this appointment, staff will:

1) provide the member (or surviving spouse) with a copy of this policy and Section 5A of the Fund's statute pertaining to PROP;

2) review the contents of this policy and provide an overview of the PROP program including a general description of the potential tax consequences;

3) provide an application for participation in PROP ("Application"), and the PROP beneficiary election form ("PROP Beneficiary Form");

4) encourage the member to seek professional tax and/or legal guidance before entering the PROP;

5) respond to any questions the member may have concerning the contents of this policy, the Statute, the Application, and the PROP Beneficiary Form;

6) assist the member in completing the Application should the member voluntarily choose to elect to participate in PROP;

7) accept the PROP Beneficiary Form; and

8) for members who have QDROs on file with the Fund, inform the member what impact the QDRO will have on his or her monthly retirement benefit and PROP account.

C. A member who elects to participate in PROP must sign the Application, initial every page, and must verify in writing that he or she: understands the terms and conditions of PROP, as expressed in this policy and as set forth in Section 5A of the Statute; in making the PROP election, has reviewed Section 5A of the Statute and this PROP policy and fully understands the terms and conditions of the PROP program; has elected an amount of his or her monthly taxable pension benefit and/or other taxable benefits that are to be credited to the PROP account; has been advised by the Fund that he or she should consider seeking advice from a professional tax advisor; and understands that by electing to participate in PROP, he or she is thereby electing to take a future distribution of that portion of his or her benefits from the Fund payable from the participant's PROP account in a form other than a life annuity.

D. PROP Applications must meet all requirements of the Statute and the Fund's Policies and Procedures.

E. Applications must be completed and submitted to the Fund at least thirty (30) days prior to the intended effective date of PROP participation.

F. An applicant's PROP Application will be reviewed by the Pension Benefits Committee.

G. Applicants may withdraw PROP applications at any time before the Committee has approved the application. Requests to withdraw must be made in writing to the Deputy Director of Member Services.

#### 21.04 Contributions to PROP

A. A PROP participant may contribute to his or her PROP account through any of the following sources:

1) the portion of the PROP participant's taxable monthly pension benefit, or "PROP credit", that the PROP participant elects to allocate to PROP;

2) all or a portion of the PROP participant's taxable Annual Supplemental Benefit provided through Section 10A of the Statute; and

3) all or a portion of the PROP participant's taxable portion of the \$5,000 additional lump-sum retirement or death benefit as shown in Section 10B of the Statute.

B. (1) If the PROP participant elects to contribute to his or her PROP account on a monthly basis, the PROP credit (election) will reduce the PROP participant's monthly pension benefit payment dollar for dollar, and the maximum amount of the monthly PROP credit is determined as follows: the participant's taxable gross monthly pension benefit, plus the \$150 monthly supplemental benefit {Section 4(d) of the Statute}, minus ineligible amount (all authorized and required deductions, plus \$300 for certain fluctuations in the deduction amounts). If a PROP participant elects the maximum monthly PROP credit and his or her deductions increase, the Fund will automatically decrease his or her monthly PROP credit in order to comply with the maximum allowable monthly PROP credit as described above.

The following are **examples** of how the maximum monthly credit to PROP will be determined:

**EXAMPLE 1:** Assume the PROP participant's monthly pension benefit is \$2,000 and he or she wishes to contribute the maximum dollar amount each month to the PROP account. The individual's authorized and required deductions are \$500. The maximum amount is determined as follows:

Monthly pension benefit	\$2,000
Monthly supplemental benefit	<u>+\$ 150</u>
Gross monthly pension benefit	\$2,150
Ineligible amount	<u>- \$ 800</u>
Maximum monthly credit to PROP	\$1,350

**EXAMPLE 2:** Assume the PROP participant's monthly pension benefit is \$3,000 and he or she wishes to contribute the maximum dollar amount each month to the PROP account. The individual's authorized and required deductions are \$1,000. The maximum amount is determined as follows:

Monthly pension benefit	\$3,000
Monthly supplemental benefit	<u>+\$ 150</u>
Gross monthly pension benefit	\$3,150
Ineligible amount	<u>- \$1,300</u>
Maximum monthly credit to PROP	\$1,850

B. (2) From time to time as the Board deems appropriate in its sole discretion, it may increase the ineligible amount. The amount allowed for monthly PROP credit will be subject to change due to possible changes in the Fund's Statute and PROP policies. PROP participants have sole responsibility for making sure that the amount designated not to go into PROP is sufficient to satisfy any health insurance or other deductions from pension distributions.

