

DEAR ACTIVE MEMBERS AND RETIREES:

The Board of Trustees of the Policemen and Firemen Retirement System of the City of Detroit is pleased to submit to you the comprehensive annual financial report for the fiscal year ended June 30, 2003.

FINANCIAL RESULTS

This year was another difficult year for the financial markets—an unprecedented fourth such year in a row. The US stock market, as measured by the S&P 500 Index, posted a modest 0.3% gain for the year. This was a relatively good result compared to the negative returns which the stock market posted in each of the three prior years. Fixed income investments performed exceptionally well with bonds delivering a double digit total return for the year.

The overall recognized return on the invested assets of the Retirement System was a negative 6.9%. This was the result of recognition of negative returns achieved in the prior two fiscal years which had been carried forward to the current year. Without this carry forward the Retirement System earned 2.6% for the year. Superior returns from the Board's allocation to bonds and real estate propped up the meager but positive returns from stocks.

While this year's total fund investment return is disappointing,

it must be considered in a longer term context. The Board's asset allocation is built upon the foundation that the obligations of the Retirement System to pay the benefits promised to its members and retirants are very long term obligations. Accordingly, the Board of Trustees must make investment decisions which it believes will be the most beneficial to the Retirement System over many years, not just one or two years. Even though the fiscal year ended June 30, 2003 was a year of negative total fund investment returns, for the ten year period ended June 30, 2003 the total fund annualized investment return was 10.4% or 30% greater than the System's actuarially assumed rate of 7.8%.

Administrative expenses were 3.5 million, down 5% from the prior year. Investments which the Board has made in technology and infrastructure improvements have increased staff productivity and reduced administrative expenses. Administrative expenses represent approximately one tenth of one percent of the assets of the System, one of the lowest expense ratios for public employee pension funds in the country. Administrative expenses are paid entirely through investment income.

BENEFITS PAID

The Retirement System and its assets exist to pay the benefits which its members have earned.

The fund balance of the Retirement System on June 30, 2003 was 3.2 billion. During the fiscal year ended June 30, 2003 the Retirement System paid \$190,516,952 in benefits to retirants and beneficiaries, plus \$72,193,981 in lump sum defined contribution plan (annuity) benefits.

OTHER ACCOMPLISHMENTS

In addition to the financial results achieved, other significant accomplishments of the Board of Trustees and staff during this past year included:

1. The System continued publishing its newsletter twice per year, expanding its scope and content.
2. The administrative staff of the Retirement System handled over 15,000 telephone requests and personal visits from members and retirees
3. The System's internet web site (www.rscd.org) was enhanced to provide a benefit estimate function, annual reports and audit reports which are available for members of the System and has been accessed over 50,000 times to date.
4. Further enhancements to the System's state-of-the-art computer systems were implemented to support the System's internet web site as well as provide staff electronic

access to member files.

5. The System continued to provide a toll-free telephone number (1-800-339-8344).

At June 30, 2003 the System had 5,257 active employee members and 8,277 retirees and beneficiaries.

CONTENTS OF THE REPORT

This is a consolidated report of the Defined Benefit Plan and the Defined Contribution Plan of the Retirement System. The report consists of six (6) sections:

- I **INTRODUCTORY SECTION** contains the Board of Trustees letter of transmittal, lists Retirement Board members, and summarizes the Plan Benefit provisions.
- II **FINANCIAL SECTION** contains the Independent Auditors report and the financial statements of the System.
- III **ACTUARIAL & STATISTICAL SECTION** contains the results of the annual valuation and statistical tables which contain significant data pertaining to the Policemen and Firemen Retirement System.
- IV **INVESTMENT SECTION** summarizes investment activities and identifies the System's advisors and consultants.
- V **SPECIAL INFORMATION SECTION** contains the "Safe Harbor Explanation" provided

BOARD OF TRUSTEES LETTER CON'T

to recipients of distributions from qualified plans in order to satisfy section 402(f) of the Internal Revenue Code.

VI QUESTION & ANSWER

SECTION contains commonly asked Retirement System related questions.

ACCOUNTING SYSTEM AND REPORTS

These financial statements have been prepared in accordance with generally accepted accounting principles applicable to governmental units. Effective with the 1994-95 fiscal year, in accordance with standards promulgated by the Governmental Accounting Standards Board (GASB), the Board of Trustees adopted the Market Value basis of reporting for investments, replacing book value reporting. Accordingly, all schedules presented in this report reflect the changes in market value for all Retirement System assets.

