RETIREMENT PLAN FOR EMPLOYEES OF NORTH TEXAS MUNICIPAL WATER DISTRICT

FUNDING POLICY

EFFECTIVE FOR PLAN YEARS BEGINNING ON AND AFTER JANUARY 1, 2023

Adopted Effective: January 1, 2023

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1. Purpose of Funding Policy

Adoption of a formal policy defining priorities and guidelines for the funding of pension benefits is considered a best practice for public retirement systems. Governing boards and plan sponsors can use a formal funding policy to communicate funding goals and to provide a plan actuary with guidance in determining the requisite contribution rates to meet those goals. In addition, Texas Government Code §802.2011 requires the governing board of a Texas public retirement system to adopt a written funding policy and submit such policy to the Texas Pension Review Board (PRB) by the 31st day following its change or adoption.

Furthermore, Section 9.05 of the Retirement Plan for Employees of North Texas Municipal Water District as amended and restated effective January 1, 2025 states:

> "The Employer intends to make the actuarially determined contributions to the Plan."

Texas Government Code §802.101 requires that an actuarial valuation include a recommended contribution rate needed to achieve and maintain an amortization of the Unfunded Actuarial Liability (UAL) over a period that does not exceed 30 years.

For the North Texas Municipal Water District (the District), the adoption of this policy is intended to:

- Define the goals and objectives of funding the Retirement Plan for Employees of North Texas Municipal Water District (the Pension Plan),
- Ensure those objectives are consistent with the Texas Pension Review Board (the PRB) funding requirements, Texas Government Code §802.2011, Section 9.05 of the Pension Plan document and Texas Government Code §802.101,
- Ensure the funding objectives consider the current recommendations of the Government Finance Officers Association (GFOA) and the Conference of Consulting Actuaries Public Plans Community,
- Enhance communications to plan members and retirees regarding the District's funding strategy, and
- Provide funding policy guidance to current and future boards.

2. Primary Funding Objective

The primary objective of the funding policy is to fully fund the long-term cost of benefits provided under the terms of the Pension Plan through disciplined and timely accumulation of contributions and prudent investment of assets, where such investments are governed by the guidelines of a separate Investment Policy Statement.

3. Funding Priorities and Guidelines

The following priorities and guidelines seek to achieve the Primary Funding Objective:

- **100% Payment of Vested Benefits** – Future contributions and current plan assets must be sufficient to pay for all vested benefits expected to be paid to members and their beneficiaries when due.

- **Target a Funded Ratio of 100%** – The funded ratio shall be determined based on the ratio of:

  - the Plan Assets (which may be determined using a smoothing methodology discussed below) to

  - the Actuarial Accrued Liability (determined using the selected actuarial Cost Method as discussed below and all other funding valuation assumptions).

- **Contribution Stability and Sound Financing of Benefits** – The financing of benefits should be based on sound actuarial principles. The District desires to minimize year-to-year employer contribution volatility to the extent reasonably possible while understanding that a sound funding policy may require employer contribution fluctuations from year-to-year in order to achieve and maintain the sound actuarial financing of benefits.

- **Intergenerational Equity** – The costs of benefits, which are shared between the District and the employee members, should be paid for by the generation that receives the benefits rather than deferring those costs to future generations, whenever possible, and in a manner consistent with the principle to pay all vested benefits when due and without reduction.

- **Benefit Enhancements** – Prior to adopting any amendments to the Pension Plan that materially improve plan benefits, the actuary shall provide the District with an analysis of the expected effect of the proposed amendment on the Pension Plan's funded ratio and the annual Actuarially Determined Contributions.

4. Funding Policy for the Pension Plan

The Funding Policy determines the manner in which plan liabilities and assets are measured for purposes of calculating the annual employer contributions to the Pension Plan and determines the level of the annual employer contributions. Typically, funding policies require the annual Normal Cost (i.e., the present value of the current year benefit accruals) plus a portion of the Unfunded Accrued Liability (UAL) (i.e., the excess of Actuarial Accrued Liability over Plan Assets) to be funded via an amortization payment.

In establishing this Funding Policy, the District considered published guidance from the Texas Pension Review Board, the Conference of Consulting Actuaries Public Plans Community and the Government Finance Officers Association. A detailed summary of this guidance, including many of the terms and concepts utilized in the Funding Policy below, is located in the Appendix of this document.

Effective with the January 1, 2023 actuarial valuation, the Pension Plan will use the following Funding Policy:

1. **Methods** – The Pension Plan shall use the following methods.

    a. **Recommended Contribution** – The annual contribution shall be determined using the **Actuarially Determined Contribution (ADC) Method**. The total ADC shall be determined as the sum of the Normal Cost plus an amortization of the Unfunded Accrued Liability (UAL) as further discussed below.