C. A PROP participant may change the amount of his or her PROP credit up to four (4) times per calendar year. This election must be made on a form supplied by the Fund, and received by the Fund on or before the fifth day of the month preceding the month that the PROP credit amount should be changed. For example, if a PROP participant is contributing \$1,000 to PROP on the first of each month, and he or she wants to change that amount to \$1,200 on March 1st, the PROP participant must complete a form requesting that change and the Fund must receive that form by the fifth of February to have \$1,200 contributed to his or her PROP on the first of March. (This will decrease the amount of taxable pension benefits that will be distributed to that individual on February 28th by \$200.) Each PROP participant will be responsible for making changes to his or her monthly PROP credit in the event of changes to monthly benefit amounts.

D. Monthly contributions to a PROP account must be at least \$50.

E. Participants who elect to discontinue contributions to their PROP account may leave their PROP account at the Fund, and the account will continue to accrue earnings as determined in Section 5A(b) of the Statute. Once contributions have been discontinued, the PROP participant shall not contribute to PROP for the remainder of that calendar year, but may resume contributions in subsequent years by notifying the Fund at least thirty calendar days from the date contributions are desired to start again and completing the appropriate form to reactivate contributions to PROP. [PROP credits to a participant's PROP account will never be pro-rated for a partial month (whether upon entrance to PROP, exit from PROP, or to effect any change in the monthly PROP Credit)].

#### 21.05 Other Credits to PROP Accounts

A. The PROP account of any PROP participant will be credited monthly with the monthly rate of the Fund's average annual earnings over a trailing 5-year period, limited to a range of interest rates as described below. In particular, the interest rate for any calendar month is calculated as follows: (i) Determine the average annual rate of return for the Fund for the last 5 fiscal years (ii) the annual interest rate to be applied to PROP accounts will be the average annual rate of return determined in (i), subject to a minimum of 5% and a maximum of 10%. (iii) Divide the rate of return from (ii) above by 12. This is the interest rate, which will be applied, and compounded monthly to a member's PROP account for the year.

B. Beginning on September 1 of each year, the interest rate that begins being applied and compounded and credited at the end of the month to a participant's PROP account will be recalculated by substituting the rate of return for the recent fiscal year for the rate of return for the earliest fiscal year when determining the 5-year average annual rate of return for the Fund, as described above.

#### 21.06 PROP Retained Within Fund Assets Until Distribution; Statement

A. A member's PROP account will be accounted for separately by the Fund in a notional account, and the member's (or surviving spouse's) assets will not physically be separated from other Fund assets until distribution. The designated portion of the retiree's or surviving spouse's monthly benefit and earnings will be credited to the notional PROP account on a monthly basis.

B. The Fund will provide each PROP participant with a balance statement of his or her PROP account on a quarterly basis.

#### 21.07 Distributions from PROP

A. By virtue of electing to participate in PROP, a participant is also electing to take a distribution of that portion of his or her benefits from the Fund payable from his or her PROP account in a form other than a life and survivor annuity, and a PROP participant's distribution options (or those of his or her eligible survivor or beneficiary, if applicable), will be limited to the forms of distribution set forth below.

B. To the extent permissible under federal tax laws, the Statute and these policies and procedures concerning PROP, as may be amended from time to time, payment of a PROP participant's PROP account can be made by means of:

1) a single sum distribution of the balance in the PROP account; or

2) such regular or irregular payments as the PROP participant may elect from time to time to receive, in writing, using such form or forms as are approved by the Fund, and following such specific procedure or procedures, as the Fund may require from time to

time; provided, however, that no more than four such payments may be requested and received in any calendar year.

C. Once a total distribution of the PROP account balance has been made to the PROP participant, no additional contributions to a PROP account for that individual will be allowed.

D. A PROP participant can elect to receive his or her form of distribution by filing a completed PROP Distribution Form with the Fund.

E. The Fund will provide PROP participants with PROP Distribution Forms upon request. A PROP participant may elect at any time to receive a single distribution of his or her entire remaining unpaid PROP balance, and such request must be made at least five Fund business days from the desired date of distribution.

