

# **Police and Fire Retirement System of the City of Detroit**

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**Financial Report  
with Supplemental Information  
June 30, 2011**

# **Police and Fire Retirement System of the City of Detroit**

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## Independent Auditor's Report

To the Board of Trustees  
Police and Fire Retirement System  
of the City of Detroit

We have audited the accompanying statement of plan net assets of the Police and Fire Retirement System of the City of Detroit (the "System") as of June 30, 2011 and 2010 and the related statement of changes in plan net assets for the years then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

Except as discussed in the following paragraph, we conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

For the year ended June 30, 2010, we were unable to obtain sufficient audit evidence supporting approximately \$103,000,000 of the System's alternative investments held at June 30, 2010, mostly related to real estate and pooled investments.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to obtain sufficient audit evidence supporting the above-mentioned investments at June 30, 2010, the financial statements referred to above present fairly, in all material respects, the financial position of the Police and Fire Retirement System of the City of Detroit as of June 30, 2011 and 2010 and the results of its operations for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis and required supplemental information (identified in the table of contents) are not required parts of the basic financial statements but are supplemental information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the required supplemental information. However, we did not audit the information and express no opinion on it.

To the Board of Trustees  
Police and Fire Retirement System  
of the City of Detroit

As explained in Note 1, the financial statements include investments valued at approximately \$910,000,000 (28 percent of 2011 net assets) at June 30, 2011 and approximately \$835,000,000 (28 percent of 2010 net assets) at June 30, 2010, whose fair values have been estimated by management in the absence of readily determinable fair values. Management's estimates are based on various methods which may include information provided by investment managers, general partners, real estate advisors, and other means.

Our audits were conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Police and Fire Retirement System of the City of Detroit's basic financial statements. The accompanying other supplemental information as identified in the table of contents is presented for the purpose of additional analysis and is not a required part of the basic financial statements. The statement of changes in plan net assets by fund included in other supplemental information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

*Plante & Moran, PLLC*

December 9, 2011

# Police and Fire Retirement System of the City of Detroit

## Management's Discussion and Analysis

### Using this Annual Report

This annual report consists of three parts: (1) management's discussion and analysis (this section), (2) the basic financial statements, and (3) required and other supplemental information. The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data. The financial statements are followed by sections of required and other supplemental information that further explain and support the information in the financial statements.

### Condensed Financial Information

The table below compares key financial information in a condensed format between the current year and the two prior years:

	Fiscal Year Ended		
	June 30, 2011	June 30, 2010	June 30, 2009
Total assets	\$ 3,717,411,629	\$ 3,474,676,111	\$ 3,661,876,658
Total liabilities	<u>337,320,028</u>	<u>456,726,876</u>	<u>609,716,040</u>
Assets held in trust for pension benefits	<b><u>\$ 3,380,091,601</u></b>	<b><u>\$ 3,017,949,235</u></b>	<b><u>\$ 3,052,160,618</u></b>
Net investment income (loss)	\$ 614,834,869	\$ 205,398,053	\$ (712,999,787)
Contributions:			
Employee	10,453,905	10,764,969	10,902,956
Employer	<u>81,642,112</u>	<u>32,808,485</u>	<u>36,151,057</u>
Total contributions	92,096,017	43,573,454	47,054,013
Benefits paid to members and retirees:			
Retirees' pension and annuity benefits	263,432,423	251,671,929	239,744,214
Member annuity refunds and withdrawals	<u>75,869,417</u>	<u>27,252,643</u>	<u>12,395,300</u>
Total benefits paid	<u>339,301,840</u>	<u>278,924,572</u>	<u>252,139,514</u>
Benefits paid in excess of contributions	(247,205,823)	(235,351,118)	(205,085,501)
Ratio of benefits paid to contributions	3.7	6.4	5.4
Other expenses	<u>5,486,680</u>	<u>4,258,318</u>	<u>4,402,828</u>
Net increase (decrease) in net assets	<b><u>\$ 362,142,366</u></b>	<b><u>\$ (34,211,383)</u></b>	<b><u>\$ (922,488,116)</u></b>

# **Police and Fire Retirement System of the City of Detroit**

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## **Management's Discussion and Analysis (Continued)**

### **Fund Overview, Membership, Governance**

The Police and Fire Retirement System of the City of Detroit (DPFRS or the "System") is a defined benefit pension plan and defined contribution plan. DPFRS exists to pay benefits to its active members, retirees, and beneficiaries. Active members earn service credit that entitles them to receive benefits in the future. Both the employer (the City of Detroit) and active members contribute to the System.

DPFRS is a relatively mature plan in that there are more retirees and beneficiaries receiving current benefits than active members. As of June 30, 2011, membership of the System consisted of 2,894 active members, 8,900 members receiving benefits, and 82 terminated plan members entitled to, but not yet receiving, benefits.

DPFRS is governed by an 11-member board of trustees (the "Board"). Six members of the Board are elected by the active membership to serve three-year terms. Expirations of terms of elected trustees are staggered. Five members serve ex-officio, these members being the mayor of the City of Detroit (or designee), the city treasurer (or deputy treasurer), one representative from the Detroit City Council, the chief of police (or designee), and the fire commissioner (or designee).

### **Contributions to the System**

Both the City of Detroit (employer) and active employees make regular contributions to the System. Basic pension and disability benefits are funded through employer and employee contributions plus investment earnings on those contributions.

The required employer contributions are determined by the System's actuaries using the entry age normal cost method. Assumptions used by the actuaries are subject to experience testing every five years.

