

MUNICIPAL EMPLOYEES' RETIREMENT SYSTEM OF MICHIGAN

'09 GROWTH IN MOTION

2009 comprehensive annual financial report | for the fiscal year ended 12.31.2009

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Anne M. Wagner – Chief Executive Officer

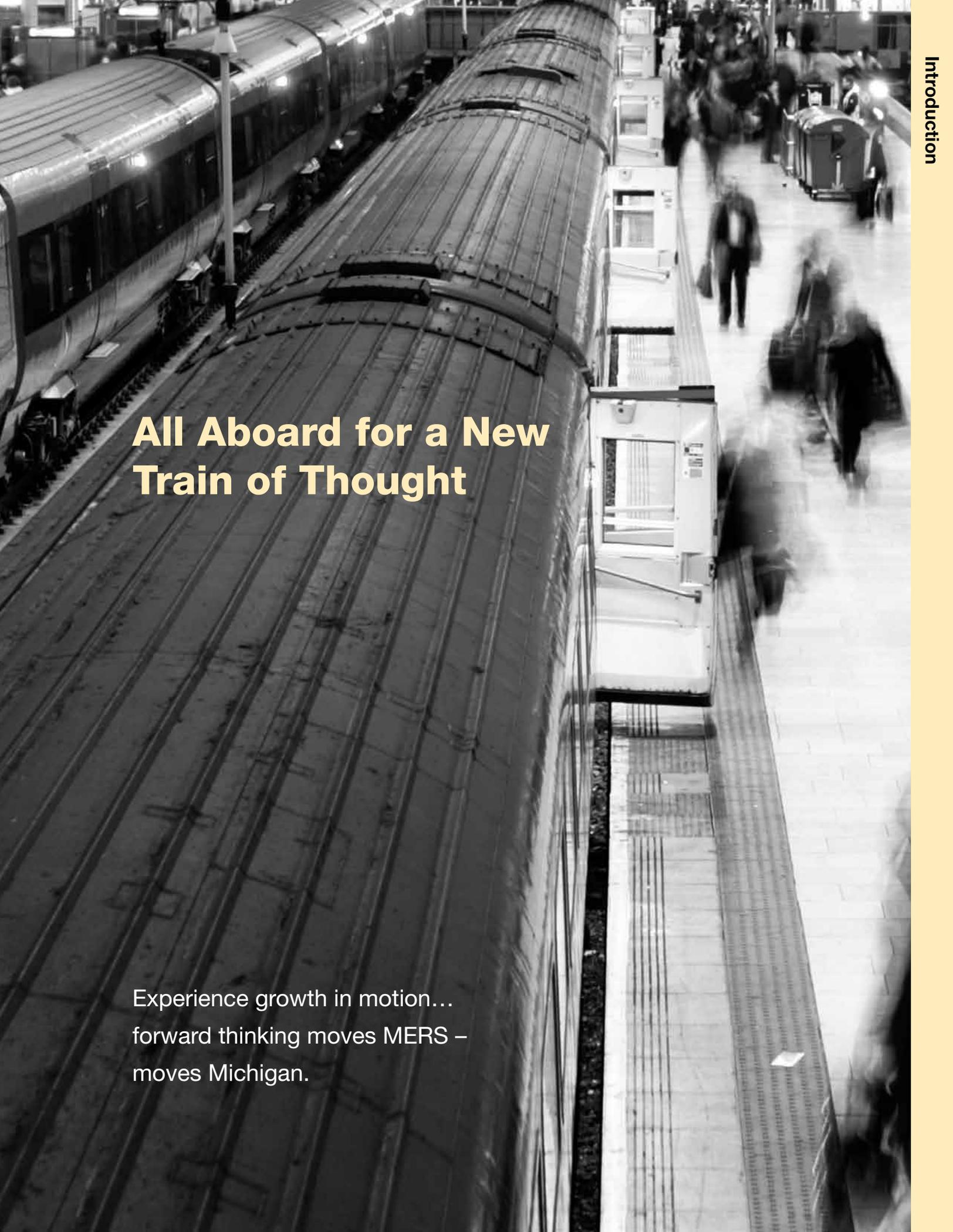
Luke Huelskamp – Chief Financial Officer

