

# INTRODUCTORY SECTION

MICHIGAN ROCKS!

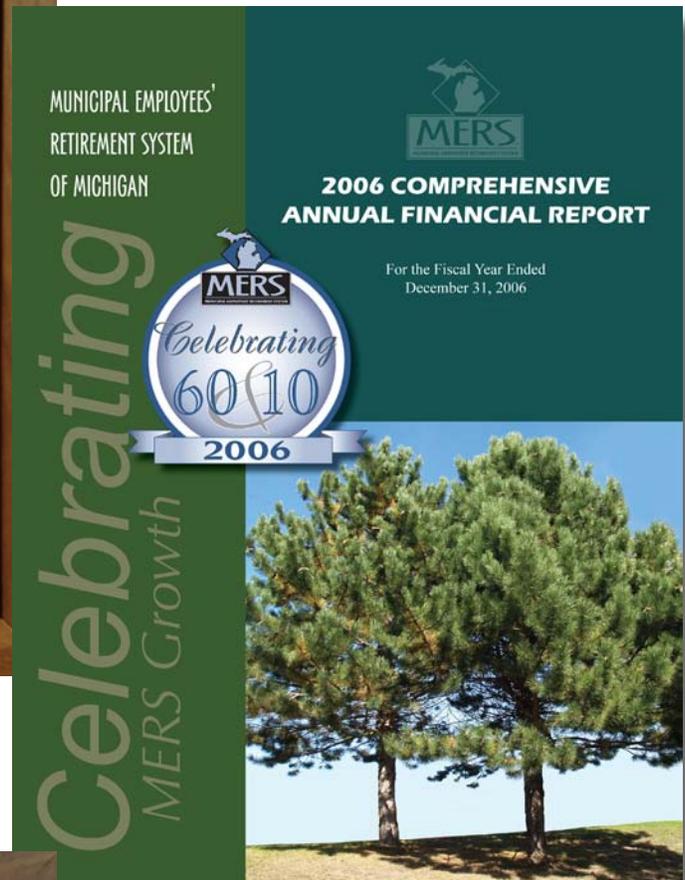
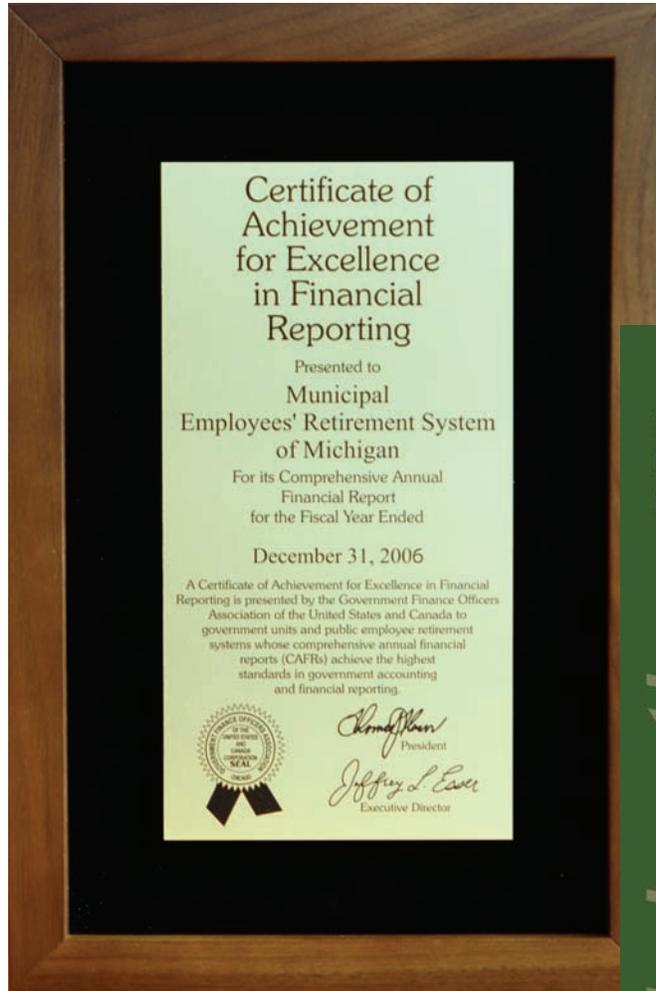


## PETOSKEY STONE

Petoskey stones are fragments of a coral reef that was originally deposited approximately 350 million years ago. When dry, the stone resembles ordinary limestone but when wet or polished, its distinctive pattern emerges. Petoskey State Park and Magnus Park are two of the few places in the state where the coral pieces can be found.

