

# *BUILDING SUCCESS TOGETHER*

SUMMARY ANNUAL  
FINANCIAL REPORT

FOR THE FISCAL  
YEAR ENDED

12.31.2012

MUNICIPAL EMPLOYEES' RETIREMENT  
SYSTEM OF MICHIGAN







**Chris DeRose**  
Chief Executive Officer

“Building Success Together” is the theme for this year’s publication. As you will see throughout this report, our priority is building on our partnership with our municipalities. By working together, we all become stronger.”

## Letter of Transmittal, June 28, 2013

### DEAR MERS PARTICIPANTS:

We are pleased to submit the Summary Annual Financial Report for the Municipal Employees’ Retirement System (MERS) of Michigan, for the fiscal year ending December 31, 2012. The information contained in this report is condensed from the audited 2012 Comprehensive Annual Financial Report (CAFR), which is available on our website, [www.mersofmich.com](http://www.mersofmich.com).

This summary presents selected information on the System’s revenues, spending and demographics in an abbreviated format.

“Building Success Together” is the theme for this year’s publication. As you will see throughout this report, our priority is building on our partnership with our municipalities. By working together, we all become stronger.

### 2012 Highlights

Our retirement trust fund at year-end held \$7.7 billion, the highest amount in our history. This makes us more cost-effective for the nearly 800 municipal organizations we partner with, and a stronger System for the almost 100,000 public employees and retirees we serve throughout Michigan. We continue to build success by focusing our initiatives in two key areas: reducing costs for our members and reducing the costs of the System. This allows us to maximize your invested funds. In 2012, we were able to reduce our planned administrative costs by \$1.5 million.

### Financial Summary

The world financial markets improved significantly, providing positive returns for the year ending December 31, 2012. The MERS portfolio earned a gross return of 11.39%. This strong performance in the financial markets, plus a significant inflow of assets from new municipalities joining MERS, increased the size of the MERS fund from \$6.6 billion to \$7.7 billion, an increase of 17%.

Many municipal governments are providing more participant directed account benefits for their employees, and MERS has innovated and expanded our benefit offerings in recent years to meet our employers’ needs. Our menu of participant directed plans includes: the MERS Defined Contribution Plan, 457 Supplemental Retirement Program, and Health Care Savings Program. In 2012, the assets in these plans grew by \$84 million to \$450 million in total assets, a growth rate of 23% for the year.

MERS also offers employer funding vehicle programs, the Retiree Health Funding Vehicle and Investment Services Program, innovative ways to help our member municipalities pre-fund benefit liability by providing access to MERS investments. These programs also experienced excellent growth in 2012, with assets growing by \$103 million to \$413 million in total funds, a growth rate of 33% for the year.

## Actuarial Summary

A measure of a municipality's funding progress is the ratio of its actuarial assets to actuarial accrued liabilities. Using this measure, most MERS municipalities remain well funded and many are very well funded. The most recent MERS actuarial valuation is as of December 31, 2011. On that date, the average funding ratio of all 706 individual MERS municipalities was 81%. This includes:

- 107 municipalities (15% of all Defined Benefit Plan and Hybrid Plan municipalities in MERS) funded at 100% or higher
- 313 municipalities (44% of all municipalities) funded at 80% or higher.
- 491 municipalities (70% of all municipalities) funded at 70% or higher.

## Acknowledgments

We are very grateful to our Board members for their tireless dedication that makes it possible for MERS to continue "Building Success Together" with our employers, members and retirees. Their conscientious oversight and diligence of our system is exemplary, and we thank them for their dedication to public service. We also express our deep gratitude to the entire MERS staff for their hard work and dedication to ensure the successful operation of MERS. Keeping MERS running as a strong organization also requires outstanding organizations and advisors who work in partnership with MERS to ensure our continued success. We also thank these talented firms and individuals for their work on our members' behalf.