F. PROP Distribution Forms will be processed by the Fund on a regular basis, three to five business days from the date that the Fund receives the form.

G. No PROP benefit will be paid to a beneficiary (either statutory or designated) until such time as the Fund receives sufficient documentation of the PROP participant's death. A Death Certificate (or Pending Death Certificate) would be deemed "sufficient documentation" of a PROP participant's death.

H. Pursuant to a QDRO, if an alternate payee is specifically awarded a dollar amount or a percentage of the member's PROP account, such amount or percentage will be distributed in the form specified in Subsection "B" above in accordance with the member's election. Any alternate payee entitled to distribution of a PROP benefit will be provided with a Tax Notice, Distribution Election Form, and Withholding Election Form (as applicable) and will be requested to complete and return the Forms prior to a distribution.

I. Notwithstanding any other provision of this Policy, in connection with a PROP participant's attainment of age 70½, the PROP participant must provide the Fund with a PROP Distribution Form and an accompanying schedule of Required Minimum Distribution ("RMD") payments each year, in order to conform with Section 401(a)(9) of the Internal Revenue Code of 1986, as amended (the "Code"). If these are determined by the Fund to be insufficient to ensure the Fund's compliance with Section 401(a)(9) of the Code, then the Fund will make a single payment to the PROP participant of his or her entire remaining PROP balance before April 1 of the calendar year following the calendar year in which the PROP participant attains age 70½.

#### 21.08 Beneficiary Designation for PROP Participants

A. Should a PROP participant die before complete distribution of the member's PROP account, the member's PROP account balance may be paid to the member's eligible spouse, or retained in the Fund as outlined in Section 5A(h) of the Statute. Other eligible

survivors or designated beneficiaries must take a complete distribution of their PROP funds within sixty (60) days from the date of death.

B. A PROP participant may designate a beneficiary to receive, upon his or her death, the balance of his or her PROP account, in the event there is no eligible survivor.

C. Should a PROP participant desire to change his or her designated PROP beneficiary, the PROP participant must execute a new PROP Designation of Beneficiary Form, which will be provided, upon request, by the Fund. The effect of the PROP Designation of Beneficiary Form is to revoke all prior beneficiary designations for the PROP participant's PROP benefits. The change in beneficiary designation will only be effective upon delivery of the new, original PROP Designation of Beneficiary Form to the Fund prior to the PROP participant's death.

D. A member should designate a contingent PROP beneficiary in the event the first PROP beneficiary dies prior to the member.

E. Any survivor or beneficiary eligible for payment under this section must request and apply for such payment by completing forms required by the Fund and available by contacting the Fund and asking for a Member Services Representative through the pension office in addition to providing the marriage and/or birth certificate(s) necessary to verify eligibility. No death benefit will be processed for payment without a Death Certificate (or Pending Death Certificate) certifying the death of the member. In instances where payment is made through a trustee or to an estate, verifiable proof of trusteeship must also be provided or be on file.

21.09 The Combination of PROP and DROP accounts is not permitted

A. DROP balances are not permitted to be placed into or combined with PROP balances;

B. PROP balances are not permitted to be placed into or combined with DROP balances.

21.10 Changes to PROP at Discretion of the Fund

(A) The Board or an appropriate committee of the Board may change the rules, policies and procedures concerning PROP participation to protect the interests and well-being of the Fund. By participation, the participant expressly consents to any future changes in PROP rules, policies and procedures. Examples of possible changes include, but are not limited to the following:

(1) The Board, or the appropriate HFRRF committee, may set a date after which additional members or surviving spouses will not be allowed to elect to participate in the PROP.

(2) The Board, or the appropriate HFRRF committee, may set a date after which the crediting of additional benefits of a member or a surviving spouse to a PROP account is not allowed.

(3) The Board, or the appropriate HFRRF committee, may limit the number of distribution transactions for all PROP participants or for any category of PROP participants.

#### 21.11 Taxation of PROP Credits

Amounts credited to the PROP account are not included in the participant's gross income until distributed to the Participant by the Fund as described in the section 21.05 above, thus deferring the federal income tax on such amounts. This is one of the primary advantages to PROP. There are certain tax implications on distributions from a qualified plan prior to the age of 59-1/2 and after the age of 70-1/2. **These tax implications can have severe adverse financial consequences (see Section 21.01).**