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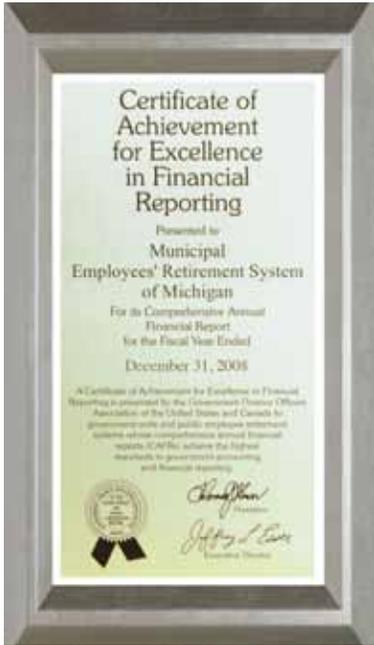


All Aboard for a New Train of Thought

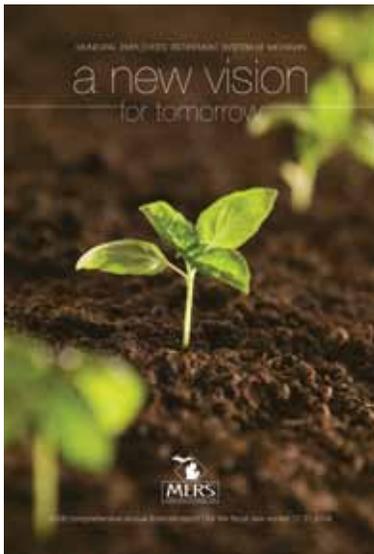
Experience growth in motion...
forward thinking moves MERS –
moves Michigan.

ACHIEVEMENTS

2009



MERS received the Certificate of Achievement for Excellence in Financial Reporting from the Government Finance Officers Association for the December 31, 2008 Comprehensive Annual Financial Report. This marks the 21st consecutive year MERS has received this honor.



MERS also received the Public Pension Coordinating Council (PPCC), Public Pension Standards Award in 2009, 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 30, 2010

Dear Board Members:

It is a pleasure to submit the *2009 Comprehensive Annual Financial Report* (CAFR) for the Municipal Employees' Retirement System of Michigan (MERS). This report contains important financial information regarding MERS activities during the fiscal year, ending December 31, 2009.

The activities outlined in this report demonstrate that we are well on our way to accomplishing the strategic goals set by the Retirement Board. These goals are designed to ensure all members receive accurate information, experience excellent service, and participate in a cost-effective, innovative retirement system. This is achieved by professional plan administration and sound investment practices. We continuously strive to exceed our member's expectations in all areas related to our products and services.

Our theme for 2009 is *Growth in Motion*. This theme reflects our continued growth over the last 64 years. Just like a train, MERS keeps on moving and delivering for our members. We are dedicated to working hard to provide excellent service, security, and solutions. We believe that what we do every day contributes to the future success of our members. The theme reflects our rich past and promising future and echoes our vision, "*our present is your future.*"

MERS primary objective is to protect the financial future of our current and former members. Following the meltdown of the financial markets beginning fall of 2008, and into the better part of 2009, the markets gradually improved toward the end of the fiscal year. Although the economy has not fully recovered from recession woes, as evidenced by a national unemployment rate around 10 percent and continued mortgage defaults. Institutional investors, though, have exhibited amazing resiliency in their ability to maintain equilibrium and withstand market volatility.

Report Structure and Contents

MERS is responsible for the integrity and fairness of the information presented in this report. This CAFR has been prepared in compliance with the reporting requirements as stipulated by Michigan Complied Laws. The accounting policies followed in preparing the financial statements conform to U.S. Generally Accepted Accounting Principles (GAAP). The financial information incorporated throughout this report is consistent with the displayed financial statements. Where necessary, some figures are based on judgments and estimates using industry best business practices.