Active employees contribute 5 percent of pay up to the date at which they are eligible for retirement. Employee contributions are maintained in separate accounts in the defined contribution plan (annuity savings fund) solely for the benefit of the contributing employee. Employee annuity savings fund accounts are credited with investment earnings equal to the rate of return earned by the System subject to minimum earnings of 0 percent. An active employee may elect to withdraw his or her accumulated contributions plus investment earnings once he or she is eligible for retirement or upon completion of 25 years of service (DPOA and fire equivalents at 20 years).

# Police and Fire Retirement System of the City of Detroit

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## Management's Discussion and Analysis (Continued)

### Benefits Paid

The System exists to pay the benefits which its members have earned. DPFRS paid out \$339 million in benefits during the year consisting of \$263 million in benefits to retirees and beneficiaries plus \$76 million in refunds of annuity savings fund balances. This represents approximately 10 percent of the net assets of the System as of June 30, 2011. Employer and employee contributions were \$93 million or 3 percent of the assets of the System. The excess of benefits over contributions is funded through investment income. The public capital markets represent the primary source of opportunities to earn investment income.

### Asset Allocation

The Board believes that the principal determinant of total fund investment performance over long periods of time is asset allocation. The DPFRS asset allocation is built upon the foundation that the obligations of DPFRS to pay the benefits promised to its members are very long-term obligations. Accordingly, the Board must make investment decisions that it believes will be the most beneficial to the System over many years, not just one or two years. The Board must also balance the desire to achieve long-term gains with the requirements of having to raise the cash to fund significant benefit payments every month.

DPFRS has established asset allocation policies which are expected to deliver more than enough investment income over a very long period of time to satisfy the obligations to pay the benefits promised to the members of the System. The following is a summary of the Board's asset allocation as of June 30, 2011:

Equities	55.0%
Fixed income	28.0%
Real estate	8.0%
Alternative investments	8.0%
Cash	1.0%

State statutes impose limitations on what fraction of the total assets of the System may be invested in assets other than government bonds, investment-grade bonds, and certain mortgages. The Board's asset allocation policies comply with these limitations.

# **Police and Fire Retirement System of the City of Detroit**

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## **Management's Discussion and Analysis (Continued)**

### **Investment Results**

Effective with the fiscal year commencing July 1, 2003, DPFRS acquired the capability to calculate investment results on an AIMR-compliant, time-weighted, GIPS method basis. This capability is utilized to calculate investment results at the total fund composite, asset class composite, managed account, sector, and individual security levels. Investment results calculated for prior periods at the total fund composite level reflected dollar-weighted returns consistent with the methods utilized by the System's actuaries. Returns presented herein have been determined using the AIMR-compliant, time-weighted, GIPS method unless explicitly stated to the contrary. All returns for periods of one year or greater have been annualized.

### **Total Fund Composite**

The DPFRS total fund composite return for the year was 13.92 percent. The financial markets have continued their recovery from the severe economic downturn that accompanied the 2008-2009 credit crises. As a result, the System continues to recover from its investment losses incurred during the recession and is showing positive returns for a second straight year. Total plan returns for the recent prior fiscal years ended June 30 are shown below:

2010	16.9
2009	-14.8
2008	-6.3
2007	17.4
2006	11.5

### **Contacting the Police and Fire Retirement System of the City of Detroit**

This financial report is intended to provide a general overview of the System's finances and investment results in relation to actuarial projections. It shows the System's accountability for the money it receives from employer and employee contributions. If you have questions about this report or need additional information, we welcome you to contact the System's office.

# Police and Fire Retirement System of the City of Detroit

## Statement of Plan Net Assets

	June 30, 2011	June 30, 2010
<b>Assets</b>		
Cash and cash equivalents (Note 3)	\$ 5,329,752	\$ 6,152,965
Investments - At fair value (Note 3):		
Short-term investments	46,104,178	80,552,840
Stocks	1,670,515,990	1,413,450,447
Bonds	547,369,053	585,261,541
Mortgage-backed securities	70,342,795	63,728,665
Mortgage and construction loans	135,312,225	146,464,663
Equity interest in real estate	410,914,734	362,177,702
Real estate investment trusts held by custodian	29,288,746	23,997,115
Pooled investments	280,811,482	247,660,427
Private placements	83,389,021	79,176,172
Accrued investment income	19,211,075	14,801,524
Contributions receivable	81,642,112	36,603,956
Receivables from investment sales	61,795,113	20,593,289
Other accounts receivable	1,073,046	929,335
Capital assets (Note 1)	1,238,895	1,476,720
Cash and investments held as collateral for securities lending (Note 3):		
Asset-backed securities	34,631,679	25,284,942
Certificates of deposit	19,102,182	12,000,324
Repurchase agreements	73,484,020	-
Commercial paper	27,138,008	-
Money market	118,546	305,458,484
U.S. corporate floating rate	118,598,977	48,905,000
Total assets	<u>3,717,411,629</u>	<u>3,474,676,111</u>
<b>Liabilities</b>		
Payables for investment purchases	26,825,265	24,667,616
Claims payable to retirees and beneficiaries	5,278,688	5,637,651
Other liabilities	5,140,413	4,474,307
Amounts due broker under securities lending agreement (Note 3)	<u>300,075,662</u>	<u>421,947,302</u>
Total liabilities	<u>337,320,028</u>	<u>456,726,876</u>
<b>Net Assets Held in Trust for Pension Benefits</b>		
(a schedule of analysis of funding progress is presented in the required supplemental information)	<u>\$ 3,380,091,601</u>	<u>\$ 3,017,949,235</u>

