# Michigan Christmas Trees

### Did You Know?

- Michigan ranks third in the nation for the number of Christmas trees harvested, supplying approximately three million fresh trees each year
- Michigan produces more than a dozen Christmas tree varieties, more than any other state
- Approximately 42,000 acres are used for Christmas tree production
- For every Christmas tree harvested, Michigan farmers plant three new trees

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# Independent Auditor's Report

Municipal Employees' Retirement System of Michigan Retirement Board:

We have audited the accompanying statement of plan net assets of the Municipal Employees' Retirement System of Michigan as of December 31, 2010, and the related statement of changes in plan net assets for the year then ended. These financial statements are the responsibility of the management of the Municipal Employees' Retirement System of Michigan. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year comparative information has been derived from the 2009 financial statements and, in our report dated June 29, 2010, we expressed an unqualified opinion on those financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Municipal Employees' Retirement System of Michigan's internal control over financial reporting. Accordingly, we express no such opinion. 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 the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the Municipal Employees' Retirement System of Michigan as of December 31, 2010, and the changes in plan net assets for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 29, 2011, on our consideration of the Municipal Employees' Retirement System of Michigan's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Financial statements include summarized prior year comparative information. Such information does not include sufficient detail to constitute a presentation in conformity with U.S. generally accepted accounting principles. Accordingly, such information should be read in conjunction with the financial statements for the year ended December 31, 2009, from which summarized information was derived.

AUBURN HILLS | BAY CITY | GRAND RAPIDS | GREATER LANSING | MIDLAND | SAGINAW

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# INDEPENDENT AUDITOR'S REPORT

## Municipal Employees' Retirement System of Michigan

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis, Schedule of Funding Progress, Schedule of Employer Contributions, and Notes to the Schedules of Required Supplementary Information be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information included in the Schedule of Administrative Expenses, Schedule of Investment Expenses, and the Schedule of Payments to Consultants and Services are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

The Introductory, Investment, Actuarial and Statistical sections listed in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. The Introductory, Investment, Actuarial and Statistical sections have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on them.

Andrews Hooper Pavlik PLC

Okemos, Michigan
June 29, 2011

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# MANAGEMENT'S DISCUSSION AND ANALYSIS

This narrative overview and analysis of MERS financial condition for fiscal year ended December 31, 2010, is presented in conjunction with the Chief Executive Officer's Letter of Transmittal. The Financial Section is comprised of the Independent Auditor's Report, Management's Discussion and Analysis, two basic financial statements with explanatory notes, two required supplementary schedules with explanatory notes and three supplementary expense schedules.

MERS exists to provide quality retirement and related services with cost-effective plan administration for members and beneficiaries. The cost of administering such benefits includes: (1) payment of benefits, (2) refunds of member contributions requested by employees that separate from employment, and (3) payment of all administrative and investment costs associated with administering the plans.

## Basic Financial Statements

1. Statement of Plan Net Assets.
2. Statement of Changes in Plan Net Assets.
3. Notes to Basic Financial Statement.

The "Statement of Plan Net Assets" and "Statement of Changes in Plan Net Assets" provide the current financial condition of the 717 individual municipal Defined Benefit Plans, 195 individual municipal Defined Contribution Plans, 155 Health Care Savings Programs, 116 Retiree Health Funding Vehicle Programs, and one Investment Services Program administered by MERS. The Hybrid Plan is included in the Defined Benefit and Defined Contribution totals.

The "Comparison Statement of Plan Net Assets" and "Comparison Statement of Changes in Plan Net Assets" presented in the Management's Discussion and Analysis, provides a comparative summary of the financial condition of the system as a whole.

Due to the long-term nature of a Defined Benefit Plan, financial statements alone cannot provide sufficient information to reflect the system's ongoing plan perspective.

## Required Supplemental Information

1. Schedule of Funding Progress.
2. Schedule of Employer Contributions.
3. Notes to the Schedules of Required Supplementary Information.

The "Schedule of Funding Progress" shows the progress MERS has made in accumulating sufficient assets to pay future retirement benefits when due. The schedule sets forth the actuarially funded status of the Defined Benefit Plan with historical trends in funding.