**Respectfully submitted,**

**Chris DeRose, Chief Executive Officer**

**Leon E. Hank, CPA, Chief Financial Officer**

## A FOUNDATION OF SUCCESS

Our priority is building on our partnership with our municipalities, and by working together, we all become stronger. We are dedicated to building on that partnership together, through the foundational principles that guide our System.

# CHIEF INVESTMENT OFFICER REPORT

I respectfully submit the investment activity report for the Municipal Employees' Retirement System (MERS) of Michigan's Summary Annual Financial Report for the fiscal year ending December 31, 2012.

As always, our goal as prudent investors is to provide our member municipalities with excellent returns at affordable costs, while protecting the pensions and assets of our many members. Our investment returns consistently outperform our benchmarks and market averages, with a prudent, long-term approach designed to provide downside protection and upside market participation.

## Economic Overview

The effects of the global economic crisis which began in 2008 are beginning to fade, but the issues which caused what is now known as the "Great Recession," continue to play out in the global markets. Slower growth in the developed world should be expected for the near future. Last year saw several events impact the investing environment: the surprising calm of the European credit crisis, reduced volatility, the U.S. election, continued political dysfunction, and an upward movement of risk assets. Global central banking activity remained cooperative and is likely to remain so through 2014. While global markets have stabilized, some world economies will likely face challenges for the immediate future. The developed governments continue to focus on reducing debt, a process at best a third of the way complete compared to the business and consumer industries. As this process continues, expect significant market changes to present both opportunities and challenges.

## MERS Total Market Fund

Regardless of economic and financial turmoil, the defined investment objective of the MERS fund is to grow assets at a rate which, combined with contributions, covers benefits to our members. The Office of Investments strives to achieve a real rate of return of at least 3.50% annually over the rate of inflation and/or exceed the actuarial assumption rate of 8.00% annually.

## MERS 2012 highlights:

- The MERS Total Market Fund return for 2012 was 11.39% gross of investment fees, which outperformed the actuarially assumed rate of 8.00% by 3.39%.
- The MERS Total Market Fund underperformed its custom policy benchmark gross of investment fees by only 0.04%. This performance is a testament of MERS portfolio asset allocation, active management, and tactical decision-making. The MERS portfolio is specifically designed to provide downside protection during unsettled markets.
- At the broad asset class level, absolute returns gross of investment fees for the year were as follows:

Total Equity	17.88%
Real Estate	13.84%
Fixed Income	6.02%
High Yield	12.69%
Commodities	6.87%
Private Equity	0.50%
Cash	1.12%