## CERTIFICATES OF ACHIEVEMENT

MERS received the Certificate of Achievement for Excellence in Financial Reporting from the Government Finance Officers Association for the December 31, 2006 Comprehensive Annual Financial Report. This marks the 19<sup>th</sup> consecutive year MERS has received this honor.



MERS also received the Public Pension Coordinating Council (PPCC), Public Pension Standards Award in 2007, in recognition of meeting the professional standards for plan design and administration as set forth in the Public Pension Standards. This award is presented by the PPCC, a confederation of the National Association of State Retirement Administrators (NASRA), the National Conference on Public Employee Retirement Systems (NCPERS), and the National Council on Teacher Retirement (NCTR).

## LETTER OF TRANSMITTAL



June 26, 2008

Dear Board Members:

I am pleased to present the 61st *Comprehensive Annual Financial Report* (CAFR) of the Municipal Employees' Retirement System of Michigan (MERS) for the fiscal year ended December 31, 2007. This financial report provides all of the required information on the financial status of our Retirement System.

MERS is a statewide voluntary organization created in 1945 by the state legislature. We gained independence in 1996 with just under 500 employer members. Currently, approximately 700 communities throughout Michigan have chosen to pool their resources with MERS to provide stable retirement plans for their employees. We continue to add new municipalities to the system with 16 new groups joining in 2007 with just over \$52 million in assets.

Our theme in 2007 was Michigan Rocks. This theme was chosen to reflect our membership because, like the rocks and minerals that are found throughout the landscape of Michigan, MERS is diverse, strong, and comes in all shapes and sizes. MERS has unique and rare gems – our members.

Two years ago, the MERS Retirement Board created an Ends Policy to provide clear strategic direction to the system. This policy identifies the initiatives crucial to MERS endeavors that will have a positive effect on the local Michigan communities and the world at large. The Board selected three Ends as follows: all employers and employees 1) will have accurate information, 2) experience excellent service and 3) participate in pooled benefits that are cost-effective and innovative. These Ends have been used to develop benchmarks to measure the performance of the system.

With these specific Ends in mind, we formulated a comprehensive plan to meet the Board's objectives. We offer educational opportunities, satisfaction surveys and various innovative strategies to improve costs and add value. With these pilot objectives, MERS continues to grow and pursues new ideas and programs specifically designed to benefit all of our members.

Examples of growth may be found in the **Introductory Section**. This section includes the Letter from the Chairperson of the Retirement Board, the GFOA Certificate of Achievement, administrative organizational details, and a review of MERS activities covering Defined Benefit (DB) Defined Contribution (DC) and MERS Group Health Solutions.

The following sections are included in this document:

- **Financial Section.** Management's Discussion and Analysis (MD&A) report of the independent auditor, and the Retirement System's financial statements and supplemental information for the DB plan.
- **Investment Section.** Summary of investment activity, an explanation of investment policy, portfolio performance information, and various investment schedules for both the DB and DC plans.
- **Actuarial Section.** Actuary's Certification Letter and summaries for the DB plan.
- **Statistical Section.** Statistical information on all plans. The responsibility for the accuracy and completeness of the financial data and the fairness of the presentation rests with the Chief Executive Officer and the management of MERS.

### Financial

The basic financial statements have been prepared in accordance with Generally Accepted Accounting Principals (GAAP) applied on a consistent basis as promulgated by the Governmental Accounting Standards Board and its predecessor, the National Council on Government Accounting. The Management's Discussion and Analysis (MD&A) provides a narrative introduction, overview and analysis to accompany the basic financial statements. This Letter of Transmittal is designed to complement the MD&A and should be read in conjunction with it. The MD&A can be found in the Financial Section immediately following the independent auditor's report (see page 14).