# Police and Fire Retirement System of the City of Detroit

## Statement of Changes in Plan Net Assets

	Year Ended	
	June 30, 2011	June 30, 2010
<b>Additions</b>		
Investment income:		
Interest and dividend income	\$ 113,698,504	\$ 127,903,231
Net appreciation in fair value	513,741,807	71,570,563
Investment expense	(17,683,842)	(15,237,023)
Securities lending income	1,028,334	1,865,072
Net gain on collateral pool	3,296,302	14,919,595
Other income	753,764	4,376,615
Net investment income	614,834,869	205,398,053
Contributions:		
Employee	10,453,905	10,764,969
Employer	81,642,112	32,808,485
Total additions - Net	706,930,886	248,971,507
<b>Deductions</b>		
Retirees' pension and annuity benefits	263,432,423	251,671,929
Member refunds and withdrawals	75,869,417	27,252,643
General and administrative expenses	5,388,530	4,169,148
Depreciation expense	98,150	89,170
Total deductions	344,788,520	283,182,890
<b>Net Increase (Decrease) in Net Assets Held in Trust for Pension Benefits</b>	362,142,366	(34,211,383)
<b>Net Assets Held in Trust for Pension Benefits - Beginning of year</b>	3,017,949,235	3,052,160,618
<b>Net Assets Held in Trust for Pension Benefits - End of year</b>	<b>\$ 3,380,091,601</b>	<b>\$ 3,017,949,235</b>

# Police and Fire Retirement System of the City of Detroit

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## Notes to Financial Statements June 30, 2011 and 2010

### Note 1 - Summary of Significant Accounting Policies

The City of Detroit (the "City") sponsors the contributory single-employer retirement plan for the Police and Fire Retirement System of the City of Detroit (the "System"). The System, which is administered by the System's board of trustees, is composed of a defined benefit component and a defined contribution component. The plans provide retirement, disability, and survivor benefits to plan members and beneficiaries. The Police and Fire Retirement System of the City of Detroit is a separate and independent trust qualified under applicable provisions of the Internal Revenue Code and is an independent entity (separate and distinct from the employer/plan sponsor) as required by (1) state law and (2) Internal Revenue Code provisions setting forth qualified plan status. The trustees of the plan have a fiduciary obligation and legal liability for any violations of fiduciary duties as independent trustees.

**Reporting Entity** - The financial statements of the System are also included in the combined financial statements of the City of Detroit as pension trust funds. The assets of the pension trust funds include no securities of or loans to the City or any other related party.

**Plan Sponsor Financial Condition** - The City of Detroit (the plan sponsor) is experiencing significant financial difficulty. In recent weeks, the mayor has announced that the City is facing a budget deficit and would need to implement severe cuts in order to balance the budget. Recently, the Department of Treasury has indicated that it will initiate a preliminary financial review of the City of Detroit's finances in accordance with Public Act 4 of 2011. Based on these facts, there is uncertainty regarding the City's ability to meet all of its future financial obligations.

**Basis of Accounting** - The Police and Fire Retirement System of the City of Detroit's financial statements are prepared using the accrual basis of accounting. Plan member contributions are recognized in the period in which the contributions are due. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

# Police and Fire Retirement System of the City of Detroit

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## Notes to Financial Statements June 30, 2011 and 2010

### Note 1 - Summary of Significant Accounting Policies (Continued)

**Methods Used to Value Investments** - Investments are reported at fair value or estimated fair value. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Mortgages are valued on the basis of future principal and interest payments. The fair value of real estate investments is based on periodic appraisals as well as the judgment of independent real estate advisors and management. Investments that do not have an established market value are reported at estimated fair value as determined by the System's management. Approximately 28 percent of the System's assets are not publicly traded and therefore do not always have a readily determinable market value. Because alternative investments are not readily marketable, their estimated value is subject to uncertainty and therefore may differ significantly from the values that would have been used had a ready market for these securities existed. The difference could be material.

**Capital Assets** - Capital assets for the System represent office equipment and furniture. Depreciation expense is calculated by allocating the net cost of the assets over their estimated useful lives.

**Use of Estimates** - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure.

**Reclassifications** - Comparative data for the prior year has been reclassified in order to be consistent with the current manner of presentation.

# Police and Fire Retirement System of the City of Detroit

## Notes to Financial Statements June 30, 2011 and 2010

### Note 2 - Plan Description and Contribution Information

At June 30, 2011, the membership of the defined benefit plan and the defined contribution plan consisted of the following:

	Defined Benefit Plan	Defined Contribution Plan
Retirees and beneficiaries receiving pension benefits	8,900	823
Terminated plan members entitled to but not yet receiving benefits	82	22
Active plan members	2,894	3,581

**Plan Description** - The System provides retirement benefits as well as survivor and disability benefits. Employees may receive cost-of-living adjustments as a percentage of their base amounts, pursuant to the collective bargaining agreement in effect at their date of retirement. The obligation to contribute to and maintain the System was established by City Charter and negotiation with the employees' collective bargaining unit.

**Contributions** - The City's policy is to fund normal costs and amortization of prior service costs. The City is required to contribute at an actuarially determined rate. Administrative costs are financed through investment earnings.

The contribution rate calculated by the actuary for 2010-2011 and 2009-2010 was 35.22 and 26.27 percent, respectively, of active member annual payroll. This computes to an actuarially required contribution of \$81,642,112 and \$57,808,485 for the two years, respectively. However, the pension system granted the City overfunding credits of \$23,000,000 in FY 2010, resulting in actual contributions from the employer of \$32,808,485 for the year ended June 30, 2010. No such overfunding credit was provided in FY 2011.