While the ultimate responsibility for this financial report rests with the Retirement Board, the staff and I assist with the

responsibilities. All necessary steps are taken to provide a system of internal controls and supporting processes to ensure transactions are authorized, assets safeguarded, and all supporting records are properly retained and managed. Controls cover a range of internal activities including, but not limited to, hiring and training staff, assessing and following proper processes, and communicating policies and guidelines to the members. Internal controls are reviewed and upgraded through an internal audit program. This includes a charter and list of all the required audits. Results are reported directly to the Retirement Board.

“Our theme for 2009 is Growth in Motion. This theme reflects our continued growth over the last 64 years. Just like a train, MERS keeps on moving and delivering for our members.”

Our external auditor, Andrews Hooper & Pavlik P.L.C. has conducted an independent audit of the financial statements in accordance with Generally Accepted Auditing Standards (GAAS). The Independent Auditor’s Report is described in the Financial Section. My management staff has provided the external auditors with unrestricted access to staff to discuss the audit and related findings. This process is repeated annually to ensure the independent substantiation of the plan’s financial reporting, and the sufficiency of our internal controls.

In addition to the *Financial Section*, this report includes an *Introductory Section* listing the system’s achievements and structure. The *Investment Section* reports investment activities and performance information. The *Actuarial Section* contains all the facts pertaining to the actuarial

assumptions and methods, as well as the actuary’s certification letter. Lastly, the *Statistical Section* provides schedules for the various aspects of the system, including a list of all our participating municipalities.

MERS Profile

We are a statewide voluntary organization created in 1945 by the Michigan Legislature for the purpose of providing retirement benefits to employees of local government. We administer benefit provisions for each member municipality through pension trust funds. The Retirement Board serves as the fiduciary, providing oversight responsibilities for the system. Annually the Retirement Board approves the budgets for the administrative and investment divisions. The Board’s governance policy requires a budget amendment for all amounts that exceed the approved budget, including staff expansions.

In 1996, the system was granted independence by a vote of the Michigan Legislature, and our member employers. Today MERS manages over 1,000 plans and programs, including Defined Benefit Plans, Defined Contribution, Hybrid, Health Care Savings, Retiree Health Funding Vehicles, Group Life and Disability, and an Investment Savings Program. We continue to grow with 75 employers adopting one or more of these benefit programs in 2009, bringing in over \$191 million in assets.

Retirement Board Governance Policy

The Retirement Board’s governance policy is reviewed and revised annually. It is comprised of four main sections: Ends Policies, Limitations on the CEO, the Board and CEO Relationship, and the Board’s Processes. With regard to processes, policies covering harassment and media

coverage were approved for inclusion this year. Succession planning and ethics were also updated and approved by the Board.

Ends Policies

The Board examined their established Ends Policies, namely providing all our members with accurate information, excellent service, and participation in a cost-effective, innovative system. The Board determined to keep them as the system's global goals.

These policies are the central focus of the governance model and provide the staff with a framework for the annual development of strategic initiatives. In the summer months, strategic planning retreats are held specifically to assess gaps, first with the Strategic Planning Group (SPG), comprised of our officers and managers, followed by the Retirement Board.

There are many discussions on the best course of action needed to implement the Ends Policies across our four business sectors namely, culture, processes, marketing results, and idea trends. Initiatives are identified within each sector to note which will improve and promote progress toward the Ends. Goal progress is measured by collecting data and reporting to the Board using a scorecard format. The data produced uses a baseline of information to report the status of initiatives and the resulting impact on members.

In 2009, as an outgrowth of these discussions, three new groups were formed using MERS staff to assist with project ideas and execution: Distributed Innovation Group (DIG) –focuses on identifying new trends and ideas. Enterprise Integration Group (EIG) has the task of managing all software projects requiring technology resources and IT support. Expanded Capabilities (ExCap) identifies

all the touch points of transition for new municipalities and new products.

2009 Initiatives

The following projects were identified as the year's main initiatives for 2009: Medicare Advantage program, Defined Contribution Request For Information (RFI); software projects included Customer Relationship Management (CRM), Human Resources software, Finance and Accounting software, and member portals. All projects are in various stages of development at the end of the fiscal year.

