STATE OF MICHIGAN
DEPARTMENT OF TREASURY
LANSING

RICK SNYDER
GOVERNOR

NICK A. KHOURI
STATE TREASURER

DETROIT FINANCIAL REVIEW COMMISSION

RESOLUTION 2018-14

ENDORSING EXTENSION OF CITY'S DEFERRED RETIREMENT OPTION PROGRAM

WHEREAS, Public Act 181 of 2014, as amended, the Michigan Financial Review Commission Act (the "Act") created the Detroit Financial Review Commission (the "Commission") to provide specified supervision of certain activities and actions of the City of Detroit (the "City") beginning on December 10, 2014; and

WHEREAS, the Act charges the Commission with, among other things, (a) ensuring that the City is meeting certain statutory requirements, (b) reviewing and approving the City's budgets and certain contracts, and (c) establishing processes to ensure effective prudent fiscal management; and

WHEREAS, the Commission granted a waiver to the City pursuant to Section 8 of the Act on April 30, 2018 in Resolution 2018-13 and is currently in a period of decreased oversight; and

WHEREAS, both the Act and the conditions of waiver approved by the Commission in Resolution 2018-13 contemplate continued monitoring of the City's financial status, even though the Commission is no longer providing day to day oversight of the City's finances; and

WHEREAS, the City has now requested that the Commission endorse the efforts by the City to lengthen the amount of time members of the Detroit Police Lieutenants and Sergeants

Association (“DPLSA”) and the Detroit Police Command Officers Association (“DPCOA”) may work under the City’s Deferred Retirement Option Program (the “DROP”) from five years to ten years; and

WHEREAS, the City has advised the Commission that the proposed change to DROP would effectively be cost-neutral and would, moreover, greatly assist the City’s efforts to retain experienced, well-trained officers—an issue of major concern in the City.

NOW THEREFORE, be it **RESOLVED** that the Detroit Financial Review Commission endorses the City’s efforts to lengthen the time members of DPLSA and DPCOA may work under the City’s Deferred Retirement Option Program from five years to ten years.

DETROIT 56620-1 1472045v2

Mayor's Office
CITY OF DETROIT

Coleman A. Young Municipal Center
2 Woodward Avenue, Suite 1126
Detroit, Michigan 48226

Phone 313•224•3400
Fax 313•224•4128
www.detroitmi.gov

August 24, 2018

To the members of the Financial Review Commission,

Attached please find a memorandum regarding a potential extension of the time period in which certain Detroit police officers can participate in the Deferred Retirement Option Program (DROP).

I agree with and endorse the analysis and conclusions in the memo. I urge the FRC to endorse, via an advisory vote, the DROP extension.

Sincerely,

Michael E. Duggan
Mayor, City of Detroit

MEMORANDUM

To: Mayor Duggan
From: Eli Savit, Senior Counsel to the Mayor
Date: August 20, 2018
Re: DROP Extension

As you know, the City of Detroit is requesting an FRC advisory vote supporting the City's efforts to amend the City's bankruptcy Plan of Adjustment (POA). Specifically, the City wishes to file a Rule 60(b) motion in bankruptcy court seeking to amend the POA to lengthen the amount of time members of the Detroit Police Lieutenants and Sergeants Association (DPLSA) and the Detroit Police Command Officers Association (DPCOA) may work under the City's Deferred Retirement Option Program (DROP).

As explained below, the proposed change to DROP would effectively be cost-neutral. It would, moreover, greatly assist the City's efforts to retain experienced, well-trained officers—an issue of major concern in the City.

I. Legal Background

The City of Detroit currently offers Police and Fire Retirement System (PFRS) members a DROP program. The DROP program allows members who are eligible to retire with a pension the option, instead, to (1) continue working, (2) "freeze" the amount of benefits that they are accruing, and (3) have 75% of the money that would have been paid as pension (had they retired) invested into an individual savings account.