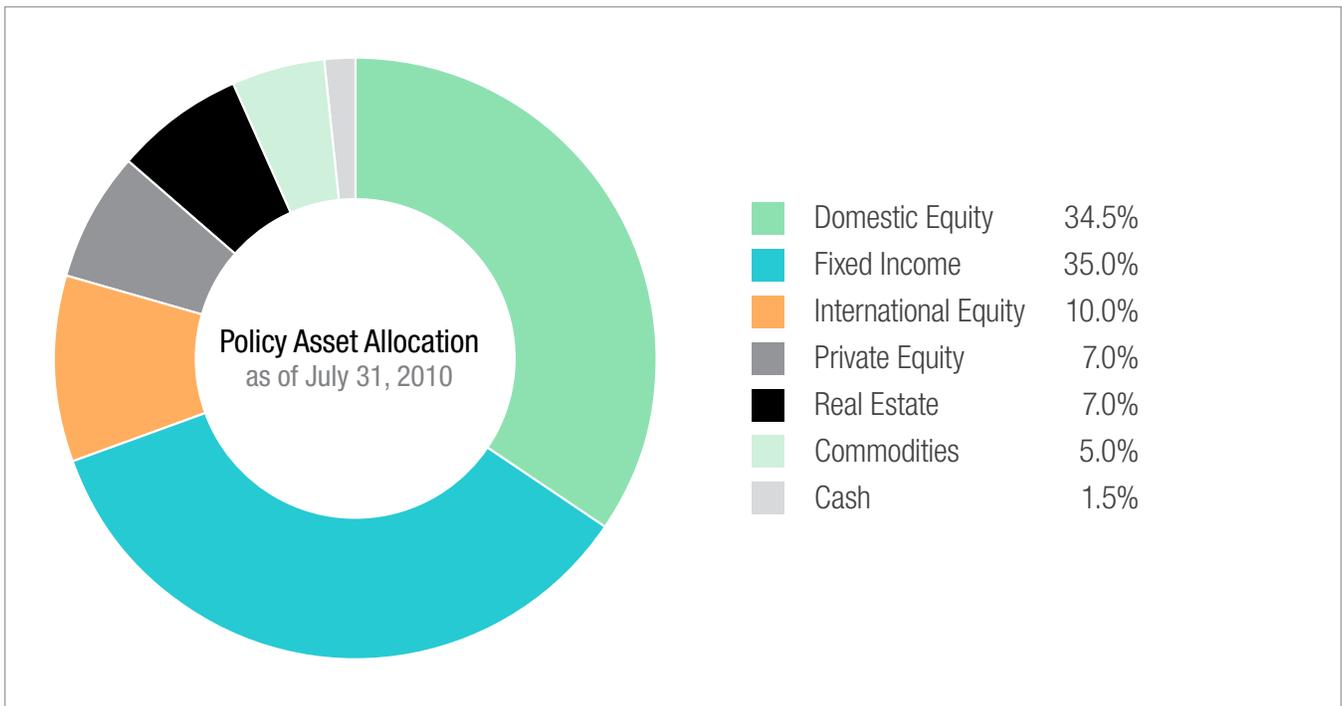
In conclusion, I would like to thank the Retirement Board, the fiduciaries of the MERS Plan, for their continued support of the Office of Investments. The clarity of MERS governance structure and the functional checks and balances has allowed the investment program to be successful for our members. This relationship makes for a more efficient decision-making process, benefiting our membership through stronger, risk-adjusted returns.

Respectfully,

**Jeb Burns, Chief Investments Officer**

## Policy Asset Allocation

The MERS Total Market Portfolio is a fully diversified portfolio combining traditional with alternative asset classes. The objective is to provide growth and income while minimizing the volatility of the capital markets.



The Office of Investments monitors the portfolio's asset allocation on an ongoing basis making strategic and tactical adjustments within the guidelines of the plan. MERS' view that a more robust portfolio-rebalancing regimen can add additional value and reduce the overall risk to the portfolio in certain market environments.