The Medicare Advantage program was launched in November after selecting Humana Medicare Plans as the program provider. By year-end, 103 Medicare retirees were enrolled in the program.

The Defined Contribution RFI project was completed in the fall after an extensive look at candidates capable of filling the role as MERS third-party administrator. The current contract with ICMA-RC continues.

Education Initiatives

Continuing to provide our membership with solid educational offerings was also a key initiative for us. The Learning Division launched two on-demand, computer-based 10-Minute Trainers for employers accessible through the MERS website. The first trainer, "Annual Actuarial Valuation" provides a better understanding of the valuation report (used by 42 members during the year), the second entitled "Naming and Changing Your Beneficiary" is used to assist members with understanding their retirement beneficiary provisions.

In addition, the Learning Division developed internal training for staff and worked with the Office of Employee and Retiree Services to provide materials for

member workshops and seminars. The Defined Benefit Retirement Process and Successful Retirement Seminars continued to be very successful during the year, and were attended by approximately 400 members. The benefit education specialists held 257 on-site employer visits, covering over 1700 employees. There were 1,578 DB retirements processed, 3,473 retirement benefit estimates completed, 2,910 applications for new members, and 31,304 member calls placed to the Call Center.

“Investment performance greatly improved in the latter part of 2009. The portfolio returned +17 percent on a net basis.”

Technology Enhancements

In addition to the new and ongoing initiatives, we continued to look at technology to enhance the member experience. The Information Technology (IT) staff worked to develop a Missing Membership Application to help identify municipalities that have not submitted membership forms for new hires. The program generates an e-mail to notify the municipality when a specific application is missing.

The IT staff has worked diligently to provide online tools and software to ensure accurate information and excellent service; including CRM, and the finance and accounting software.

Work also began in the fall to design the requirements needed for both employer and employee member portals. The expected rollout is fall 2010.

MERS Retirement Solutions

During 2009, five new employers and nine divisions from existing employers joined the Defined Benefit Plan with assets of \$99 million. The Defined Contribution Program grew by three new employers and 17 divisions from existing employers with a total of \$28.9 million in assets. The Hybrid Program added two new employers and five divisions from existing employers with new start-up monies of \$20,000.

The first two Native American Tribes joined MERS Tribal Government Retirement System: the Pokagon Band of Potawatomi is located in Southwestern Michigan with tribal government functions in Dowagiac. The Lac Vieux Desert Band of Chippewa is located in Watersmeet, the western most region of the Upper Peninsula.

Investments

Investment performance greatly improved in the latter part of 2009. The portfolio returned +17 percent on a net basis. Our actual returns for the one-year, three-year, five-year, and ten-year periods can be found on page 58.

The financial markets continued to wobble due somewhat to weak economic news. Any minor improvement resulted in stock market gains. By year-end, the southern part of Europe was beginning to show the strains of excessive government debt. Business in the United States began a slow climb to recovery, as the weaker dollar made U.S. products cheaper to overseas buyers.

As trading improved, our Investments staff rebalanced the portfolio in compliance with the target policy bands, and maintained fund liquidity throughout the crisis. The staff manages 13.8 percent of the portfolio

internally, using equity indexes and short-term fixed income strategies.

The Board's investment policy is reviewed annually, focusing on preserving the system's assets while maximizing long-term growth. This policy takes a disciplined approach regarding the selection of allocation percentages to asset classes by creating a diversified portfolio. The allocation model is determined after an extensive review of risk and return profiles from the various asset classes. Over the course of the year, allocations to equity and cash were rebalanced. The Board's Investment Committee retains oversight and approval authority for tactical recommendations by our internal Investments staff.

Group Health Solutions

Group Life and Disability Insurance Programs (GL&D) This program allows MERS members to collectively purchase various life and disability insurance products through our partnership with The Standard Insurance Company of Portland, Oregon. GL&D has grown to over 120 groups, adding 19 employers in 2009. By removing the outside intermediary, we were able to improve the pricing to our member employers.