### Investments – Defined Benefit Portfolio

The U.S. economy began to reflect the stresses imposed by the sub prime and housing credit market problems which first surfaced in the spring of the year. With new home sales sliding by 70% at year-end, the equity markets declined. In response, the Federal Reserve Board lowered the federal funds rate by 150 basis points to 3%. The weakened U.S. dollar provided an opportunity for U.S. companies to reap gains in overseas sales. Supported by the global economic growth, commodities, global fixed income and infrastructure, investments posted strong returns in the portfolio.

MERS Defined Benefit (DB) portfolio, with \$6.5 billion in assets, ranked in the 38th percentile for the five-year period ending 12/31/07 in the Northern Trust universe of public funds. The universe is comprised of 42 plans with a total market value of \$380 billion, with a median market value of \$4.1 billion.

The DB portfolio maintains a well-diversified posture. It is positioned to take advantage of market movements. For the fiscal year-end, the portfolio gross return was 8.57% for the one-year period and 8.2% for the ten-year period and outperformed its policy benchmark for the three-year period by 31 basis points. These positive returns assist in meeting our actuarial assumption rate of 8% and a real rate of return of +3.5% to the Consumer Price Index.

The Board's investment policy is reviewed annually with a consistent focus on preserving the Retirement System's assets while maximizing the long-term growth of those assets. They maintain a focused discipline policy on the asset allocation of the portfolio. The allocation model is determined after extensive

examination of risk and return profiles approximately every five years. The portfolio is rebalanced annually to the selected allocation weightings. In 2007, the allocation to commodities rewarded the portfolio with returns of 34.48%. The Board's Investment Committee retains oversight and approval authority for any tactical recommendations by the MERS Investment staff.

### **Funding**

The December 31, 2005 Actuarial Valuation reports the consolidated funding to be an increase from 76.05% in 2005 to 76.43% in 2006. The increase was attributable to investment experience, new municipalities and benefit provision changes. All of the effects of the unfavorable investment markets in 2000-2002 were offset by MERS very favorable returns in 2003, 2004 and 2006. MERS receives no state funded contributions. Each member municipality is legally responsible for funding the pensions earned by their employees under the provisions of the Michigan Constitution and the MERS Plan Document. Each municipality is a separate trust account in MERS. The pension obligations are paid from that account. MERS does not fund or borrow from one municipality's account to cover another municipality's obligation to pay its pensioners.

### **Group Health Solutions Programs**

In 2003, MERS expanded into the health care arena by introducing a Group Life and Disability insurance program. This program has 126 member municipalities and allows the members to collectively purchase various life and disability insurance products through The Standard Insurance Company of Portland, Oregon.

The Health Care Savings Program (HCSP) and Retiree Health Funding Vehicle (RHFV) followed closely behind. These programs continued to grow over the past year: HCSP with 83 municipalities and growth of \$3 million to end the year with approximately \$10 million in assets. RHFV grew by \$67 million to end the year with over \$113 million in assets and 68 municipalities.

MERS Premier Health, with its own duly elected board, provides group health coverage for public employers including employee and retiree medical, prescription drug, dental and vision benefits. It is a municipal risk pool regulated and authorized by the State of Michigan as the first public Multiple Employer Welfare Arrangement (MEWA) in Michigan. The year closed with 1,891 contracts or approximately 4,500 lives in the program.

Michigan continues to lead the country with the highest unemployment rate. The budget problems at both the state and local level plague the Michigan taxpayer. MERS continues to provide economies of scale to our members, continuity of service and remains firmly committed to provide solutions in a variety of ways. We are dedicated to improving the health and economic welfare of our members.

### **Education**

With the development of a comprehensive education plan, MERS staff continues to explore how to use technology to reach our members. We hosted regional meetings, retirement seminars, municipality meetings and the Successful Retirement Seminar (introduced in 2006). Members attending these events increased this year. Regional meetings cover pension, benefits, health care, and insurance topics of interest for employers and employees. Retirement seminars review MERS basics and are intended for members contemplating retirement in the next three to five years. The Successful Retirement Seminar is designed to cover aspects of interest in retirement including financial planning, Social Security and health care.