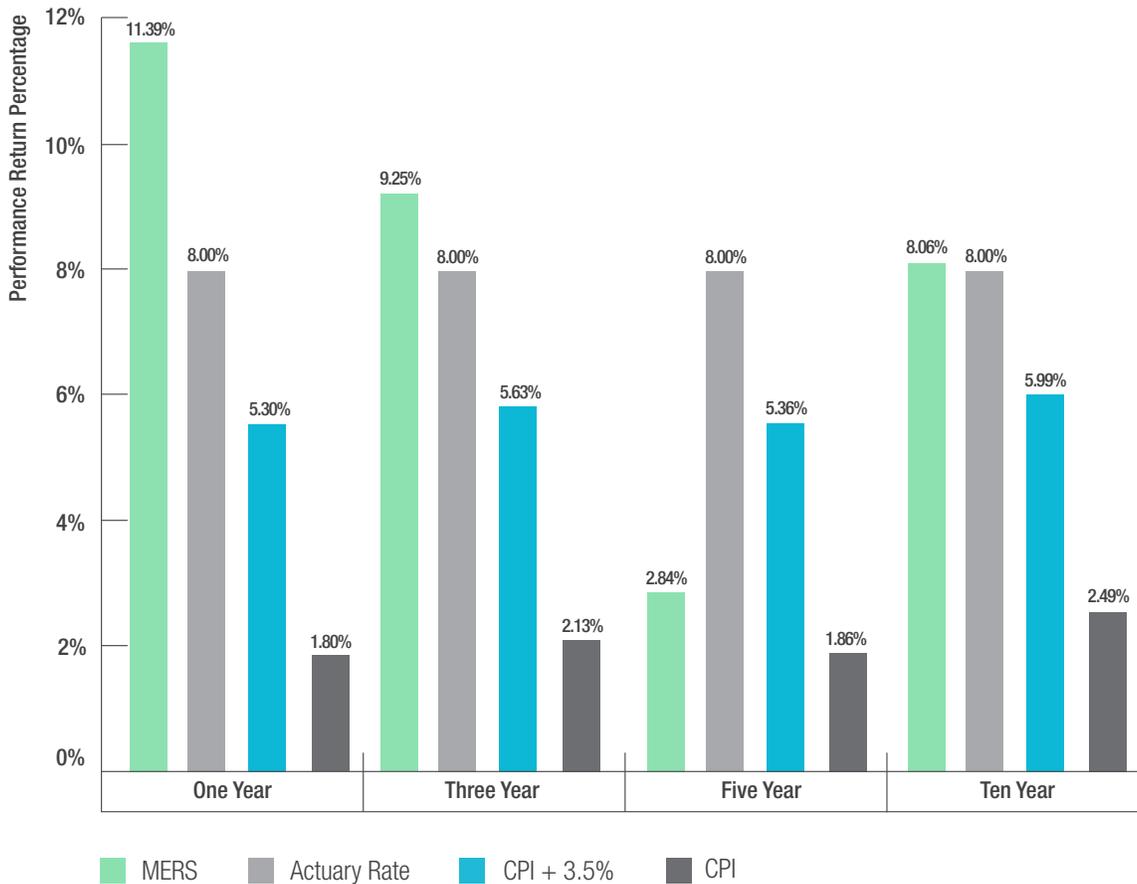
## PRUDENT INVESTMENT

Our Investments Department, under direction of the Retirement Board, provides strict oversight and due diligence of our investment managers, available investment funds for our participant-directed programs, and ensures our programs meet our standards of security and stability for our members.

## Investment Performance

The performance of the Total Market Fund was favorable when compared to the benchmark over the past 10 years. The gross return of 11.39% was above the 8% actuarial return assumption target for the year. For both the five- and 10-year periods, the gross returns were 2.84% and 8.06% respectively, which compared unfavorably to the actuarial return assumption for the five-year return and favorably for the 10-year return.

Performance Versus Custom Benchmarks as of December 31, 2012 (gross of fees)



## A TRADITION OF SERVICE

We were created by the Michigan Legislature in 1945 with one simple goal: to help municipalities offer affordable, sustainable retirement solutions for their employees. Our longevity is designed to complement the longevity of our participants, and to ensure the financial soundness and well being of our member municipalities.

## Comparison Statement of Plan Net Position (Dollars in Thousands)

	As of Dec. 31, 2012	As of Dec. 31, 2011	Increase (Decrease) Amount	Increase (Decrease) Percent
<b>Assets</b>				
Cash and Short-Term Investments	\$47,926	\$104,658	\$(56,732)	(54%)
Receivables	945,682	346,165	599,517	173
Interfund Receivables	305	276	29	11
Loans	3,932	3,816	116	3
Investments, at fair value	7,634,304	6,533,652	1,100,652	17
Invested Securities Lending Collateral	618,756	771,418	(152,662)	(20)
Other Assets/Prepays	285	223	62	28
Net Capital Assets	8,508	7,300	1,208	17
<b>Total Assets</b>	<b>9,259,698</b>	<b>7,767,508</b>	<b>1,492,190</b>	<b>19</b>
<b>Liabilities</b>				
Purchase of Investments	893,464	370,788	522,676	141
Securities Lending Collateral	620,739	776,696	(155,957)	(20)
Administrative and Investment Costs	10,197	6,250	3,947	63
Interfund Payables	305	276	29	11
<b>Total Liabilities</b>	<b>1,524,705</b>	<b>1,154,010</b>	<b>370,695</b>	<b>32</b>
<b>Net Position-Restricted for Pension and Health Benefits and Investment Accounts Held for Others</b>	<b>\$7,734,993</b>	<b>\$6,613,498</b>	<b>\$1,121,495</b>	<b>17%</b>