From members' perspective, the DROP program allows them to continue working (and earning a salary), but realize some benefits from the pension they would have been eligible to receive had they retired. From the City's perspective, the DROP program facilitates the retention of experienced officers, and allows it to avoid the costs associated with replacing such officers.[1]

Pursuant to the combined PFRS plan approved as part of the bankruptcy POA, however, members who elect the DROP program can generally work for only five years after making the DROP election. *See* POA, Combined PFRS Plan at § 12.1. That truncated period restricts the degree to which both the City and members can benefit from the DROP program. Accordingly, pursuant to collective bargaining agreements recently reached with DPCOA and DPLSA, the City agreed to use its best efforts to amend the POA to lengthen the amount of time—to ten years—that DPCOA and DPLSA members can work post-DROP. Specifically, the City agreed to seek bankruptcy court approval to amend §12.1 of the Combined PFRS Plan to add a new paragraph (3) along the following lines:

> *(3) Notwithstanding paragraph 2 of this section or any other provision of this Plan, a member of the Detroit Police Lieutenants and Sergeants Association*

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[1] Additional information about the DROP program can be found at http://www.pfrsdetroit.org/Portals/PFRS2/Documents/Helpful%20PDFs/DROP%20_Guidelines%20_v%205_3.pdf.

or the Detroit Police Command Officers Association shall be entitled to participate in the DROP program under Component I for a maximum of ten (10) years. At the end of such ten (10) year period of participation in the DROP program, the member shall be retired and separated from employment.

A member who is participating in the DROP program pursuant to this paragraph §12.1(3) or pursuant to Component II of the Police and Fire Retirement System must be able to perform the essential functions of his or her permanent position for the duration of his or her participation in the DROP program. Provided, however, that such a member may remain on restricted duty for a maximum cumulative total of 365 days during the DROP period. If a member participating in the DROP program pursuant to this paragraph §12.1(3) or Component II of the Police and Fire Retirement System remains on restricted duty for the maximum cumulative total of 365 days, that member shall be retired and separated from employment.

While participating in the DROP program pursuant to paragraph §12.1(2), this paragraph 12.1(3) or pursuant to Component II of the Police and Fire Retirement System, a member of the Detroit Police Lieutenants and Sergeants Association or the Detroit Police Command Officers Association must receive bi-annual satisfactory performance evaluations according to the performance evaluation standards then in place for sworn officers. Any such member who receives an unsatisfactory performance evaluation shall be entitled to the appeals process then in place, as well as final review by the Chief of Police. If a member receives a final unsatisfactory evaluation, that member shall be retired and separated from employment.

The City plans to fulfill that obligation by filing a "Rule 60(b)" motion with the bankruptcy court, seeking partial relief from a judgment or order. Federal Rule of Civil Procedure 60(b) broadly provides that a party may seek relief from a judgment or order for "any . . . reason that justifies relief." The City believes that an advisory vote by the FRC supporting the proposed amendment would help to ensure that the bankruptcy court grants its motion.