Health Care Savings Program and Retiree Health Funding Vehicle

In response to GASB requirements to disclose funding liability on Other Post-Employment Benefits (OPEB), we created the Health Care Savings Program (HCSP) and Retiree Health funding Vehicle (RHFV). These programs continue to grow: HCSP added 31 new employers and 22 new divisions with assets in excess of \$16 million, RHFV added 15 employers with over \$48 million in assets. As of December 31, 2009, HCSP and RHFV had 139 and 104 active programs, respectively.

MERS Premier Health

Due to declining membership and increased competition from high-deductible plans, we decided to close the Premier Health program. Discontinuation of the program will be completed in early 2010, following all the required processes as outlined by the State of Michigan Office of Financial and Insurance Regulation.

Summary of Financial Information

The basic financial statements have been prepared in accordance with Generally Accepted Accounting Principles (GAAP), applied on a consistent basis as promulgated by the Governmental Accounting Standards Board and its predecessor, The National Council on Governmental 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.

Actuarial Overview

Funding

The December 31, 2008 actuarial valuation reports the consolidated funding of all MERS member municipalities to be a decrease from 77.3 percent to 75.0 percent. This decrease is almost entirely attributable to the investment experience of 2008. We receive no state funded contributions. Each member municipality is legally responsible for funding the pensions earned by the employees under the provisions of the Michigan Constitution, and the MERS Plan Document. Each municipality has a separate trust account and pension obligations are paid from that account. We do not fund or borrow

from one municipality's account to cover another municipality's obligation to pay its pensioners.

Awards

We received the following awards for 2009:

Certificate of Achievement for Excellence in Financial Reporting

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 (CAFR) for the fiscal year ended December 31, 2008. This was the 21st consecutive year we have achieved this prestigious award. The Certificate of Achievement is awarded to a governmental unit that publishes an easy-to-read and efficiently organized CAFR. The report must satisfy GAAP and applicable legal requirements. The Certificate is valid for one year only. We believe this CAFR continues to meet the Certificate of Achievement requirements, and we are submitting it to the GFOA to determine its eligibility for another certificate.

Public Pension Standards Award

We received the Public Pension Coordinating Council (PPCC), Public Pension Standards Award in 2009. This award is for public pension plans who meet professional standards for plan design and administration as provided 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).

Acknowledgments

This report is the culmination of efforts from the staff and advisors working under your leadership. The intent of this report is to provide complete and reliable information regarding MERS in order to assist in the management-making decision process. It also serves as a means for determining compliance of legal requirements, and allows for the accurate and complete evaluation of responsible stewardship for the entire system. Again, this year as in the past, we received an unqualified opinion from the independent auditors on the financial statements in this report. This opinion can be found on page 13.

Copies of the CAFR are provided to the Governor, State Auditor General, and members of the Michigan Legislature. We hope all recipients find the information instructive and useful.

My sincere appreciation goes to the entire MERS staff for their unflinching efforts to ensure the successful operation of the system. A special note of thanks goes to you as members of the Board, for your commitment and wisdom in overseeing the system. In addition, I would like to extend my appreciation to the many organizations, advisors, and individuals who work in partnership with MERS to assist our efforts in managing the system.

Respectfully submitted,

Anne Wagner

Chief Executive Officer



LETTER FROM THE CHAIRPERSON

June 18, 2010

Dear Board Members:

On behalf of the MERS Retirement Board, it is a pleasure to present the 63rd Comprehensive Annual Financial Report (CAFR) of the Municipal Employees' Retirement System of Michigan for the fiscal year ended December 31, 2009. This financial report provides information on the status of our retirement system.

During the Annual Meeting of the Retirement System held September 15-17, 2009, at the Amway Grand Hotel in Grand Rapids, the member delegates duly elected Mr. John Ogden and Mrs. Lori Newberg to three-year terms on the Board. Mr. Ogden, finance director for the City of Port Huron, will serve as the officer member, and Mrs. Newberg, Employee Services Coordinator for Ingham County, will service as the employee member. I was appointed as the retiree Board member for the three-year term beginning January 1, 2010, and was elected to serve as the Board's chairperson for a one-year term. Ms. Sally Dreves will serve as vice-chairperson. Congratulations to all of these fine individuals as they continue their excellent service to the retirement system.