The Statements of Plan Net Position are summaries of what MERS owns and what it owes as of the end of the fiscal year.

## FINANCIAL HIGHLIGHTS

The following financial highlights occurred during the fiscal year ended December 31, 2012:

- Total net position for the Defined Benefit Plan\*, Defined Contribution Plan, Health Care Savings Program, Retiree Health Funding Vehicle, 457 Program, and Investment Services Program increased by 17% during 2012. MERS finished the year with \$7.7 billion in net position, \$1.1 billion higher than the previous year.
- Investment returns saw a gain of 11.39%. The 10 year return of 8.06% remains on target with MERS' expected investment rate of return of 8%.
- MERS' most recent actuarial valuation dated December 31, 2011 showed 491 of MERS 706 municipalities, funded 70% or better with 107 municipalities being over 100% funded. The average funding ratio of all 706 MERS municipalities was 81% at the latest valuation date based on the actuarial value of assets.
- Administrative expenses increased slightly by 2% in 2012 to \$26 million in a year when MERS grew significantly and brought in 131 new municipal programs. This increase is significantly lower than previous years' administrative expense increases reflecting stronger cost control measures implemented in 2012.
- Investment expenses totaled \$18 million. This is a 6% decrease from 2011 primarily due to lower investment manager fees.
- Total annual retirement benefits paid to retirees and beneficiaries increased \$63 million to a total of \$599 million.

\* Includes MERS Hybrid Plan Part I.

Comparison Statement of Changes in Plan Net Position (Dollars in Thousands)

	Year ended Dec. 31, 2012	Year ended Dec. 31, 2011	Increase (Decrease) Amount	Increase (Decrease) Percent
<b>Additions</b>				
Contributions	\$996,946	\$451,524	\$545,422	121%
Investment Net Income Investing Activities	746,132	136,531	609,601	446
Investment Net Income-Securities Lending	3,759	2,900	859	30
Miscellaneous Income	94	446	(352)	(79)
<b>Total Additions</b>	<b>1,746,931</b>	<b>591,401</b>	<b>1,155,530</b>	<b>195</b>
<b>Deductions</b>				
Benefits	598,752	536,168	62,584	12
Special Expenses and Fees	71	444	(373)	(84)
Transfers and Forfeitures	760	150	610	407
Administrative Expense	25,853	25,289	564	2
<b>Total Deductions</b>	<b>625,436</b>	<b>562,051</b>	<b>63,385</b>	<b>11</b>
Net Increase (Decrease)	1,121,495	29,350	1,092,145	3721
Net Position-Restricted for Pension and Health Benefits and Investment Accounts Held for Others				
Balance Beginning of Year	6,613,498	6,584,148	29,350	0
<b>Balance End of Year</b>	<b>\$7,734,993</b>	<b>\$6,613,498</b>	<b>\$1,121,495</b>	<b>17%</b>

The Statements of Changes in Plan Net Position summarize the flow of money in and out of the fund throughout the fiscal year.