    The Employees' portion of the ADC shall be determined under the terms of the Pension Plan document (i.e., under Section 3.04 of the current Pension Plan document, the employee contributions for employees who enter service on and after January 1, 2018 are presently equal to 5% of Earnings as defined thereunder).

    The Employer's portion of the ADC shall not be less than the total ADC reduced by the Employees' portion of the ADC.

    b. **Cost Method** – The actuarial cost method shall be the Entry Age Normal Level Percent of Pay method.

    c. **Asset Method** – The Pension Plan shall use the smoothed value of assets as defined below:

    Market Value of Assets as of the valuation date equals Fair Value plus any receivable contributions made or to be made for a prior plan year. The Actuarial Value of Assets (AVA) equals the Market Value adjusted by deferred recognition of asset gains and losses over a five-year period. The asset gains/(losses) are equal to the excess/(shortfall) of actual Market Value over/(under) expected Market Value determined using the assumed rate of investment return, which is 7.25% as of the date of adoption of this Funding Policy, was 7.75% in 2022 and 8.00% in years prior to 2022. The asset

gains/(losses) are determined at the end of the year in which they occur. These gains/(losses) are recognized twenty percent (20%) each year over the next five (5) years beginning in the year in which the gain or loss occurs. The AVA is subject to a 20% corridor such that the market value adjusted by the deferred asset gains and losses will not be less than 80% nor greater than 120% of the market value of assets.

d. **Amortization Method** – The amortization method shall be determined as follows:

Amortization Method	Selected Method
Closed Period vs. Open Period	Closed Period
Level Dollar vs. Level Percent	Level Percent
Single vs. Layered	Layered

Source of Amortization Layers	Selected Amortization Period
Actuarial Experience Gain/Loss	20 years
Assumption and Method Changes	20 years
Plan Amendments	15 years
Transition to New Policy	21 years[1]

[1] Prior to January 1, 2023, the District utilized a funding practice whereby the UAL was amortized in a single layer over a 30-year closed period beginning January 1, 2014. As of January 1, 2023 (i.e., the transition date to this Funding Policy), there are 21 years remaining of the original closed 30-year period.

As indicated above, the expected UAL as of January 1, 2023 prior to reflecting any actuarial experience gains/losses, assumption/method changes or plan amendments will be amortized over a 21-year period in order to transition to the new funding policy without changing the amortization period that was otherwise scheduled as of January 1, 2023.

In any year in which the Pension Plan's Funded Ratio equals or exceeds 100% (i.e., the plan is in a surplus position), the unamortized portion of all outstanding amortization layers shall be eliminated, and the total ADC for such year shall be set equal to the Normal Cost. If the Funded Ratio exceeds 120%, the District shall evaluate whether the ADC shall include an amortization of the surplus as an offset to the Normal Cost.

2. Other Considerations

a. **Actuarial Experience Studies –** The District shall authorize an actuarial experience study from time-to-time to examine the Pension Plan's actual experience relative to the expected experience based on the actuarial assumptions in effect. Each experience study will examine both demographic assumptions and economic assumptions, including the investment return

assumption (i.e., the discount rate). The District shall adopt new actuarial assumptions if warranted based on the results of each actuarial experience study. Actuarial experience studies shall be conducted at least once every three to five years.

b. **Risk-Sharing –** If the ADC becomes untenable, then the District reserves the right to examine adjustments to the Funding Policy to restore the ADC to a sustainable level. For example, the District may examine the use of longer amortization periods (that remain within the recommended ranges) while still meeting the Primary Funding Objectives in order to reduce the ADC or otherwise restore the ADC to a sustainable level. Furthermore, outside of this Funding Policy and subject to the measures and procedures required to amend the Pension Plan, the District may examine changes to the Pension Plan in addition to or in lieu of changes to the Funding Policy.

c. **Review of Funding Policy -** This policy may be amended from time-to-time to reflect changes in other District policies, emerging best practices for public defined benefit pension plans, prevailing opinions of future District board members and Retirement Plan Committee members, and suggested changes by Retirement Plan stakeholders. The District will review the policy periodically and make recommendations if necessary to maintain progress towards the District's goals and objectives.

d. This policy will be reviewed and approved by the Retirement Plan Committee and the District's Board of Directors. The Policy will reside in the District's Financial Policies Manual.

ADOPTION BY THE RETIREMENT PLAN COMMITTEE

This Policy was passed and approved by the North Texas Municipal Water District's Retirement Plan Committee of the in a regular meeting on the 27 day of February, 2025.