REVENUES

The reserves needed to fund retirement benefits are accumulated through the collection of employer and employee contributions and from income on investments. Employer contributions for the 2002-2003 fiscal year totaled \$66,843,029 and employee contributions were \$10,143,948. At the time of ordering of printing of this report the employer had paid only \$31,874,450. The Retirement System obtained a Judgement dated December 5, 2003 in the amount of

34,968,579 which had not been paid at date of ordering of printing. The Board of Trustees will take all necessary action to collect the amount due to the Retirement System. Net investment income for the fiscal year was a negative \$240.4 million resulting in an interest credit to Defined Contribution Plan accounts (annuity) for the 2004-2005 fiscal year of 0.0%.

EXPENSES

Benefit payments are the primary disbursements of a Retirement System. Consequently, recurring benefit payments prescribed by the plan, refunds of contributions from the Defined Contribution Plan and the cost of administering the System comprise the total expenses. Administrative expenses are funded entirely from investment income.

Benefits disbursed during the 2002-2003 fiscal year totaled \$190.5 million paid to fulfill the System's recurring obligation to its retirants and beneficiaries, an \$8 million increase or 4.3% from the prior year. Defined Contribution Plan refunds were \$72.2 million. Benefits plus defined contribution plan refunds paid during the 2002-2003 fiscal year represented approximately 8.2% of the assets of the Retirement System.

FUNDING AND RESERVES

The trust funds consist of contributions and earnings that

are accumulated by the Retirement System in order to meet current and future benefit obligations to retirants and beneficiaries. A higher level of funding and a larger accumulation of assets leads to a greater potential for higher investment income. Continuous improvement in the funding of the System is the primary objective of the Board of Trustees.

As of June 30, 2003, the fund balances of the assets of the Retirement System totaled \$3.2 billion and the actuarial accrued liabilities were \$3.7 billion resulting in a funding deficit (excess of liabilities over assets) of \$516 million or 16.1% of the liabilities of the System.

INVESTMENTS

The Retirement System invests all available funds in order to maximize both current income and long-term appreciation. The primary objective of the System's investment policy is to assure that the System meets its responsibilities for providing all promised retirement benefits. The Board of Trustees invests all available funds in a diversified portfolio of investments with the objective of maximizing the overall long term appreciation of the Retirement System's assets while generating sufficient current income to pay the benefits which the members of the System have earned. The portfolio is diversified

to provide the highest possible total return on the System's assets with the least exposure to risk.

ACKNOWLEDGMENTS

The preparation of this report reflects the combined efforts of the Retirement Systems' staff under the direction of the Board of Trustees. It is intended to provide complete and reliable information as a basis for making management decisions, to disclose compliance with legal provisions, and as a means of disseminating vital and pertinent information to all active and retired members of the Policemen and Firemen Retirement System of the City of Detroit. This report is being distributed to all active members and retirees plus other interested parties.

Respectfully submitted,

Board of Trustees
Policemen and Firemen
Retirement System
of the City of Detroit

ELECTED EMPLOYEE MEMBERS:

GEORGE ORZECH
Fire Lieutenant,
Fire Department
Term expires June 30, 2003

DERRICK ROYAL
Police Officer,
Police Department
Term expires June 30, 2003

MARK KNOWLES
Fire Sergeant,
Fire Department
Term expires June 30, 2004

JOHNNY GOLDEN
Sergeant,
Police Department
Term expires June 30, 2004

WILLIAM L. FAIRWEATHER
Battalion Fire Chief,
Fire Department
Term expires June 30, 2005

LAURA ISOM
Inspector,
Police Department
Term expires June 30, 2005

EX-OFFICIO MEMBERS:

KWAME M. KILPATRICK
Mayor

ALBERTA TINSLEY-TALABI
Council Designate,
City Council

CLARENCE WILLIAMS
Treasurer

JERRY A. OLIVER SR.
Chief of Police

TYRONE C. SCOTT
Fire Commissioner

OFFICERS:

SEAN K. WERDLOW
CFO/Finance Director
Ex-officio Secretary

NICHOLAS DEGEL
Executive Secretary

WALTER STAMPOR
Assistant Secretary

ACTUARY:

GABRIEL, ROEDER,
SMITH & CO.

MEDICAL DIRECTOR:

REGINALD E. O'NEAL, D.O.

PERFORMANCE

EVALUATION:

SMITH BARNEY

LEGAL ADVISOR:

RONALD ZAJAC

REAL ESTATE

CONSULTANT:

THE TOWNSEND GROUP

MASTER CUSTODIAN:

STATE STREET CORPORATION

FULL SERVICE

CONSULTANT:

GRAY & COMPANY

SUMMARY OF PLAN BENEFIT PROVISIONS

AGE AND SERVICE RETIREMENT

ELIGIBILITY – 25 years of service regardless of age.