### **Technology**

MERS Automated Pension System (MAPS) was scheduled for completion by year-end with plans to enter the testing phase in early 2008. This project has been an enormous undertaking because the new software is replacing the current PeopleSoft pension administration software. The goal of the project is to expand our capabilities to capture information, eliminate redundant entry and achieve superior data integrity.

MERS Information Technology (IT) staff work aggressively to expand web-based capabilities. They continuously examine security-enhanced software and on-line services for our current and prospective members. We are proactive in turning to technology to address the needs of our members and the system.

### **Awards**

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to MERS for its Comprehensive Annual Financial Report for the year ended December 31, 2006. This was the 19th consecutive year that MERS has achieved this prestigious award.

In order to be awarded the Certificate of Achievement, a governmental unit must publish an easily read and efficiently organized comprehensive annual financial report. This report must satisfy GAAP and applicable legal requirements. A Certificate of Achievement is valid for a period of one year only. We believe this current report continues to meet the Certificate of Achievement requirements, and we are submitting it to the GFOA to determine its eligibility.

### **Acknowledgments**

This report reflects the best combined efforts of the MERS staff under the leadership of the MERS Retirement Board. I deeply appreciate the staff's efforts in creating another outstanding report. I also want to extend my appreciation to the Retirement Board for their tireless efforts and dedication to the task of overseeing the system. Their conscientious service is exemplary to the staff and members of the system. I am also grateful to the many organizations, advisors and individuals who work diligently to assure the success of the Municipal Employees' Retirement System of Michigan.

Respectfully submitted,

Anne M. Wagner  
Chief Executive Officer

## LETTER FROM THE CHAIRPERSON



June 26, 2008

Dear Board Members:

On behalf of the MERS Retirement Board, it is my pleasure to present the *62nd Comprehensive Annual Financial Report (CAFR)* of the Municipal Employees' Retirement System of Michigan for the fiscal year ended December 31, 2007. This financial report provides information on the status of our retirement system.

This past year we saw significant changes to the Retirement Board's members with the retirement of three Board members: Raymond Klosowski, employee delegate from Isabella County on July 1, Harold Hailey, officer delegate from Ingham County on October 1, and Dale Walker, officer delegate from the city of Cadillac on December 1. The delegates at the Annual Meeting elected Mrs. Beverly Crumley, administrative assistant to the city manager at Sault Ste. Marie, to finish the last year of a three-year term left vacant by Mr. Klosowski. The Retirement Board appointed two members to serve until the election at the 2008 Annual Meeting: Mr. Randy Girard, township manager of Marquette, and Mr. Michael Brown, county administrator for Barry County. The Board selected Mr. Larry Opelt, the retiree Board member, to serve as the Board chairperson.

MERS nine-member Retirement Board is comprised of three employer and three employee members elected by the membership; two expert consultants and one retiree member appointed by the Retirement Board. These individuals work conscientiously to fulfill their fiduciary responsibilities and serve the membership. MERS is fortunate to have trustees with such diverse backgrounds, expertise and experience.

The allocation and diversification of the Defined Benefit portfolio provides the ability to take advantage of market movements. It was a key component in delivering a net return for the one-year period in 2007 of 8.57% and 8.2% for the ten-year period. These positive returns exceeded our actuarial assumption rate of 8% and real rate of return of 3.5% over the Consumer Price Index. The Board's investment policy is reviewed annually with a steadfast focus on preserving the retirement system's assets while maximizing the long-term growth of those assets.

Educational seminars and regional meetings with MERS members played a significant role last year for the system's participants. The MERS staff works diligently to provide excellent service to all of our member municipalities, whether by on-site visits or answering questions through the MERS Call Center. Over 5,000 members have attended some type of educational meeting conducted by the MERS staff. The Successful Retirement Seminar, introduced in the spring of 2006, is a comprehensive approach to assist our members with various issues as they approach retirement. Such topics include Social Security, health care, and

financial planning. This seminar was repeated four times in 2007 to sold-out crowds. The MERS in-house retirement seminars cover MERS basics and are intended for those members contemplating retirement in the next three to five years. Regional meetings cover pension, benefits, health care, and insurance topics of interest for employers and employees.