## A COMMITMENT TO ACCOUNTABILITY

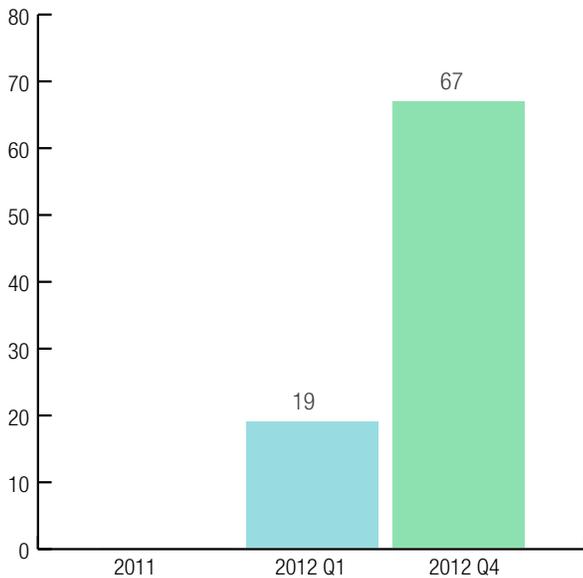
We are committed to promoting fiscally sound policies in our business practices and also to our members and participants. As trustee and fiduciary of the MERS Plan, the Board has the duty to operate on behalf of municipalities for the exclusive benefit of retirees, beneficiaries and participants.

## MERS 457 SUPPLEMENTAL RETIREMENT PROGRAM CONTINUES GROWTH

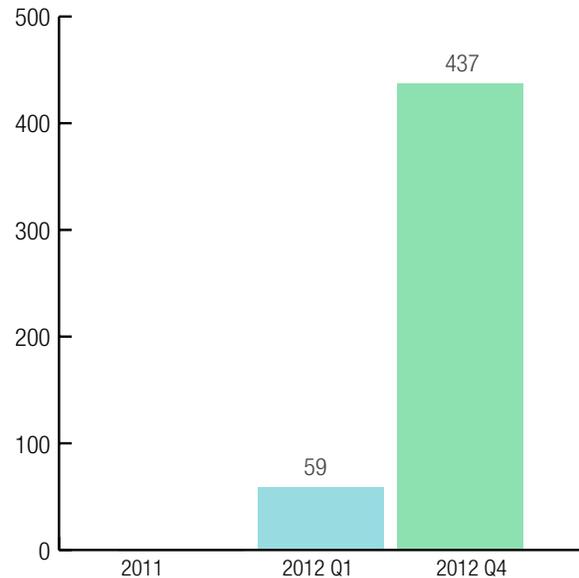
Based on the feedback and requests of our municipalities, MERS announced the MERS 457 Supplemental Retirement Program in the fall of 2011, with the official launch in 2012. In its first year, the program has grown substantially, offering employers an affordable way to help their employees save for life after the workplace.

For more about MERS 457 Program, please visit our website, [www.mersofmich.com](http://www.mersofmich.com).

MERS 457 Supplemental Retirement Program  
Participating Municipalities as of December 31, 2012



MERS 457 Supplemental Retirement Program  
Participant Accounts as of December 31, 2012



## STRENGTH - IN OUR NUMBERS

We are committed to providing quality employee benefit services to our members. Today, we proudly count nearly 800 municipal members and 100,000 participants, many of them your friends and family, your neighbors, coworkers or constituents. More than 90 percent of MERS 26,000-plus retirees stay in the state, contributing more than \$475 million to the Michigan economy each year.