The Retirement Board is comprised of nine-members, three employer and three employee members elected by the membership; two expert investment professionals and one retiree member appointed by the Board, works diligently

to fulfill their fiduciary responsibilities and serve the membership. MERS is fortunate to have trustees with such diverse backgrounds, expertise and experience.

The system weathered the disastrous market downturn caused by the collapse of the financial markets in 2008. The markets remained fairly illiquid into the early months of 2009. MERS retained enough cash to ensure that pensions were paid on time without selling assets at a loss. Gradually, as the economic news began to improve,

“MERS Investment Policy is reviewed annually with a fixed goal of preserving the system's assets and maximizing the long-term growth of those assets.”

the equity markets began to appreciate, and trading resumed to a more normal level. This resulted in the portfolio returning 17.3 percent for the fiscal year, trailing the policy benchmark by six percent as the markets rebounded faster than the rebalancing to the asset targets could prudently occur.

MERS Investment Policy is reviewed annually with a fixed goal of preserving the system's assets and maximizing the long-term growth of those assets. Every five years an asset allocation study is undertaken. In 2010, the study will

examine all aspects of risk and portfolio construction.

MERS surveys the membership annually on ways to improve the system. The staff consistently receives high marks from our members for their level of service, as well

“Our members can be confident that we remain focused on providing accurate information, excellent service, and a cost-effective, innovative system for all members to enjoy.”

as their ability to manage the many complex Defined Benefit, Defined Contribution, and Hybrid Programs. The staff works diligently with our members to arrive at suitable retirement solutions in order to meet their needs.

In closing, I would like to take this opportunity to thank the members of the Board and the staff for their unwavering commitment to provide expertise and professionalism to our members during a very tough financial environment. MERS vision statement “*our present is your future*” reflects that what we do every day is important for the future of all our members. Our members can be confident that we remain focused on providing accurate information, excellent service, and a cost-effective, innovative system for all members to enjoy. It is my pleasure to serve as MERS chairperson.

*Sincerely,
Larry Opelt, Chairperson
MERS Board of Trustees*



MERS Retirement Board and Chief Executive Officer – 2008/2009

Back row: Ms. Sally Dreves, Ms. Beverly Crumley, Mr. Bruce Johnson, Mr. James Wiersma, Mr. Michael Brown, Mr. John Ogden, and Ms. Lori Newberg. **Front row:** Mr. Larry Opelt, Ms. Anne Wagner, and Mr. Randy Girard.