Signed by:
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BOBBY SIMS, Secretary

Signed by:
7137C59438E1462...

JEANNE CHIPPERFIELD, Chair

Glossary of Actuarial Terms

Actuarial Accrued Liability or Accrued Liability	This is computed differently under different actuarial cost methods. Generally, the Actuarial Accrued Liability or Accrued Liability represents the portion of the Present Value of Future Benefits attributed to periods of service preceding the valuation date.
Actuarial Gain (Loss)	A measure of the difference between actual experience and that expected based on the actuarial assumptions during the period between two actuarial valuation dates, as determined in accordance with the particular actuarial cost method used.
Actuarial Value of Assets	The value of Plan Assets used by an actuary for an actuarial valuation.
Entry Age Normal Actuarial Cost Method	An actuarial cost method under which the Present Value of Future Benefits of each individual included in an actuarial valuation is allocated on a level basis over the earnings or service of the individual between entry age and assumed exit ages. The portion of this actuarial present value allocated to the year of service during the valuation year is called the Normal Cost. The portion of this present value not provided for at a valuation date by the Present Value of Future Normal Costs is called the Accrued Liability.
Market Value of Assets	Market Value of Assets as of a valuation date equals Fair Value plus any receivable contributions made or to be made for a prior plan year.
Normal Cost	Computed differently under different actuarial cost methods, the Normal Cost generally represents the portion of the actuarial Present Value of Future Benefits attributed to the current year of service for active employees.

Open Period vs. Closed Period Amortization

The amortization method determines the manner over which the Unfunded Accrued Liability (UAL) is amortized. The UAL can be amortized over an:

- Open Period, whereby the amortization period is the same each year (e.g., a 30-year Open Period amortization would use a 30-year amortization for the January 1, 20X0 valuation, followed by another 30-year open period on January 1, 20X1 and so on without the 30-year period ever changing), or

- Closed Period, whereby the amortization period reduces each successive period (e.g., a 30-year Closed Period amortization would use a 30-year amortization for the January 1, 20X0 valuation, followed by a 29-year closed period on January 1, 20X1 and so on until the final year of the amortization is reached in the 30th year).

Plan Assets

Used interchangeably with Actuarial Value of Assets. See definition of Actuarial Value of Assets above.

Present Value of Accrued Benefits

The actuarial present value of all accrued benefits (i.e., all benefits attributed by the pension benefit formula to employee service and compensation rendered prior to the valuation date).

Present Value of Future Benefits

Future benefits include all benefits estimated to be payable to plan members (retirees and beneficiaries, terminated employees entitled to benefits but not yet receiving them, and current active members) as a result of their service through the valuation date and their expected future service. The actuarial Present Value of Future Benefits as of the valuation date is the present value of the cost to finance benefits payable in the future, discounted to reflect the expected effects of the time value (present value) of money and the probabilities of payment.

Present Value of Future Normal Costs

The difference between the Present Value of Future Benefits and the Actuarial Accrued Liability under a given actuarial cost method.

Unfunded Accrued Liability (UAL)

The excess, if any, of the Actuarial Accrued Liability over the Actuarial Value of Assets.

Appendix

Published Guidance on Key Elements of a Funding Policy

The Funding Policy determines the manner in which plan liabilities and assets are measured for purposes of determining the annual employer contributions to the Pension Plan and determines the level of the annual employer contributions. Typically, funding policies require the annual Normal Cost (i.e., the present value of the current year benefit accruals) plus a portion of the Unfunded Accrued Liability (UAL) (i.e., the excess of Actuarial Accrued Liability over Plan Assets) to be funded via an amortization payment.

Published guidance by the following entities has been considered in developing the Funding Policy:

1. **Texas Pension Review Board (the PRB) "Guidance for Developing a Funding Policy" and "Pension Funding Guidelines" adopted on July 25, 2024** – This guidance is intended to assist public entities in Texas in developing a policy that meets the requirements of Texas Government Code §802.2011;

2. **Conference of Consulting Actuaries Public Plans Community (CCA PPC) "Actuarial Funding Policies and Practices for Public Pension Plans" published in October 2014 (First Edition) and August 2024 (Second Edition)** – This publication is a "white paper" that develops principal elements and parameters of actuarial funding policy for U.S. public pension plans. The guidance offered in the white paper "is not intended to supplant or replace the applicable Actuarial Standards of Practice (ASOPs)" and is "nonbinding and advisory only", but it is intended as advice to actuaries and retirement boards in setting funding policy. The white paper develops a Level Cost Allocation Model that recommends actuarial funding methods for measuring both plan liabilities and plan assets, as well as recommends amortization periods for funding the UAL. These recommendations are discussed further below; and

3. **Government Finance Officers Association's (the GFOA) Best Practice "Sustainable Funding Practices for Defined Benefit Pensions and Other Postemployment Benefits" approved by the GFOA's Executive Board in January 2016** – This paper includes recommendations for best practices for adopting a funding policy and incorporates by reference the GFOAs' Best Practice "Core Elements of Funding Policy" published in 2013 which also recommends parameters for a funding policy.