ANNUAL AMOUNT – An annuity equal to the actuarial equivalent of the member’s accumulated contribution account plus a defined benefit, which, when added to the annuity, will provide the following:

- **Pre-1969 Members** 2.5% of AFC times the first 25 years of service, with a maximum allowance of 15/22 of a police officer’s or firefighter’s annual rate of compensation.
- **1969 Plan Members** 2.5% of AFC times the first 25 years of service plus 2.1% of AFC times each of the next 10 years of service.

Members may elect to receive their accumulated contribution account in a lump sum after 25 years of service. The defined benefit at retirement is then reduced by the actuarial equivalent of the amount of principal withdrawn. No reduction is made with regard to the interest portion of the withdrawal.

Pre-1969 plan members may elect 1969 plan benefits at the time of retirement.

TYPE OF AVERAGE FINAL COMPENSATION (AFC) – Average of the current compensation for the ranks held in each of the last five years (last three years for DPCOA, Executive members and their Fire equivalents) plus longevity. Pension benefits for nonunion employees may not be diminished due to a reduction in compensation because of fiscal emergency. AFC includes prior longevity distributions during the averaging period in accordance with the following schedule: 1% of compensation after 5 years of service, 2% after 11 years, 3% after 16 years and 4% after 21 years.

DEFERRED RETIREMENT VESTED BENEFIT

ELIGIBILITY – Age 40 with 8 years of service, or if a DPOA Member or their Fire equivalents who terminate employment on or after August 29, 2003 with ten years of credited service regardless of age.

ANNUAL AMOUNT – Same as regular retirement but based on average final compensation and credited service at the time of termination.

BENEFIT COMMENCEMENT – Members hired prior to 7/1/85: Unreduced benefit begins at the age when the member would have first been eligible for regular retirement had the member continued in City service. **DPOA Members and their Fire equivalents hired after 6/30/85:** Unreduced benefit begins at age 62. All members may elect a reduced benefit payable immediately.

DUTY DISABILITY RETIREMENT

ELIGIBILITY – No age or service requirements.

ANNUAL AMOUNT – A basic benefit of 50% of final compensation and a supplemental benefit of 16 2/3% of final compensation. After 24 months, members disabled from any occupation continue to receive both benefits, otherwise, members receive only the 50% benefit. Upon attaining 25 years of service, members receive only the basic benefit of 50%. Members convert to regular retirement at age 65. Workers Compensation payments are offset.

Members who filed for duty disability retirement prior to July 1, 1995, for DPOA members and fire equivalents or prior to June 30, 1998, for all others receive 66 2/3% of final compensation payable to the eligibility date for regular retirement. After the eligibility date for regular retirement, benefit is computed as a regular retirement benefit. Workers Compensation payments are offset.

SUMMARY OF PLAN BENEFIT PROVISIONS CON'T

6

NON-DUTY DISABILITY RETIREMENT

ELIGIBILITY – 5 years of service.
ANNUAL AMOUNT – Computed as a regular retirement benefit, but based on average final compensation and credited service at the time of disability. Minimum benefit is 20% of average final compensation.

DUTY DEATH BEFORE RETIREMENT

ELIGIBILITY – No age or service requirement.
ANNUAL AMOUNT – Widow receives 5/11 of a patrolman's or fireman's compensation and each child under age 18 receives 1/10 of such compensation with a maximum total of 7/33 of such compensation. If there is no widow, each child receives 1/4 of such compensation with a maximum total of 1/2 of such compensation. If there is no widow or children, each dependent parent receives 1/6 of such compensation. Worker's compensation payments are offset.

NON-DUTY DEATH BEFORE RETIREMENT

ELIGIBILITY – No age or service requirement.
ANNUAL AMOUNT – Same as regular retirement benefit to a widow or dependent widower, but reduced in accordance with a 100% joint and survivor option election. Minimum benefit is 20% of average final compensation. Each child under 18 receives 1/7 of a patrolman's or fireman's compensation with a maximum total of 2/7 of such compensation. If there is no spouse or children, each dependent parent receives 1/7 of such compensation.

POST RETIREMENT COST-OF-LIVING ADJUSTMENTS

PRE-1969 PLAN MEMBERS: Allowances increase in proportion to active member compensation for the corresponding rank.
POST-1969 PLAN MEMBERS: Pensions increase by 2.25% of the **original** pension amount. LSA and DPCHA members, and their Fire equivalents, who retire July 1, 1998 or later and DPOA members and their Fire equivalents, who retire July 1, 2001 or later the 2.25% annual increase shall be compounded.

MEMBER CONTRIBUTIONS

5% of covered compensation payable until first eligible for regular retirement.