The Retirement Board conducted an annual review of their Board Governance Policy in July. This Policy provides the Board the necessary framework to be fully participatory in measuring the strategic outcomes of the system while assigning the internal staff to perform the daily tasks of running the system. The Board adopted three Ends Policies which drive the strategic initiatives of the system. The Board reviews department reports quarterly to ensure that these policies are being met and goals are being achieved. The Ends state that all employers and employees of the system shall have accurate information, experience excellent service and participate in cost-effective, innovative measures. An education manager was hired to assist in developing a robust curriculum for both the internal staff and external members. Service was defined with goals for the staff to achieve, namely visiting every member municipality. Delivering information and assistance in formulating retirement benefit solutions for members is the goal for the staff in Employer Services.

In closing, I wish to express my appreciation to the Board members and the staff for their continued high level of commitment and service to the system's participants. The dedication and excellence these individuals bring ensures that the promises made for retirement are kept and resources are available when needed. MERS continues to grow and develop as a healthy, well-funded retirement system. *Our present is your future* is not just a statement but the true vision we share for the future. It is a pleasure to serve as MERS chairperson.

Sincerely,

Larry Opelt, Chairperson  
MERS Board of Trustees

## MERS RETIREMENT BOARD – 2007



*From left to right:* Sally Dreves, Beverly Crumley, John Ogden, Larry Opelt, Randy Girard, Sue Stahl, Michael Brown, Dennis Murphy, Anne Wagner, Bruce Johnson – *Not Pictured*