MERS Membership as of December 31, 2012

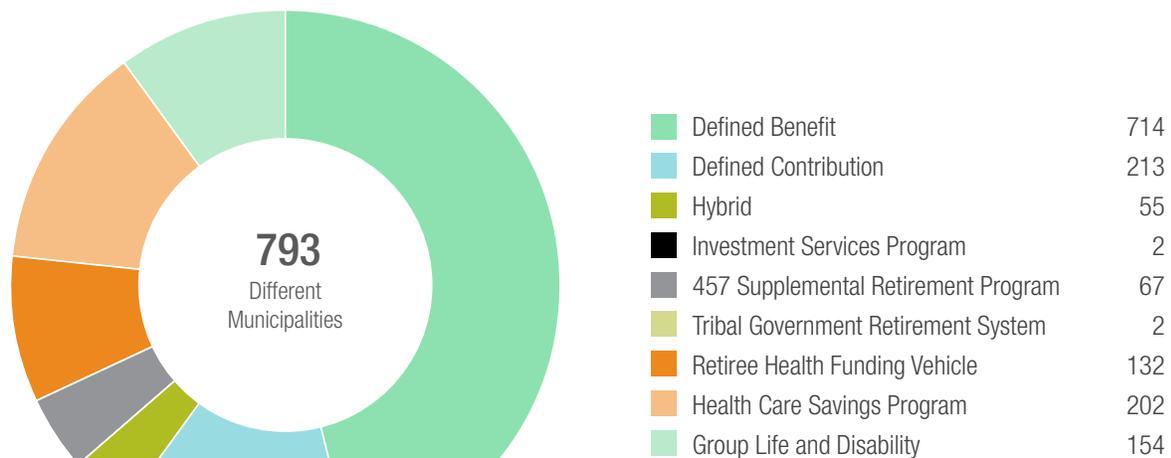
	Defined Benefit	Defined Contribution	Hybrid	Health Care Savings Program	457
Active	33,969	7,885	518	6,423	404
Deferred	7,738	NA	20	NA	NA
Retired	32,348	NA	8	NA	NA
Contributions not Vested	8,276	NA	375	NA	NA
Terminated	NA	2,325	NA	1,627	33
<b>Product Totals</b>	<b>82,331</b>	<b>10,210</b>	<b>921</b>	<b>8,050</b>	<b>437</b>

Total MERS Employment*	101,949
Total MERS Membership**	94,262

\* Total Employment represents the total number of accounts within MERS, individuals may be represented multiple times across categories

\*\* Total membership represents the number of unique individuals that have a liability in a program. At least one of the individual's employments fell into the following categories: Active Status, Retired Status, Terminated Status DB vested, Terminated Status DB not vested but has a contribution balance, Terminated Status Hybrid vested, Terminated Status Hybrid not vested but has a contribution balance, Terminated Status DC with a contribution balance, or Terminated Status HCSP with a contribution balance.

MERS Participating Municipalities (All Plans and Programs) as of December 31, 2012



Note: There are 793 different municipalities who have adopted a total of 1,541 programs; many municipalities have more than one MERS product.

Any "municipality" (a term defined by Section 2b (2) of the Retirement Act, Michigan Compiled Law 38.1502b (2)) within the state may elect to become a participating member of MERS by a majority vote of the municipality's governing body, or by an affirmative vote of the qualified electors. Changes in retirement plan coverage are available to bargaining units after approval by a majority vote of the municipality's governing body.

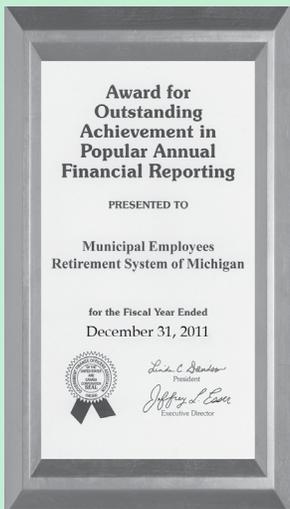


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## Award for Outstanding Achievement from the Government Finance Officers Association

MERS received the Award for Outstanding Achievement in Summary Annual Financial Reporting from the Government Finance Officers Association for the December 31, 2011, Summary Annual Financial Report. This is the ninth year MERS has received this award.



## MERS Retirement Board And Chief Executive Officer

**Back row from left to right:** Philip LaJoy, Amy Deford, James R. Wiersma, Chris DeRose, John Ogden, Randy Girard

**Front row from left to right:** Michael Brown, Lori Newberg, Sally Dreves, Michael Gilmore