



CITY OF PHILADELPHIA

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April 29, 2009

Zach Stalberg, President & CEO
Committee of Seventy
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Philadelphia, PA 19103

RECEIVED APR 29 2009

Dear Mr. Stalberg:

This letter responds to your letter of March 26, 2009, which I first received from a member of the press. You ask me to review my predecessor's opinion letter of June 29, 2006, concerning the DROP program, which you say you "just received . . . after filing a request under the Commonwealth's Right to Know Act." The 2006 opinion letter, though, has been available to the public since shortly after its issuance.

For purposes of brief factual background, DROP is a program that provides a retirement benefit alternative to "employees," as defined in the Public Employees Retirement Code at 22 Phila. Code §105(14), who are eligible to retire and have completed ten years of service. A more detailed description of the program, with examples of its fiscal implications, is attached to this letter as Exhibit "A."

In his 2006 opinion letter, Solicitor Romulo L. Diaz, Jr., concluded that (i) elected officials are included within the scope of Council's DROP ordinance; (ii) once an elected official retires within four years after entering the DROP, as required by the DROP ordinance, she or he may thereafter return to service, if re-elected by the voters; and (iii) nothing in the DROP ordinance or any other law requires the official to retire for any prescribed period of time.

This Office does not normally provide legal advice to members of the public; the City Solicitor's mandate under the City Charter is to provide legal advice to City officials. The matter you raise, however, is one of significant public interest, and you have chosen to share your

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opinion request with the press. I therefore believe it appropriate for me to respond directly to your request, and I am confident that you will in turn promptly share my response with the public.

You state that the legal conclusions of the 2006 opinion do not “comport[] with a commonsense view.” My job, and that of my predecessors, is to provide legal advice—to interpret the law—and to enforce the law. My role is not to make pension policy or to determine what makes “common sense” to others. The elected officials of this City make the laws governing pension benefits. Elected officials adopted the current DROP ordinance; and elected officials must determine whether to enact the revisions to that program the Mayor recently proposed or any other changes they deem appropriate. Moreover, as far as “common sense” goes, I prefer to leave that question to the voters, who will and do decide whether to return elected officials to office, knowing full well that some of those officials have participated in DROP.

With regard to the law, however, I have reviewed carefully the opinion of my predecessor. I have also given consideration to the legal arguments your attorneys presented when we met in my office on April 8, 2009.

I agree with the reasoning and logic of the June 29, 2006 opinion. The DROP ordinance, as enacted by City Council, does not distinguish between elected officials and other City officials; does not prohibit retirement between the time of the general election and the time of re-taking office on the basis of that election; does not prescribe any particular length of retirement for an official, subsequent to participation in the DROP; and does not bar any City official from returning to City office post-retirement. Most importantly, it does not bar an elected official from returning to office after being re-elected by the people. In sum, the conduct about which you complain is not illegal.

As Solicitor Diaz explained in his opinion letter, the DROP ordinance at Section 22-310 merely requires that participants “make an irrevocable commitment to separate from City service and retire upon ceasing participation in the DROP,” and creates an entitlement to receive the DROP payment upon “separat[ion] from active service with the City.” The ordinance does not impose any requirements regarding the length of any separation or retirement. Moreover, the DROP ordinance itself contemplates the possibility that a former participant could later be rehired by the City, Phila. Code § 22-310(5)(g) (“A retiree may be re-hired by the City . . .”), and imposes no restrictions on that rehire other than with respect to any further pension benefits that may accrue.

This policy may not make sense to you, and I certainly respect your views on that issue. My job, and that of my predecessor, however, is to interpret the ordinances enacted by the Council, not to apply your or my sense of good public policy or decide whether an elected official should be returned to office by the voters. The policy-makers in this area are the elected

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officials who adopt the laws and the voters themselves. I suggest you raise your concerns with them.

Sincerely,

A handwritten signature in black ink, appearing to read "Shelley R. Smith". The signature is fluid and cursive, with the first name being the most prominent.

Shelley R. Smith
City Solicitor

cc: Honorable Michael A. Nutter, Mayor
Honorable Anna C. Verna, City Council President

EXHIBIT “A”

Deferred Retirement Option Plan (DROP)

Background on Pension Benefits

- Employee pension benefits are calculated as a monthly amount based on years worked and employee salary
- An employee must be vested to retire – currently, vesting occurs after either 5 or 10 years of service and between 50 and 60 years of age (depending on employee union)
- Employee pension benefits are currently capped at 100% of salary and service. Therefore, at a certain point, an employee's monthly pension benefit (upon retirement) cannot increase.

What is DROP?