The "Schedule of Employer Contributions" shows the current annual employer contributions and the historical trend of employer contributions. From a long-term investment perspective, these schedules provide a better understanding of the changes over time in the funded status of the plan.

## Supplementary Expense Schedules

1. Schedule of Administrative Expenses.
2. Schedule of Investment Expenses.
3. Schedule of Payments to Consultants.

The expense schedules summarize all expenses associated with administering the Defined Benefit Plan.

## FINANCIAL HIGHLIGHTS

The following financial highlights occurred during fiscal year ended December 31, 2010:

- Total plan net assets for the Defined Benefit Plan, Defined Contribution Plan, Health Care Savings Program, Retiree Health Funding Vehicle and Investment Services Program increased by $840 million during the 2010 fiscal year. MERS finished the year with $6.6 billion in net assets, the highest in history.
- Total retirement benefits paid to retirees and beneficiaries increased $45 million to a total of $464 million. This is due to an aging population and an increase in retirements. This is not a cause of concern as this is built into the actuarial projections.
- Administrative expenses increased 15% in 2010 to $22 million. Much of this increase was due to hiring additional staff to handle the increased number of retirees, and an increase in legal services, computer consultants, and software maintenance.
- Investment expenses totaled $20 million. This is a 12% increase from 2009 primarily due to higher investment manager fees. This increase was not unexpected with the market increases of the past year.

*Did You Know?*

**Total farmland in Michigan is approximately 10 million acres**

## USING THIS FINANCIAL REPORT

Due to the long-term nature of a Defined Benefit Plan, financial statements alone cannot provide sufficient information to reflect the system's ongoing plan perspective. This financial report consists of two financial statements, and two required schedules of historical trend information.

The "Statement of Plan Net Assets" and "Statement of Changes in Plan Net Assets" provide financial information about the activities of the 2,139 individual municipal plans administered by MERS in its Defined Benefit Plan, Defined Contribution Plan, Retiree Health Funding Vehicle, Health Care Savings Program and Investment Services Program, as well as comparative summary information about these activities for the system as a whole.

The "Schedule of Funding Progress" includes historical trend information about the actuarially funded status of the Defined Benefit Plans from a long-term, ongoing plan perspective, and the progress made in accumulating sufficient assets to pay benefits when due. The "Schedule of Employer Contributions" presents historical trend information about the annual actuarially required contributions of employers and the actual contributions made by employers. These schedules provide information that contribute to understanding the changes over time in the funded status of the Defined Benefit Plans.

### Peaches

- Michigan's Red Haven peaches are famous throughout the country
- Michigan's first commercially successful fruit was the peach
- The first peach trees were planted in the 1780s

## Comparison Statement of Plan Net Assets

| | As of Dec. 31, 2010 | As of Dec. 31, 2009 | Increase (Decrease) Amount | Increase (Decrease) Percent |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash and Short-Term Investments | $90,356,008 | $47,440,502 | $42,915,506 | 90.46% |
| Receivables | 295,533,786 | 370,153,123 | (74,619,337) | -20.16% |
| Interfund Receivables | - | 953,983 | (953,983) | -100.00% |
| Investments, at fair value | 6,463,126,165 | 5,701,945,005 | 761,181,160 | 13.35% |
| Securities Lending Collateral | 965,406,902 | 1,001,205,736 | (35,798,835) | -3.58% |
| Other Assets/Prepaids | 173,239 | 703,273 | (530,035) | -75.37% |
| Net Capital Assets | 6,346,492 | 4,963,358 | 1,383,134 | 27.87% |
| **Total Assets** | **7,820,942,592** | **7,127,364,980** | **693,577,612** | **9.73%** |
| **Liabilities** | | | | |
| Purchase of Investments | 252,618,509 | 354,943,179 | (102,324,670) | -28.83% |
| Securities Lending Collateral | 972,419,765 | 1,017,278,740 | (44,858,975) | -4.41% |
| Administrative and Investment Costs | 11,661,471 | 9,735,724 | 1,925,747 | 19.78% |
| Interfund Payables | - | 953,983 | (953,983) | -100.00% |
| Other Accounts Payable | 94,565 | 54,778 | 39,787 | 72.63% |
| **Total Liabilities** | **1,236,794,310** | **1,382,966,404** | **(146,172,094)** | **-10.57%** |
| **Net Assets Held in Trust for Pension and Health Benefits and Investment Accounts Held for Others** | **$6,584,148,282** | **$5,744,398,576** | **$839,749,706** | **14.62%** |