### **Officer Members**

John Ogden  
Michael Brown  
Randy Girard

### **Employee Members**

Sally Dreves  
Beverly Crumley  
Sue Stahl

### **Public Members**

Dennis Murphy  
Bruce Johnson

### **Retiree Member**

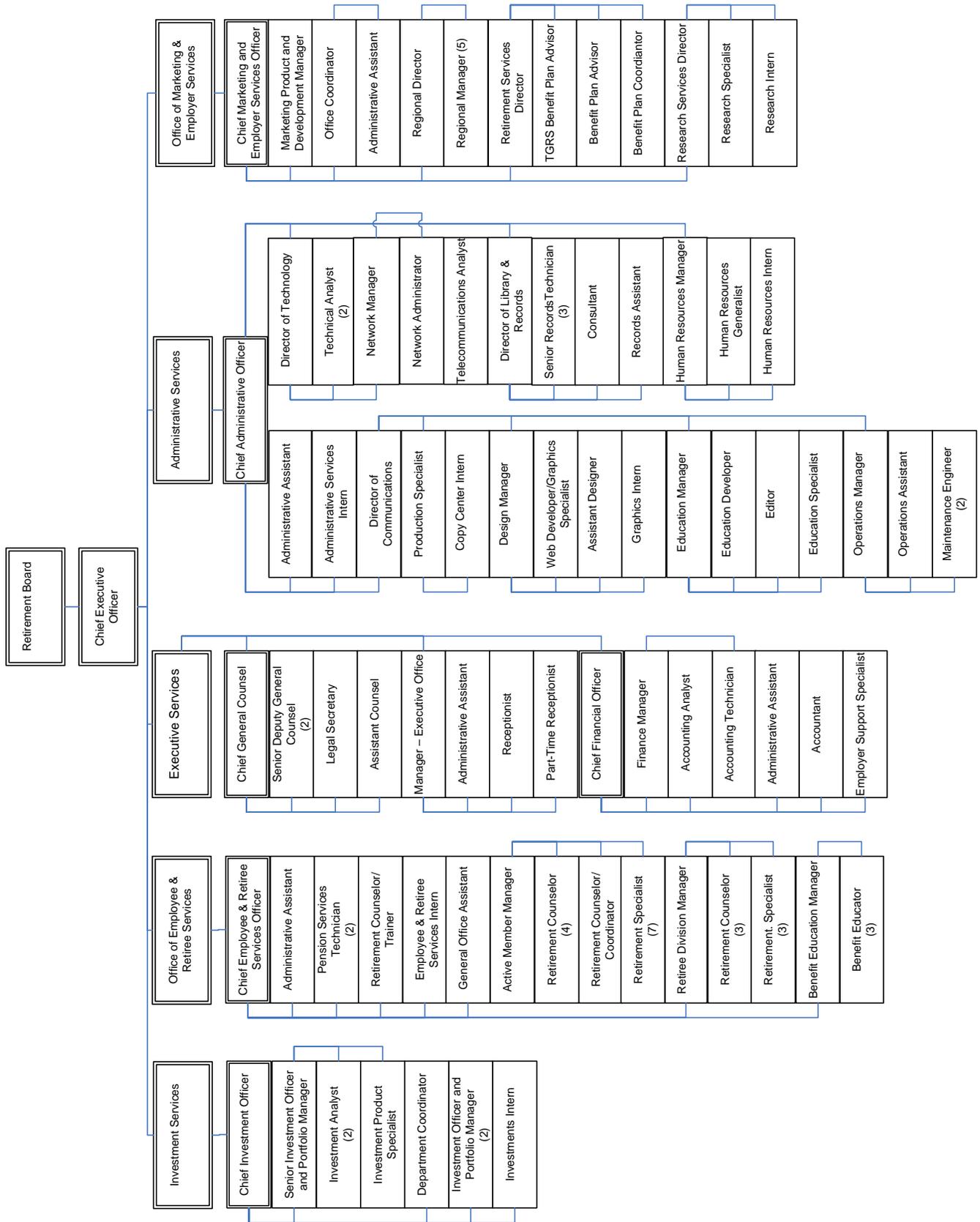
Larry Opelt

## MERS OFFICERS – 2007

*From left to right:* Jeb Burns, Caryn Mateer, Mike Moquin, Anne Wagner, Carrie Lombardo, Luke Huelskamp, Debra Peake



ORGANIZATIONAL CHART – 2007



## OUTSIDE PROFESSIONAL SERVICES

### Professional Consultants

#### *Actuary*

Gabriel, Roeder, Smith & Company

#### *Actuary Auditor*

Segal Company

#### *Auditor*

Andrews, Hooper & Pavlik, PLC

#### *Defined Contribution Third-Party Administrator*

International City/ County Management  
Association Retirement Corporation (ICMA-RC)

#### *Investment Custodian*

The Northern Trust Company

#### *Legal Counsel*

Ice Miller

Loomis, Ewert, Parsley, Davis & Gotting  
Miller, Canfield, Paddock & Stone, PLC

#### *Legislative Consultants*

Karoub Associates  
Matt Wesaw

#### *Medical Advisor*

Consulting Physicians

#### *Security Lending Agent*

The Northern Trust Company

#### *Systems Implementation and Maintenance*

Gabriel, Roeder, Smith & Company  
Oracle / PeopleSoft

#### *Third-Party Administrators*

Omega Recordkeeping Group, LLC

### Investment Managers

#### *Domestic Equity*

Ariel Capital Management  
C. S. McKee  
Delaware Investment Advisors  
Kennedy Capital Management  
Johnson Investment Counsel  
LSV Asset Management  
Wellington Management Company

#### *International Equity*

Acadian Asset Management  
Barclays Global Investors  
Mondrian Investment Advisors

#### *Fixed Income*

Barclays Global Investors  
Evergreen Investments  
Reams Asset Management  
Stone Harbor Investment Partners  
Western Asset Management

#### *Real Estate*

Townsend Group Consultants  
AMB Institutional Alliance  
Blackstone Real Estate Partners  
CB Richard Ellis Investors  
Colony Capital  
FIA Timber Partners  
Guggenheim Structures Real Estate Fund  
J.P. Morgan Investment Management  
KBS Realty Advisors  
LaSalle Investment Management  
Prudential Property Management  
Square Mile Partners  
Starwood Capital Group  
UBS Realty Investors, LLC  
Hancock Timber Resources  
Urdang Investment Management

#### *Private Equity*

Credit Suisse CFG  
Barclays Global Investors  
Mesirow Capital Partners

#### *Commodities*

Cargill Risk Management