Officer Members: John Ogden, Michael Brown, Randy Girard

Employee Members: Sally Dreves, Beverly Crumley, Lori Newberg

Public Members: Bruce Johnson, James Wiersma

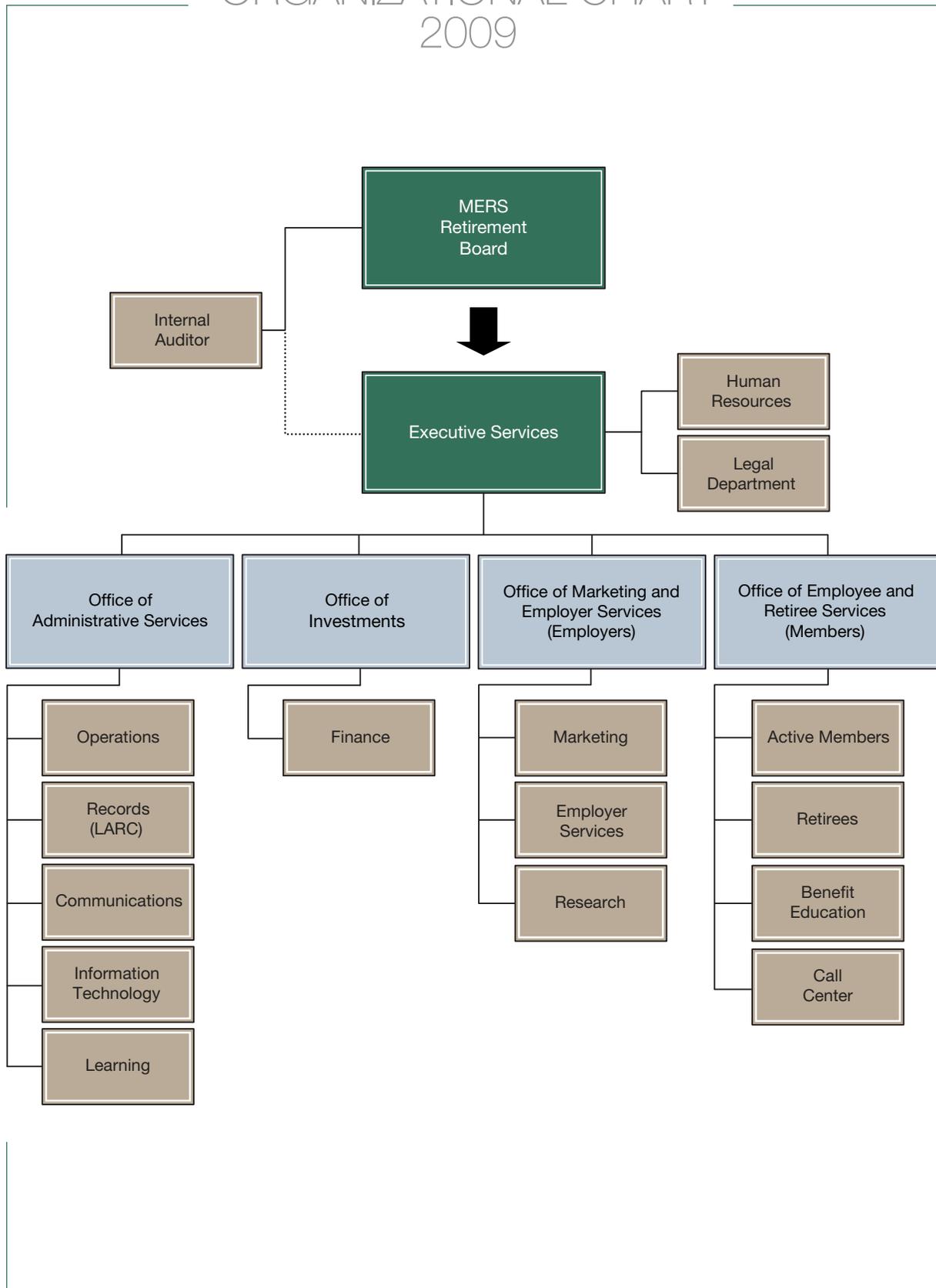
Retiree Member: Larry Opelt, Chairperson



MERS Officers – 2009

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

ORGANIZATIONAL CHART 2009



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

State Street Bank and Trust Company

Legal Counsel

Ice Miller, LLP

Miller, Canfield, Paddock & Stone, PLC

Legislative Consultants

Karoub Associates

Medical Advisor

Consulting Physicians

Security Lending Agent

State Street Bank and Trust Company

Systems Implementation and Maintenance

Tegrit Financial Group

Oracle/People Soft

Third-Party Administrators

Tegrit Administrators, LLC

Investment Managers

Domestic Equity

AMBS Investments

BRC Investment Management

C.S. McKee

Delaware Investments

Kennedy Capital Management

Wellington Management

International Equity

Acadian Asset Management

Barclays Global Investors

Driehaus Global Growth

Hexam

Mondrian Investment Advisors

Fixed Income

Barclays Global Investors

C.S. McKee

Credit Suisse

First International Advisors

Reams Asset Management

High Yield

Stone Harbor

Stone Tower

Real Estate

The Townsend Group

AMB Institutional Alliance

ARA Fund Management

Blackstone Real Estate Partners

CB Richard Ellis Investors

Colony Investors

FIA Timber Partners

IL & FS Investment Managers

J.P. Morgan

LaSalle Investment Management

Prudential Real Estate Investors

Square Mile Capital Management

Starwood Capital

UBS Realty Investors

Hancock Timber

Urdang Capital Management

Private Equity

Credit Suisse

Mesirow Capital Partners

Commodities

Cargill Risk Management

Mount Lucas