Employees are required to make contributions toward annuity savings in the amount of 5 percent of base compensation until eligibility for retirement is reached. Contributions from employees totaled \$10,453,905 and \$10,764,969 for the years ended June 30, 2011 and 2010, respectively. The contribution requirements of plan members and the City of Detroit are established and may be amended by the board of trustees in accordance with the City Charter, union contracts, and plan provisions.

# Police and Fire Retirement System of the City of Detroit

## Notes to Financial Statements June 30, 2011 and 2010

### Note 2 - Plan Description and Contribution Information (Continued)

**Annual Pension Costs** - The annual contribution for the year ended June 30, 2011 was \$81,642,112. The annual contribution was determined as part of an actuarial valuation at June 30, 2009, using the entry age cost method. Significant actuarial assumptions used include (a) a 7.5 percent investment rate of return, (b) projected salary increases of 4 percent per year, due to inflation, (c) additional salary increases of 1 percent to 5.2 percent per year based on merit and/or longevity, and (d) cost-of-living adjustments for certain members of 2.25 percent per year. Both (a) and (b) are determined using techniques that smooth the effects of short-term volatility over a three-year period and include an inflation component of 4 percent. The unfunded actuarial liability is being amortized as a level percent of payroll on a closed basis. The remaining amortization period is 27 years.

Per the actuarial report dated June 30, 2010, which will be used to determine the contributions in fiscal year 2011-2012, several assumptions have changed, including the following: an 8.0 percent investment rate of return, a seven-year smoothing of assets, and a 30-year amortization. The impact of these changes resulted in a fiscal year 2011-2012 required contribution of \$66,100,000, which is approximately \$48,000,000 less than it would have been had the assumptions remained constant.

**Funded Status and Funding Progress** - As of June 30, 2010, the most recent actuarial valuation date, the plan was 96.6 percent funded on an actuarial basis. The actuarial accrued liability for benefits was \$3,987,524,204 and the actuarial value of assets was \$3,853,279,381, resulting in underfunding of \$134,244,823. The covered payroll (annual payroll for active employees covered by the plan) was \$228,829,999.

The schedule of funding progress, presented as required supplemental information following the notes to the financial statements, presents multi-year trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Three-year trend information as of June 30 is as follows:

	Fiscal Year Ended June 30		
	2009	2010	2011
Annual pension costs	\$ 61,151,057	\$ 57,808,485	\$ 81,642,112
Percentage of APC contributed	100%	100%	100%
Net pension obligation	\$ -	\$ -	\$ -

See Note 4 for disclosure of required reserves.

# Police and Fire Retirement System of the City of Detroit

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## Notes to Financial Statements June 30, 2011 and 2010

### Note 3 - Deposits and Investments

The System is authorized by Michigan Public Act 314 of 1965, as amended, to invest in certain reverse repurchase agreements, stocks, diversified investment companies, annuity investment contracts, real estate leased to public entities, mortgages, real estate, debt or equity of certain small businesses, certain state and local government obligations, and certain other specified investment vehicles. The investment policy adopted by the Board is in accordance with Public Act 196 of 1997 and has authorized the investments according to Michigan Public Act 314. The System's deposits and investment policies are in accordance with statutory authority other than REIT and real estate asset balances under Section 19(1) and 19(2), respectively, being in excess of statutory limits by approximately 1 percent and 1.5 percent, respectively.

The System invests in various investment securities. Investment securities are exposed to various risks, such as interest rate, market, and credit risks, and overall market volatility. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and such changes could materially affect the amounts reported on the statement of changes in plan net assets.

The System's cash and investments are subject to several types of risk, which are examined in more detail below:

#### **Custodial Credit Risk of Bank Deposits**

Custodial credit risk is the risk that in the event of a bank failure, the System's deposits may not be returned to it. The System does not have a deposit policy for custodial credit risk. The System had no bank deposits (certificates of deposit, checking, and savings, etc.) at June 30, 2011 or 2010 that were uninsured and uncollateralized. The System believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all deposits. As a result, the System evaluates each financial institution with which it deposits funds and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories.

# Police and Fire Retirement System of the City of Detroit

## Notes to Financial Statements June 30, 2011 and 2010

### Note 3 - Deposits and Investments (Continued)

#### Interest Rate Risk

Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. The System's investment policy does not restrict investment maturities.

At June 30, 2011, the average maturities of investments are as follows:

Investment Type	Fair Value (\$000)	Investment Maturities (in Years)			
		Less Than 1	1-5	6-10	More Than 10
U.S. government	\$ 55,887	\$ 3,009	\$ 34,229	\$ 9,653	\$ 8,996
Government assets and mortgage backed	70,623	-	300	-	70,323
Treasuries	6,658	6,658	-	-	-
Corporate**	419,265	19,005	154,341	151,155	76,729
Other fixed income	71,838	3,199	35,788	20,279	3,072
Convertible bonds	28,738	231	19,020	2,035	7,452
Pooled and mutual funds**	58,680	-	-	-	-
Commingled bonds**	1,024	-	-	-	-
State and local obligations	139	-	139	-	-
Convertible preferred stock	8,705	1,365	6,848	-	491
Construction loans	18,616	18,616	-	-	-
Mortgages	116,696	6,355	108,831	1,510	-
<b>Total</b>	<b>\$ 856,869</b>	<b>\$ 58,438</b>	<b>\$ 359,496</b>	<b>\$ 184,632</b>	<b>\$ 167,063</b>

\*\*Not all pooled, mutual funds, corporate, and commingled bonds are subject to interest rate risk.