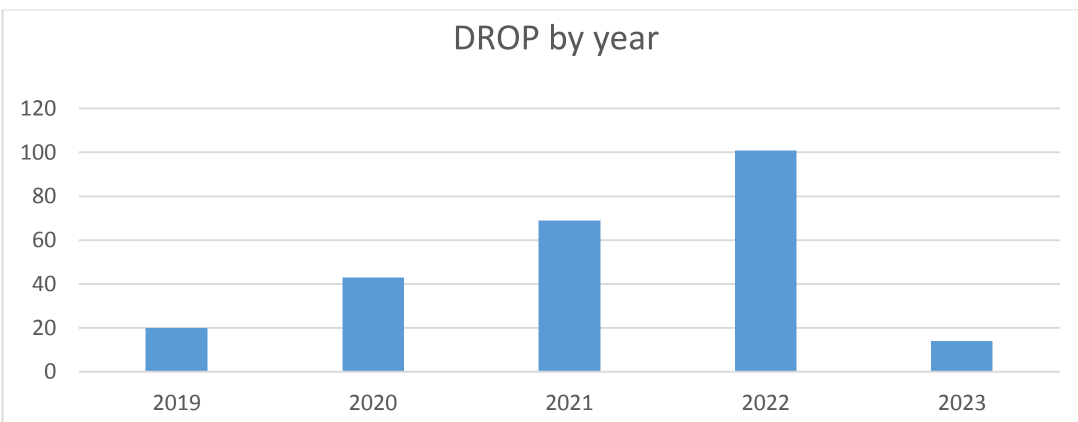
To be sure, the Financial Review Commission Act does not expressly provide a mechanism for an advisory vote. As such, the vote would have no legal effect. But both the Act and the conditions of waiver approved by the FRC contemplate continued monitoring of the City's financial status, even though the Commission is no longer actively overseeing the City's finances. *See, e.g.,* MCL 141.1642(1); 141.1637(b); 141.1638(2)(d). Accordingly, as part of that continued oversight, an advisory vote is appropriate. And, as noted below, lengthening the amount of time an officer can be on DROP makes good policy and fiscal sense.

II. Detroit's Officer Retention Challenge

The Detroit Police Department (DPD), in recent years, has faced significant challenges in retaining officers. In the past, approximately 70% of the officers leaving DPD left due to retirement. Today, that number has dropped to 39%. A full 40% of the officers separating from DPD now leave as a result of a voluntary resignation.

Turnover in DPD is particularly acute during the first five years in an officer's career. Today, nearly 1/3 of the officers who resign have less than five years seniority. That imposes significant real-world costs on the police force. It means that a higher percentage of the police force is relatively inexperienced. And the constant churn means that DPD must spend more to recruit and train newer officers.

These challenges are exacerbated by the fact that many of Detroit's most senior officers can only continue working for five years after they choose to DROP. That policy forces out the door some of Detroit's most prized veteran officers. The problem will only grow in the coming years. Last year, the City conducted a retirement-forecast study to guide its planning processes for the coming years. Per that study, there are currently 248 officers who have already opted to DROP who will end their employment in the next five years. What is more, the number of officers who will have to leave employment because of the 5-year DROP requirement is scheduled to skyrocket in 2020, 2021, and 2022. The graph below—which details the number of police officers whose 5-year DROP timetable will end in each of the five forthcoming calendar years—illustrates that change.



As a result, there is a real need—both operationally and fiscally—to modify the DROP program to ensure that participants work longer.

III. The Proposed Amendments Will Be Cost-Beneficial

Lengthening the amount of time in which officers may participate in DROP will not only be revenue-neutral—it will be cost-beneficial.

Again, under DROP, eligible PFRS members may defer the receipt of their full retirement benefit and instead continue active service, while collecting 75% of their monthly retirement benefit into a third-party account. DROP participants no longer accrue additional service credit in the Hybrid plan during their remaining active service.

Based on a February 24, 2017 actuarial study completed by Gabriel Roeder Smith for the PFRS, extending the DROP to 10 years would reduce the Unfunded Actuarial Accrued Liability (UAAL) of the Component II Legacy plan by $21.7 million and of the Component I Hybrid plan by $2 million compared to the PFRS FY 2015 actuarial valuation. It would also reduce the employer normal cost for new service credit in the Hybrid plan. This is due to assumed changes in behavior due to the proposed policy change. It is expected that the number of DROP participants would increase, and DROP participants would work longer. The result is an overall delay in actual retirement from service for PFRS members, thus reducing the outflow of retirement benefits.[2]

A copy of the actuarial study is attached.

cc: John Hill
David Massaron
Chuck Raimi
Trisha Stein

[2] The actuarial study examined the impact on the full PFRS system, not just DPCOA and DPLSA. It should be noted that the City has provided for the lengthened program as part of a collective bargaining agreement with DPCOA and DPLSA—thus providing the City and the unions the additional benefit of having an operative contract in place.