- DROP is a program that provides a retirement benefit alternative to employees who are eligible to retire and have completed 10 years of service
- Without DROP, eligible employees have two options:
 - Option 1: Continue working and earn additional pension benefits toward monthly payments (upon retirement), assuming the employee has not reached their maximum monthly pension benefit; OR
 - Option 2: Retire and begin receiving monthly pension payments based on compensation and years of service (and, depending upon individual circumstances, seek other employment);
- With DROP, eligible employees have a third option:
 - Option 3:
 - Commit to retire within four years
 - Lock-in the amount of pension benefits earned toward monthly payments at the level in place at the time of the DROP enrollment
 - Begin accumulating the locked-in retirement benefit payments in a tax-qualified fund, accumulating a guaranteed 4.5% interest rate
 - No longer contribute to the Pension Fund
 - Upon retirement, receive locked-in monthly pension payments and the accumulated fund balance as a lump-sum

What is the Purpose of DROP?

- To encourage experienced employees to continue working, retaining their experience and training.
- To allow management to identify participants' retirement plans in order to plan for their departure. That planning allows the government to restructure in ways that can reduce the number of staff positions in government.

Who Pays for DROP?

- DROP payments are made from the Pension Fund. The Pension Fund is a combination of:
 - Employee contributions (\$51.7 Million in FY2008)
 - City contributions (\$367.3 Million in FY2008)
 - State contributions (\$59.6 Million in FY2008)
 - Pension Fund market earnings (or losses) (-\$216.4 Million in FY2008)
- The City's General Fund funds a substantial portion of the Pension Fund
 - \$367 Million in FY2008

What is the Financial Impact of DROP?

- The financial impact of an employee's participation in DROP depends on several factors:
 - The level of benefits accrued at the time an employee enters DROP versus the additional benefit not accrued because an employee has entered DROP
 - The amount of time an employee continues working once they enter DROP versus how long they would have continued working otherwise
 - The guaranteed 4.5% interest earnings on DROP payments versus the Pension Fund market earnings (or losses)

Below are Two Examples of the Financial Impact of DROP from the City's Perspective. For the purposes of the examples, the following assumptions are made: 1) the employee has a salary of \$112,000 and will not receive a salary increase in the next four years; 2) the employee has earned a monthly pension benefit payment of \$7,467; 3) the employee has maxed out his or her monthly pension benefit; 4) the employee will live for an additional 17 years; 5) it costs the City 6.657% of the employee's salary to cover its "normal" pension costs; 6) the employee serves an essential function and will be replaced upon retirement so that the City will continue to incur the cost of the employee's position.

- **Example 1: An employee enters DROP and will retire in 4 years**

Salary of \$112,000 for 4 years	\$ 448,000
DROP payment of \$7,467 for 4 years with 4.5% interest rate	\$ 392,194
Monthly pension benefit of \$7,467 for 13 years	\$1,164,852
Savings of \$7,456 for 4 years to the City's "normal" pension cost	<u>(\$ 29,823)</u>
Total Cost to the City	\$1,975,223

Each month for four years the employee is receiving her regular salary of \$112,000. At the same time, for the next four years the pension fund puts \$7,467 per month into the employee's DROP account at a guaranteed interest rate of 4.5%. The pension fund is paying her DROP amount and the general fund is paying her salary. Upon retirement, the pension fund will pay \$7,467 per month for the remaining 13 years of

the employee's life. In addition, once an employee enters the DROP the City will generate \$29,823 in savings over four years to the City's "normal" pension cost.

Note: The level of her benefits is frozen at the level that she had accrued at the point at which she enters DROP. So, if she had not maxed out her benefit, she would have received less each year than she would have if she had not entered the DROP -- in the long run that will create a savings for the pension fund. However, that savings will be offset by the fact that she is receiving her benefit for a longer period of time (since she is beginning to accrue pension payments once she enters the DROP, rather than upon retirement). Whether the pension fund will have a long-term savings or costs depends on the trade-off between what level of additional benefit she will not accrue because she has entered into the DROP and the extra cost to the pension fund of her receiving her pension benefits for an additional four years.

- **Example 2: An employee chooses to retire immediately**

Monthly pension benefit of \$7,467 for 17 years	\$1,523,268
Salary of \$112,000 for 4 years (for a new employee)	<u>\$ 448,000</u>
Total Cost to the City	\$1,971,268

The employee would begin receiving her \$7,467 monthly pension payments and they would be the same as if she had entered DROP -- except without the guaranteed 4.5% interest earnings for the first four years (the guaranteed earnings on DROP funds). At the same time, a new employee would have replaced her and would earn the same salary of \$112,000 and be accruing pension benefits. The pension fund's costs would be slightly different because it would not be guaranteeing the 4.5% interest, but it would be incurring a new liability -- the pension costs for the new employee. In this example, the general fund is paying the salary of the new employee while the pension fund is paying the original employee's monthly pension benefits.