At June 30, 2010, the average maturities of investments are as follows:

Investment Type	Fair Value (\$000)	Investment Maturities (in Years)			
		Less Than 1	1-5	6-10	More Than 10
U.S. government	\$ 58,820	\$ 7,585	\$ 33,595	\$ 5,950	\$ 11,690
Government assets and mortgage backed	63,993	-	-	336	63,657
Treasuries	1,116	1,000	-	-	116
Corporate	448,796	6,546	200,553	153,750	87,947
Other fixed income	56,957	5,478	34,146	11,060	6,273
Convertible bonds	23,918	1,230	13,904	2,403	6,381
Pooled and mutual funds**	141,105	-	-	-	-
Certificate of deposit	2	2	-	-	-
State and local obligations	589	-	-	-	589
Convertible preferred stock**	3,594	-	2,702	-	694
Construction loans	41,453	-	41,453	-	-
Mortgages	105,012	-	94,657	10,355	-
<b>Total</b>	<b>\$ 945,355</b>	<b>\$ 21,841</b>	<b>\$ 421,010</b>	<b>\$ 183,854</b>	<b>\$ 177,347</b>

\*\*Not all pooled, mutual funds, and convertible stock are subject to interest rate risk.

# Police and Fire Retirement System of the City of Detroit

## Notes to Financial Statements June 30, 2011 and 2010

### Note 3 - Deposits and Investments (Continued)

#### Credit Risk

State law limits investments in commercial paper to the top two ratings issued by nationally recognized statistical rating organizations. The System has no investment policy that would further limit its investment choices.

As of June 30, 2011, the credit quality ratings of debt securities (other than the U.S. government) as rated by S&P are as follows:

*Quality Ratings of TSY and AGY have been assigned by The Bank of New York*

Investment Type and Fair Value (\$000)	AAA	AA	A	BBB	BB
Pooled and mutual funds	\$ 1,966	\$ -	\$ -	\$ -	\$ -
Government fixed income	-	535	-	860	-
Government assets and mortgage backed	-	-	-	-	-
Corporate fixed income	36,827	18,562	70,259	80,041	38,624
Other fixed income	614	3,889	6,965	11,038	10,200
Convertible bonds	847	468	4,161	6,834	3,934
Convertible preferred stock	-	-	-	561	254
Mortgages	-	-	-	-	-
Construction loans	-	-	-	-	-
Government agencies	849	-	-	-	-
State and local obligations	-	139	-	-	-
Total	<u>\$ 41,103</u>	<u>\$ 23,593</u>	<u>\$ 81,385</u>	<u>\$ 99,334</u>	<u>\$ 53,012</u>

Investment Type and Fair Value (\$000)	B	CCC and Below	NR
Pooled and mutual funds	\$ -	\$ -	\$ 56,714
Government fixed income	-	-	-
Government assets and mortgage backed	-	-	-
Corporate fixed income	103,665	19,480	51,806
Other fixed income	15,973	8,423	14,737
Convertible bonds	3,943	348	8,695
Convertible preferred stock	-	-	7,399
Mortgages	-	-	116,696
Construction loans	-	-	18,616
Government agencies	-	-	-
Commingled bonds funds	-	-	1,024
Total	<u>\$ 123,581</u>	<u>\$ 28,251</u>	<u>\$ 275,687</u>

# Police and Fire Retirement System of the City of Detroit

## Notes to Financial Statements June 30, 2011 and 2010

### Note 3 - Deposits and Investments (Continued)

As of June 30, 2010, the credit quality ratings of debt securities (other than the U.S. government) as rated by S&P are as follows:

*Quality Ratings of TSY and AGY have been assigned by The Bank of New York*

Investment Type and Fair Value (\$000)	AAA	AA	A	BBB	BB
Pooled and mutual funds	\$ 971	\$ -	\$ -	\$ -	\$ -
Government fixed income	-	536	-	1,175	-
Government assets and mortgage backed	-	-	-	-	-
Corporate fixed income	37,611	20,748	76,843	105,237	50,325
Other fixed income	-	3,464	7,996	9,236	5,134
Convertible bonds	511	660	4,939	4,281	-
Convertible preferred stock	-	-	-	1,138	2,715
Mortgages	-	-	-	-	-
Construction loans	-	-	-	-	-
Certificates of deposit	-	-	-	-	-
Government agencies	56,251	-	-	-	-
Treasuries	-	-	-	-	-
State and local obligations	-	-	-	-	-
Total	\$ 95,344	\$ 25,408	\$ 89,778	\$ 121,067	\$ 58,174

Investment Type and Fair Value (\$000)	B	CCC and Below	NR
Pooled and mutual funds	\$ -	\$ -	\$ 140,134
Government fixed income	-	-	-
Government assets and mortgage backed	-	-	-
Corporate fixed income	103,176	25,731	48,375
Other fixed income	15,869	8,853	15,904
Convertible investments	3,065	655	7,092
Convertible preferred stock	694	-	1,762
Mortgages	-	-	105
Construction loans	-	-	41
Certificates of deposit	-	-	2
Government agencies	-	-	-
Treasuries	-	-	116
State and local obligations	-	-	-
Total	\$ 122,804	\$ 35,239	\$ 213,531

# Police and Fire Retirement System of the City of Detroit

## Notes to Financial Statements June 30, 2011 and 2010

### Note 3 - Deposits and Investments (Continued)

#### Foreign Currency Risk

Foreign currency risk is the risk that an investment denominated in the currency of a foreign country could reduce its U.S. dollar value as a result of changes in foreign currency exchange rates. The System does not restrict the amount of investments in foreign currency.