GRS

Gabriel Roeder Smith & Company
Consultants & Actuaries

One Towne Square
Suite 800
Southfield, MI 48076-3723

248.799.9000 phone
248.799.9020 fax
www.gabrielroeder.com

February 24, 2017

CONFIDENTIAL

The Police and Fire Retirement System
of the City of Detroit
Coleman A. Young Municipal Center
2 Woodward Avenue - Suite 900
Detroit, Michigan 48226

Attention: Mr. David Cetlinski, Assistant Executive Director

Re: Police and Fire Retirement System of the City of Detroit – Supplemental Actuarial Valuation of Proposed Changes in DROP Provisions

Dear Mr. Cetlinski

Enclosed is a supplemental actuarial valuation report for the Police and Fire Retirement System of the City of Detroit (PFRS) regarding the financial effects of removing the maximum five-year DROP period. This report contains results for both the Component I (Hybrid) and Component II (Legacy) plans.

Please do not hesitate to contact us if you have any questions.

Sincerely,

Kenneth G. Alberts

Kenneth G. Alberts

KGA:bd
Enclosure

cc: Judith A. Kermans
David T. Kausch

POLICE AND FIRE RETIREMENT SYSTEM OF THE CITY OF DETROIT SUPPLEMENTAL ACTUARIAL VALUATION AS OF JUNE 30, 2015

Requested By: Police and Fire Retirement System of the City of Detroit

Date: February 24, 2017

Submitted By: Kenneth G. Alberts
Judith A. Kermans, EA, FCA, MAAA
David T. Kausch, FSA, EA, FCA, MAAA
Gabriel, Roeder, Smith & Company

This report contains an actuarial valuation of a proposed change in benefits for members of the City of Detroit Police and Fire Retirement System (DPFRS). The Proposed change is to remove the 5-year maximum DROP participation period so that members may participate in the DROP plan for an unlimited period (or until mandatory retirement age, if applicable). The purpose of this report is to estimate the financial effect of the proposed change on the DPFRS.

Judy A. Kermans and David T. Kausch are Members of the American Academy of Actuaries and meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinions contained herein.

This report may be shared with other parties, but only in its entirety and only with the permission of the DPFRS. GRS is not responsible for unauthorized use of this report. This report should not be used for any purpose other than the purpose stated above. The individuals issuing this report are independent of the plan and the plan sponsor.

The date of the valuation was June 30, 2015. This means that the results of the supplemental valuations indicate what the June 30, 2015 valuations would have shown if the proposed benefit changes had been in effect on that date. Supplemental valuations do **not** predict the result of future actuarial valuations. Rather, supplemental valuations give an indication of the probable long-term cost of the **benefit change only** without comment on the complete end result of the future valuations.

Actuarial assumptions and methods were consistent with those used in the regular actuarial valuation of the Retirement System on the valuation date, unless otherwise noted. For additional information, please see the June 30, 2015 actuarial valuation of Component II issued September 28, 2016 and the June 30, 2015 actuarial valuation of Component I issued January 24, 2017. Actuarial assumptions are adopted by the Retirement Board of Trustees and the Investment Committee. In particular:

- The assumed rate of interest was 6.75%;
- The assumed VPIF (COLA) rate for Component I (Hybrid) was 0.5%;
- Wage inflation was 2.0% for first 5 years; 2.5% for next 5 years and 3.0% thereafter;
- Component II benefits were frozen as of June 30, 2014;
- Employer contributions through 2024 are fixed by plan and/or the POA approved by the Bankruptcy Court. The Board has not established a funding policy for post 2024 contributions. Changes in UAAL were amortized over alternate periods of 15 and 20 years for purposes of illustrating the magnitude of the proposed change relative to an annual contribution.

It is our understanding that benefits for current inactive, retired members, and members who entered the DROP before June 30, 2014 would not be affected by the proposed benefit changes. They were excluded from this study.

A brief summary of the data, as of June 30, 2015, used in this valuation is presented below.