All three sources of published guidance discuss the following key elements of a funding policy.

- **Recommended Contribution** – There are two methods used to determine recommended employer contributions to Public Pension Plans:

  - **Fixed Rate Method** – The Fixed Rate method determines the annual employer contribution as a constant percentage (i.e., a fixed rate) of payroll. This method is

used to minimize volatility in the contribution amount and does not vary from year-to-year unless certain conditions are met.

However, if it is determined that the fixed rate is insufficient to maintain or improve a pension plan's funded ratio, there can be significant lags between when the rate becomes insufficient and when a new fixed rate is adopted by the governing entity, potentially resulting in further reduction to the plan's funded ratio in the meantime.

- **Actuarially Determined Contribution (ADC) Method** – The ADC is determined as the sum of the Normal Cost plus an amortization of the UAL. The ADC changes each year as the Normal Cost and UAL fluctuate. This volatility permits the plan funding to be adjusted as needed in order to continue funding towards 100% over a set period of time.

  As discussed below the Normal Cost and Actuarial Accrued Liability are determined based upon the actuarial Cost Method that is selected, and the Plan Assets can either be determined using Market Value or a smoothed Actuarial Value of Assets. Lastly, the period(s) over which the UAL is amortized as well as the methods of setting the period(s) (open period vs. closed period and level dollar amortization vs. level percent of pay amortization) are also key components in the determination of the ADC.

The PRB and GFOA recommend using the ADC method. **The CCA PPC white paper is written solely in the context of the ADC method**; however, the white paper indicates that plans that use the Fixed Rate method should also develop an ADC rate for comparison. Similarly, the PRB recommends that if a Fixed Rate method is used, then an ADC rate should be used as a benchmark for determining if the Fixed Rate is reasonable, as well as to identify conditions in which the Fixed Rate should be changed to move towards the ADC rate either via changes to the rate or benefit reductions.

- **Cost Method** – The actuarial cost method is used to allocate the Present Value of Future Benefits to past, current and future service periods.

  - **Actuarial Accrued Liability** – This is the portion of the Present Value of Future Benefits assigned to past service (i.e., service before the actuarial valuation date).

  - **Normal Cost** – This is the portion of the Present Value of Future Benefits that is assigned to the current year of service (i.e., it is the present value of the current year's accruals).

  - **Present Value of Future Normal Costs** – This is the portion the Present Value of Future Benefits that is assigned to future service after the valuation year (i.e., it represents the present value of future years' accruals).

The PRB, the CCA PPC and the GFOA all recommend that plan liabilities be determined using the Entry Age Normal Level Percent actuarial cost method for

plans with pay-related benefits. This method funds each individual's benefits over their career as a level percent of pay.

- **Asset Method** – Rather than use the Market Value of Assets in each annual valuation as the measure of Plan Assets, an Actuarial Value of Assets (AVA) can be used to smooth investment gains and losses and thus reduce year-to-year volatility in developing a funding policy contribution. Some AVA methods also place a corridor around the Market Value of Assets to limit the maximum amount of the smoothing during periods in which the market has been very volatile.

  The PRB, the CCA PPC and the GFOA have various recommended ranges for the length of the period over which assets can be smoothed, but all three entities indicate that a 5-year smoothing period is reasonable. Furthermore, the CCA PPC and GFOA neither recommend nor discourage a corridor for a 5-year smoothing period (but they do recommend corridors for smoothing periods in excess of 5 years), while the PRB does not state a position on this matter.

- **Amortization Method** – The amortization method determines the manner and period over which the Unfunded Accrued Liability (UAL) is amortized.

  - **Level Dollar vs. Level Percent** – The UAL can be amortized as a:

    - Level Dollar amount, where the amortization installment is fixed each year, or

    - Level Percent amount, where the amortization installment increases each year as payroll increases, but this can sometimes result in negative amortization.