At June 30, 2011, the following securities are subject to foreign currency risk (in \$000):

	Equity	Forward Contracts Unrealized Gain (Loss)	Cash	Fixed Income
Australian dollar	\$ 13,769	\$ 41	\$ 472	\$ -
Brazilian real	1,267	-	-	-
British pound sterling	85,186	(4,216)	290	504
Canadian dollar	21,151	5,437	114	-
Danish krone	6,860	(390)	217	-
Euro currency	118,279	(6,085)	4,607	-
Hong Kong dollar	9,616	232	29	-
Indian rupee	687	-	-	-
Indonesian rupiah	406	-	-	-
Israeli shekel	1,205	615	24	-
Japanese yen	55,998	(3,354)	263	-
Malaysian ringgit	680	-	-	-
Mexican nuevo peso	215	-	-	-
New Taiwan dollar	1,235	-	-	-
New Zealand dollar	26	-	34	-
Norwegian krone	4,594	766	101	-
New Turkish lira	-	-	2	-
Philippines peso	185	-	-	-
Polish zloty	251	-	-	-
Renminbi yuan	379	-	-	-
Russian new ruble	878	-	-	-
Singapore dollar	4,314	31	394	-
South African rand	447	-	-	-
South Korean won	1,272	-	-	-
Swedish krona	4,365	1,702	22	-
Swiss franc	29,539	1,267	261	-
Thai baht	681	-	(62)	-
Total	<u>\$ 363,485</u>	<u>\$ (3,954)</u>	<u>\$ 6,768</u>	<u>\$ 504</u>

# Police and Fire Retirement System of the City of Detroit

## Notes to Financial Statements June 30, 2011 and 2010

### Note 3 - Deposits and Investments (Continued)

At June 30, 2010, the following securities are subject to foreign currency risk (in \$000):

	Equity	Forward Contracts Unrealized Gain (Loss)	Cash	Cash Equivalent
Australian dollar	\$ 9,189	\$ 2,563	\$ 241	\$ -
Brazilian real	534	-	-	\$ -
British pound sterling	78,076	(7,810)	404	-
Canadian dollar	16,128	4,465	89	-
Danish krone	4,878	-	10	-
Euro currency	82,875	(5,367)	5,018	118
Hong Kong dollar	7,721	-	115	-
Hungarian forint	-	-	-	-
Indian rupee	1,181	-	(5)	-
Indonesian rupiah	1,092	-	29	-
Israeli shekel	218	670	13	-
Japanese yen	50,268	(12,173)	175	-
Malaysian ringgit	184	-	1	-
Mexican nuevo peso	318	-	-	-
New Taiwan dollar	387	-	3	-
New Zealand dollar	97	-	2	-
Norwegian krone	2,970	(848)	53	-
Renminbi yuan	777	-	-	-
Singapore dollar	4,189	-	177	-
South African rand	453	-	5	-
South Korean won	344	-	-	-
Swedish krona	3,217	2,346	45	-
Swiss franc	22,133	4,498	83	-
Thai baht	437	-	8	-
Turkish lira	1,001	-	15	-
Total	<u>\$ 288,667</u>	<u>\$ (11,656)</u>	<u>\$ 6,481</u>	<u>\$ 118</u>

As permitted by state statutes and under the provisions of a securities lending authorization agreement, the System lends securities to broker-dealers and banks for collateral that will be returned for the same securities in the future. The System's custodial bank manages the securities lending program and receives cash, government securities, or irrevocable bank letters of credit as collateral. The custodial bank does not have the ability to pledge or sell collateral securities unless the borrower defaults. Borrowers are required to deliver collateral for each loan equal to not less than 102 percent of the market value of the loaned securities.

# Police and Fire Retirement System of the City of Detroit

## Notes to Financial Statements June 30, 2011 and 2010

### Note 3 - Deposits and Investments (Continued)

The System did not impose any restrictions during the fiscal year on the amount of loans made on its behalf by the custodial bank. There were no failures by any borrowers to return loaned securities or pay distributions thereon during the fiscal year. Moreover, there were no losses during the fiscal year resulting from a default of the borrowers or custodial bank.

The System and the borrower maintain the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested together with the cash collateral of other lenders in an investment pool. The average duration of this investment pool as of June 30, 2011 and 2010 was 27 and 10 days, respectively. Because the loans are terminable on demand, their duration did not generally match the duration of the investments made with cash collateral. On June 30, 2011 and 2010, the System had no credit risk exposure to borrowers. The collateral held (at cost) and the fair market value of underlying securities on loan for the System as of June 30, 2011 were \$300,075,661 and \$294,780,690, respectively.

The following represents the balances relating to the securities lending transactions as of June 30, 2011 on loan:

<u>Securities Lent</u>	<u>Underlying Securities</u>
U.S. government and agencies	\$ 22,172,123
U.S. corporate fixed income	41,415,506
U.S. equities	220,536,215
Non-U.S. equities	<u>10,656,846</u>
Total	<u>\$ 294,780,690</u>

The fair market value of the collateral pool related to securities lending at June 30, 2011 was \$273,073,412. The investments were in asset-backed securities, certificates of deposit, money markets, commercial paper, repurchase agreements, and U.S. corporate securities (floating rate). Approximately 53 percent of these securities had a duration of less than one year, 41 percent had a duration between 1-5 years, and 6 percent had a duration over 15 years.