Component I (Hybrid):

Group	Number Eligible	Annual Payroll/Benefits	Average in Years	
			Age	Eligibility Service
Non-DROP Active Members				
Police	1,808	$ 97,702,744	41.0	14.3
Fire	676	33,992,725	40.9	13.8
Total	2,484	131,695,469	41.0	14.2
DROP Members after 6/30/2014	118			

Component II (Legacy):

Group	Number Eligible	Annual Payroll/Benefits	Average in Years	
			Age	Eligibility Service
Non-DROP Active Members				
Police	1,785	$ 101,236,911	41.4	14.7
Fire	601	33,522,045	42.3	15.5
Total	2,386	134,758,956	41.6	14.9
DROP Members after 6/30/2014	88			

The June 30, 2015 valuation was the first valuation for which Component I data was independently submitted. In addition, FY 2015 was the first plan year of Component I. Some data for Component I had to be estimated, including the actual Component I benefits for the current 118 members DROPed in Component I. Further details on the estimates are described in the June 30, 2015 actuarial valuation of the Component I plan.

PRESENT PROVISIONS:

Component I (Hybrid): A Member shall be entitled to participate in the DROP program under Component I **for a maximum of five years**.

Component II (Legacy): Participation in the DROP program for Members who elected to participate in the DROP program prior to July 1, 2014 shall be limited to ten years. Participation for Members who elect to participate in the DROP program **after June 30, 2014 shall be limited to five years**.

PROPOSED PROVISIONS:

Component I (Hybrid): A Member shall be entitled to participate in the DROP program under Component I **for an amount of time that shall not be limited, except by any mandatory retirement provisions**.

Component II (Legacy): Participation in the DROP program for Members who elected to participate in the DROP program prior to July 1, 2014 shall be limited to ten years. Participation for Members who elect to participate in the DROP program **after June 30, 2014 shall not be limited to any amount of time, except by any mandatory retirement provisions**.

Discussion

Currently most members of the DPFRS are subject to a mandatory retirement age of 60. However, we understand that the mandatory retirement age is currently not enforced for Police members. Recent membership data indicates that very few Police members stay in employment past age 65. We have, therefore, assumed employment would end at age 65 for Police members and age 60 for Fire members regardless of the length of their DROP participation at that age.

We understand that the members and the employer expect the removal of the maximum 5-year DROP period to 1) increase participation in the DROP program, and 2) lengthen the members overall careers (for members who utilize the DROP provision). Since we have no specific data upon which to estimate the increase in members utilizing the DROP provisions or the increase in the length of DROP participation (and potential deferral of retirement) as a result of the proposed change, we have attempted to show a range of possible results by assuming two different levels of changes in behavior as a result of the proposed provision change. Our current assumptions include a 60% DROP participation rate and a 5-year DROP period subject to an age 65 (Police)/60 (Fire) maximum. The levels are described as follows:

- Level 1: Increase DROP participation from 60% to 65% and increase the average expected length of participation from 5 years to 7 years but not beyond age 60 (Police)/65 (Fire); and
- Level 2: Increase DROP participation from 60% to 75% and increase the average expected length of participation from 5 years to 10 years but not beyond age 60 (Police)/65 (Fire).

These changes in assumed behavior effectively measure the financial impact of an overall delay in actual retirement from service for members. Delaying retirement is expected to result in a lower estimate of System costs (normal costs and accrued liabilities), all other things being unchanged.