  - **Open Period vs. Closed Period** – The UAL can be amortized over an:

    - Open Period, whereby the amortization period is the same each year (e.g., a 30-year Open Period amortization would use a 30-year amortization for the January 1, 2023 valuation, followed by another 30-year open period on January 1, 2024 and so on without the 30-year period ever changing), or

    - Closed Period, whereby the amortization period reduces each successive period (e.g., a 30-year Closed Period amortization would use a 30-year amortization for the January 1, 2023 valuation, followed by a 29-year Closed Period on January 1, 2024 and so on until the final year of the amortization is reached in the 30th year).

  - **Single Amortization vs. Layered Amortization** – The UAL can be amortized using:

- **Single Amortization** – Under the Single Amortization method, the full amount of the UAL is amortized over a single period each year.

- **Layered Amortization** – Under the Layered Amortization method, different amortization layers of the UAL are established at each actuarial valuation, and the sum of the layers is equal to the full UAL. In addition, within a single valuation, multiple layers of UAL can be established for different sources of changes in the UAL. The Layered Amortization method requires that a new amortization base (or layer) be created each year for Actuarial Experience Gains/Losses that occur during the year. In addition, new amortization layers are created in years in which actuarial assumptions or methods are changed and in years in which plan amendments are enacted.

  Creating a new amortization layer for each year reduces the volatility of the amortization of the UAL relative to the Single Amortization method, particularly as the Closed Period becomes shorter if a Closed Period amortization method is used. In addition, different amortization periods can be used for different types of layers created in years in which actuarial assumptions or methods are changed and in years in which plan amendments are enacted. This allows the funding of each layer to be better aligned with an appropriate amortization period.

As shown in the tables below, the PRB, CCA PPC and GFOA all recommend a Layered Amortization approach with Closed Periods but with different amortization periods and different recommendations for Level Dollar versus Level Percent.

Method	Amortization Methodology		
	PRB	CCA PPC	GFOA
Closed Period vs. Open Period	Closed Period	Closed Period	Closed Period
Level Dollar vs. Level Percent	Either[1]	Level Percent[2]	Either
Single vs. Layered	Layered	Layered	Layered

Source of Amortization Layers	Amortization Period		
	PRB[1]	CCA PPC[2]	GFOA
Actuarial Experience Gain/Loss	10 to 25 years	15 to 20 years	15 to 25 years[5]
Assumption and Method Changes	10 to 25 years	15 to 25 years	15 to 25 years[5]
Plan Amendments	10 to 25 years	10 to 15 years[3]	15 to 25 years[5]
Transition to New Policy	Not discussed	Up to 30 years[4]	Not discussed

[1] The PRB indicates that "level dollar amounts are preferable unless payroll is expected to decrease in the future". The PRB also states that 10 to 25 years is the preferable range, and while it indicates that a layered approach is acceptable, it does not provide separate preferred ranges for each of the layers.

[2] The white paper indicates that "level dollar could be appropriate for sponsors and plans that are particularly averse to future cost increases, e.g., utilities setting rates for current rate payers." Furthermore, the white paper states "level dollar is generally faster amortization than level percent of pay so longer periods may be reasonable."

[3] The white paper recommends that Plan Amendments be amortized over the actual remaining active future service for amendments affecting active members (where 15 years can be used as an approximation) or over actual remaining retiree life expectancy for amendments affecting inactive members (where 10 years can be used as an approximation).

[4] The white paper indicates that transition policies would allow current fixed period amortization layers with periods not to exceed 30 years to continue with new amortization layers subject to recommended guidelines.

[5] GFOA states that amortization periods should "ideally fall in the 15-20 year range" but "never exceed 25 years".

- **Other Considerations** – The PRB, CCA PPC and GFOA each recommend other considerations to manage growth in plan liabilities and mitigate other risks.

  - **Actuarial Experience Studies** - An actuarial experience study examines a Pension Plan's actual demographic and economic experience relative to the expected experience based on the actuarial assumptions used in an actuarial valuation. Adjustments should be made to the actuarial assumptions whenever actual plan experience deviates materially from the assumptions in order to produce the best long-term estimate and to better align the contributions with the long-term expected cost of the plan.

    The GFOA recommends an actuarial experience study be conducted at least once every three to five years, the PRB indicates that the frequency of actuarial experience studies can be included in the funding policy and the CCA PPC does not address assumption selection in its white paper.

  - **Risk Mitigation Strategies** – Other strategies can be implemented to mitigate risks, such as the risk of large contribution increases year-to-year, sharing risks with employees via increased employee contributions or benefit reductions in certain scenarios. Managing growth in plan liabilities via restrictions on plan amendments should also be considered.

    The PRB, CCA PPC and GFOA all suggest various strategies for mitigating risks and managing growth in plan liabilities, and the referenced publications for each of these bodies suggest incorporating some risk mitigation strategies into a plan's funding policy.