# Police and Fire Retirement System of the City of Detroit

## Notes to Financial Statements June 30, 2011 and 2010

### Note 3 - Deposits and Investments (Continued)

The credit ratings of the securities lending collateral pool held at June 30, 2011 as rated by S&P are as follows:

Ratings	Amount
AAA	\$ 32,547,440
AA	58,522,799
A	44,044,233
A-I	46,240,190
B	4,444,847
CCC	7,921,337
NR	79,352,566
Total	<u>\$ 273,073,412</u>

The following represents the balances relating to the securities lending transactions as of June 30, 2010; investments are reported at fair value:

Securities Lent	Underlying Securities
U.S. government and agencies	\$ 44,517,736
U.S. corporate fixed income	67,217,577
U.S. equities	285,936,289
Non-U.S. equities	<u>8,321,934</u>
Total	<u>\$ 405,993,536</u>

The fair market value of collateral of the securities lending at June 30, 2010 was \$391,648,750. The investments were in asset-backed securities, certificates of deposit (floating rate), money markets, and U.S. corporate securities (floating rate). Approximately 94 percent of these securities had a duration of less than one year, 1 percent had a duration between 5-15 years, and 5 percent had a duration over 15 years.

# Police and Fire Retirement System of the City of Detroit

## Notes to Financial Statements June 30, 2011 and 2010

### Note 3 - Deposits and Investments (Continued)

The credit ratings of the securities lending collateral pool held at June 30, 2010 as rated by S&P are as follows:

AAA	\$	3,829,070
AA		25,427,248
A		22,524,686
A-I		12,000,324
BBB		1,939,142
B		5,559,937
CCC		11,009,859
NR		<u>309,358,484</u>
Total	\$	<u>391,648,750</u>

**Subsequent Event - Declines in Investment Values** - Subsequent to year end, the fair value of the System's non-alternative investment portfolio at October 31, 2011 declined by approximately \$185,000,000, or 8 percent, given the overall market fluctuations. Because the values of individual investments fluctuate with market conditions, the amount of losses that will be recognized in subsequent periods, if any, cannot be determined.

### Note 4 - Reserves

The plan requires that employee contributions be segregated. In addition, amounts must be set aside as determined by the actuary to fund benefits to retirees currently approved to receive benefits. As of June 30, 2010, these reserves were less than the net assets of the Plan.

	2011	2010
Reserved for employee contributions	\$ 229,666,031	\$ 297,755,895
Reserved for retired employees	2,777,265,296	2,948,411,972

A statement of changes in plan net assets by fund is included in the other supplemental information.

# **Police and Fire Retirement System of the City of Detroit**

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## **Notes to Financial Statements June 30, 2011 and 2010**

### **Note 5 - Pension Obligation Certificates**

In June 2005, the City of Detroit issued \$1,440,000,000 of pension obligation certificates to provide funding for the unfunded actuarially accrued liability (UAAL) which existed at June 30, 2003 in both the General Employees' Retirement System of the City of Detroit and the Police and Fire Retirement System of the City of Detroit. Any future UAAL that may arise will continue to be paid by the City, as well as the annual normal cost. The proceeds of the pension obligation certificates were deposited into the System and are accounted for in the Accrued Liability Fund (pension obligation certificate reserve). Approximately \$740,000,000 was deposited into the General Employees' Retirement System of the City of Detroit and approximately \$630,000,000 was deposited into the Police and Fire Retirement System of the City of Detroit, net of issuance costs and premiums. On an annual basis, funds will be transferred from the Accrued Liability Fund reserve to the pension accumulation reserve based on a computation performed by the City of Detroit. The Accrued Liability Fund was credited with investment earnings commensurate with the overall earnings of the System.

### **Note 6 - Credit Enhancement Agreements and Funding Commitments**

The System had credit enhancement agreements totaling \$24,500,000 and \$25,000,000 during 2011 and 2010, respectively. In exchange for the credit enhancement, the System receives fees from the companies to which the enhancement agreements have been given.

When the System enters into various investments, it may not completely fund the entire investment at the beginning. Rather, it enters into commitments to fund remaining capital amounts at certain points in time. At June 30, 2011 and 2010, the remaining capital funding commitment for the System is approximately \$86 million and \$160 million, respectively.

## **Required Supplemental Information**

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# Police and Fire Retirement System of the City of Detroit

## Required Supplemental Information Schedule of Analysis of Funding Progress

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
06/30/05	\$ 3,757,894,417	\$ 3,780,447,414	\$ 22,552,997	99.4%	\$ 250,491,872	9.0%
06/30/06	3,980,254,576	3,808,952,741	(171,301,835)	104.5	228,140,160	-
06/30/07	4,307,183,758	3,896,814,229	(410,369,529)	110.5	230,173,964	-
06/30/08	4,316,263,291	4,071,053,752	(245,209,539)	106.0	232,812,606	-
06/30/09	3,945,205,453	4,221,291,045	276,085,592	93.5	231,795,528	119.1
06/30/10	3,853,279,381	3,987,524,204	134,244,823	96.6	228,829,999	58.7

# Police and Fire Retirement System of the City of Detroit

## Required Supplemental Information Schedule of Employer Contributions

Year Ended June 30	Annual Required Contribution	Contribution Made	Percentage Contributed	Transfer from Accrued Liability Reserve *
2006	\$ 57,807,332	\$ 57,807,332	100	\$ 29,859,352
2007	57,423,366	57,423,366	100	32,935,982
2008 **	58,934,636	41,113,934	70	34,074,039
2009 **	61,151,057	36,151,057	59	36,791,369
2010 **	57,808,485	32,808,485	57	41,403,282
2011 ***	81,642,112	81,642,112	100	43,874,394

The information presented above was determined as part of the actuarial valuations at the dates indicated. Additional information as of June 30, 2010, the latest actuarial valuation, is as follows:

Valuation date	June 30, 2010
Actuarial cost method	Entry age
Amortization method	Level percent
Remaining amortization period	30 years
Asset valuation method	7-year smoothed market
Actuarial assumptions:	
Investment rate of return ****	8.0%
Projected salary increases ****	5.0% - 9.2%
****Includes inflation at	4.0%
Cost-of-living adjustments	2.25%

\* In accordance with the pension obligation certificate requirements, annual transfers are made from the Accrued Liability Fund to the Pension Accumulation Reserve for the amortization of the unfunded liability that existed at the date the certificates were issued.