ACTUARIAL STATEMENT

The financial effect of the proposal is shown below:

	UAAL (Millions)	Employer Normal Cost	Illustrative Computed Employer Contribution Rate* (w/Amortization Period of) 15 Years	20 Years
Component I (Hybrid)				
Current (60% DROP for 5 Years)	$ 36.3	10.07%	12.47%	11.83%
Increase For Level 1 Changes (65% DROP for 7 Years)	$ (0.8)	(0.15)%	(0.22)%	(0.21)%
Increase For Level 2 Changes (75% DROP for 10 Years)	$ (2.0)	(0.37)%	(0.55)%	(0.51)%
Component II (Legacy)				
Current (60% DROP for 5 Years)	$ 858.6	N/A	$ 95.0	$ 81.3
Increase For Level 1 Changes (65% DROP for 7 Years)	$ (8.4)	N/A	$ (1.0)	$ (0.8)
Increase For Level 2 Changes (75% DROP for 10 Years)	$ (21.7)	N/A	$ (2.5)	$ (2.1)

* *Shown as a level percent of pay for Component I (Hybrid) and as a level dollar amount for Component II (Legacy). The illustrative contribution shown is assumed to be paid for the indicated amount of years beginning in the 2017 fiscal year.*

The figures shown above are based on the June 30, 2015 actuarial valuation. Please remember that these changes, if adopted, would likely impact the June 30, 2016 valuation which will be based on member data and financial results as of June 30, 2016.

See important comments on the following pages.

Comments

Comment 1 — The financial effects of the proposal represent potential long-term cost savings if more members enter the DROP and work longer than under the current provision. A range of likely results is shown, based on the assumed level of change in member behavior. However, the range is not exhaustive. If actual experience is outside the range modeled, the change in cost will be outside the range shown. In fact, if members accelerate the time at which they leave active status (to DROP or retire) as a result of the proposed change, costs could potentially increase as a result of the proposed provision.

Comment 2 — If the proposed change is adopted, we recommend the Board adopt the assumptions associated with Level 1 until such time as experience emerges. Once experience emerges, we would recommend using assumptions based on experience, to the extent it is credible.

Comment 3 — The current method of estimating amortization rates for Component I assumes the non-DROP active headcount remains constant and non-DROP payroll grows at 2% for five years, 2.5% for five years and 3.0% per year thereafter. To the extent that member behavior changes the length of time spent in the DROP, the actual non-DROP headcount and payroll growth may differ from assumed.

Comment 4 — This report does not reflect the potential impact on restoration benefits of Component II or fiscal responsibility provisions of Component I. Any change in member behavior regarding entry into DROP will likely affect the short-term growth of non-DROP payroll and therefore contributions received, since members in DROP do not make contributions. These changes will be reflected in valuations as they occur.

Comment 5 — The calculations are based upon assumptions regarding future events, which may or may not materialize. They are also based upon present and proposed plan provisions that are outlined in the report. If you have reason to believe that the assumptions that were used are unreasonable, that the plan provisions are incorrectly described, that important plan provisions relevant to this proposal are not described, or that conditions have changed since the calculations were made, you should contact the authors of this report prior to relying on information in the report.

Comment 6 — If you have reason to believe that the information provided in this report is inaccurate, or is in any way incomplete, or if you need further information in order to make an informed decision on the subject matter of this report, please contact the authors of the report prior to making such decision.

Comment 7 — No statement in this report is intended to be interpreted as a recommendation in favor of the changes, or in opposition to them.

Comment 8 — In the event that more than one plan change is being considered, it is very important to remember that the results of separate actuarial valuations cannot generally be added together to produce a correct estimate of the combined effect of all of the changes. The total can be considerably greater than the sum of the parts due to the interaction of various plan provisions with each other, and with the assumptions that must be used.

Comments

Comment 9 — This report is intended to describe the financial effect of the proposed plan changes on the Retirement System. Except as otherwise noted, potential effects on other benefit plans were not considered.

Comment 10 — The reader of this report should keep in mind that actuarial calculations are mathematical estimates based on current data and assumptions about future events (which may or may not materialize). Please note that actuarial calculations can and do vary from one valuation year to the next, sometimes significantly if the group valued is very small (less than 30 lives). As a result, the cost impact of a benefit change may fluctuate over time, as the demographics of the group changes.

Comment 11 — A determination of the Plan sponsor's ability to make contributions when due (before and/or after the proposed changes) was outside our scope of expertise and was not performed.