\*\* For the years ended June 30, 2010, 2009, and 2008, the System gave a credit to the City for the current year contributions.

\*\*\* As of June 30, 2011, these employer contributions have not been paid. However, per agreement, they will be paid within FY 2012.

## **Other Supplemental Information**

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# Police and Fire Retirement System of the City of Detroit

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## Other Supplemental Information Description of Funds

**Annuity Savings Fund** - This fund represents cumulative required and voluntary contributions made by the active employees plus accumulated interest.

**Annuity Reserve Fund** - Transfers are made from the Annuity Savings Fund into the Annuity Reserve Fund when an employee retires, becomes disabled, or if a surviving spouse elects an annuity rather than a lump-sum payout of accumulated employee contributions.

Both annuity funds are referred to as defined contribution plans.

**Market Stabilization Fund** - This fund represents designations from the plans' investment income (loss) to be used to cushion the market value adjustments within the other funds. The board of trustees authorized the creation of this fund, and the reserve amounts are calculated using a three-year average method.

**Accrued Liability Reserve Fund** - This fund originated during June 2005 when the City issued pension obligation certificates to fund the unfunded actuarial accrued liability that existed at June 30, 2003 (subject UAAL). On an annual basis, the actuary will inform the System of the amount to transfer from the accrued liability reserve to the Pension Accumulation Fund in lieu of contributions from the City for the subject UAAL.

**Survivor Benefits Fund** - This fund is used to accumulate the DPFRS employee and City contributions for certain survivor benefits from which the related benefits are paid.

**Pension Accumulation Fund** - This fund represents accumulated City contributions to the System for the payment of pensions and other benefits to future retirees. Additionally, pre-employment military service credit contributions are captured in this fund.

**Pension Reserve Fund** - This fund represents funded pension benefits available for retired members and is funded by actuarially determined transfers from the Pension Accumulation Fund.

# Police and Fire Retirement System of the City of Detroit

	Annuity Reserves		
	Annuity Savings Fund	Annuity Reserve Fund	Market Stabilization Fund
<b>Additions</b>			
Net investment income	\$ -	\$ 1,898,660	\$ 341,857,463
Contributions:			
Employee	10,453,905	-	-
Employer	-	-	-
Total additions - Net	10,453,905	1,898,660	341,857,463
<b>Deductions</b>			
Retirees' pension and annuity benefits	-	-	-
General and administrative expenses	-	-	-
Depreciation expense	-	-	-
Member refunds and withdrawals	75,869,417	-	-
Total deductions	75,869,417	-	-
<b>Net (Deductions) Additions - Before transfers</b>	(65,415,512)	1,898,660	341,857,463
<b>Transfers - Net</b>	(2,674,352)	2,239,435	(395,465,739)
<b>Net (Decrease) Increase in Net Assets Held in Trust for Pension Benefits</b>	(68,089,864)	4,138,095	(53,608,276)
<b>Net Assets Held in Trust for Pension Benefits - Beginning of year</b>	297,755,895	27,309,058	(398,810,857)
<b>Net Assets Held in Trust for Pension Benefits - End of year</b>	<b>\$ 229,666,031</b>	<b>\$ 31,447,153</b>	<b>\$ (452,419,133)</b>

**Other Supplemental Information**  
**Statement of Changes in Plan Net Assets by Fund**  
**Year Ended June 30, 2011**  
(with comparative totals for the year ended June 30, 2010)

Accrued Liability Reserve Fund	Pension Reserves			Total	
	Survivor Benefits Fund	Pension Accumulation Fund	Pension Reserve Fund	2011	2010
\$ 52,874,590	\$ 207,926	\$ 5,486,680	\$ 212,509,550	\$ 614,834,869	\$ 205,398,053
-	-	-	-	10,453,905	10,764,969
-	-	81,642,112	-	81,642,112	32,808,485
52,874,590	207,926	87,128,792	212,509,550	706,930,886	248,971,507
-	-	-	263,432,423	263,432,423	251,671,929
-	-	5,388,530	-	5,388,530	4,169,148
-	-	98,150	-	98,150	89,170
-	-	-	-	75,869,417	27,252,643
-	-	5,486,680	263,432,423	344,788,520	283,182,890
52,874,590	207,926	81,642,112	(50,922,873)	362,142,366	(34,211,383)
(43,874,394)	-	564,136,948	(124,361,898)	-	-
9,000,196	207,926	645,779,060	(175,284,771)	362,142,366	(34,211,383)
680,858,878	5,186,645	(515,453,298)	2,921,102,914	3,017,949,235	3,052,160,618
<b>\$ 689,859,074</b>	<b>\$ 5,394,571</b>	<b>\$ 130,325,762</b>	<b>\$ 2,745,818,143</b>	<b>\$ 3,380,091,601</b>	<b>\$ 3,017,949,235</b>