## Wheat

- Michigan is ranked 14th in total U.S. wheat production
- Michigan has more than 600,000 acres of winter wheat

## Comparison Statement of Changes in Plan Net Assets

| | Year ended Dec. 31, 2010 | Year ended Dec. 31, 2009 | Increase (Decrease) Amount | Increase (Decrease) Percent |
|---|---|---|---|---|
| **Additions** | | | | |
| Contributions | $519,556,971 | $507,731,883 | $11,825,088 | 2.33% |
| Transfers from Defined Benefit Plan | 1,005,605 | 198,729 | 806,876 | 406.02% |
| Transfers from Other Plans and Other Items | 3,696,142 | 1,555,390 | 2,140,752 | 137.63% |
| Net Investment Income Investing Activities | 812,538,191 | 853,883,014 | (41,344,823) | 4.84% |
| Net Investment Income-Securities Lending | 3,294,781 | 4,623,005 | (1,328,224) | -28.73% |
| Miscellaneous Income | 1,726,190 | 1,387,459 | 338,731 | 24.41% |
| **Total Additions** | **1,341,817,880** | **1,369,379,480** | **(27,561,600)** | **-2.01%** |
| **Deductions** | | | | |
| Benefits | 464,089,382 | 418,734,712 | 45,354,670 | 10.83% |
| Refunds of Contributions | 7,011,682 | 9,510,225 | (2,498,543) | -26.27% |
| Special Expenses and Fees | 1,648,860 | 1,341,348 | 307,512 | 22.93% |
| Transfers to Defined Contribution Plan | 1,005,605 | 198,729 | 806,876 | 406.02% |
| Medical Disbursements Paid to Members | 889,941 | 511,902 | 378,039 | 73.85% |
| Disbursements Paid to Municipalities | 5,564,350 | 39,681,182 | (34,116,832) | -85.98% |
| Forfeited Employer Contributions | 85,142 | 64,171 | 20,971 | 32.68% |
| Administrative Expense | 21,773,212 | 19,009,298 | 2,763,914 | 14.54% |
| **Total Deductions** | **502,068,174** | **489,051,567** | **13,016,607** | **2.66%** |
| Net Increase (Decrease) | 839,749,706 | 880,327,913 | (40,578,207) | -4.61% |
| Net Assets Held in Trust for Pension and Health Benefits and Investment Accounts Held for Others | | | | |
| Balance Beginning of Year | 5,744,398,576 | 4,864,070,663 | 880,327,913 | 18.10% |
| **Balance End of Year** | **$6,584,148,282** | **$5,744,398,576** | **$839,749,706** | **14.62%** |

## Analysis of Plan Net Assets

Combined plan net assets increased by $840 million over the previous fiscal year. Looking at additions to and deductions from plan net assets, the increase was primarily attributable to economic conditions (the market recovery), and net investment gains of $817 million. The Health Care Savings Program saw a 45% increase in net assets from the previous year due to new groups joining the program. The Retiree Health Funding Vehicle also saw an increase in net assets of 41% compared to the previous year.

Employer and employee contributions increased by $11.8 million due chiefly to an increase in municipalities joining MERS in 2010. Some municipalities also had fluctuations due to changes in required actuarial contribution rates resulting from salary adjustments, benefit enhancements, plan modifications, and the number of employees. Total employer contributions declined slightly due to less employer contributions coming in from new groups joining MERS. Employer contributions from new groups joining MERS decreased from $93 million in 2009 to $67 million in 2010.

Employee contributions increased by 30% to $92 million from the previous year. Employee contributions from new groups joining MERS increased from $4 million in 2009 to $19 million in 2010. Employee contributions are also increasing as a percentage of pay relative to employer contributions.

MERS has capital assets, net of accumulated depreciation, of approximately $6 million, mostly comprised of software and computer servers needed to run the system's pension administration and financial programs. MERS has no long-term liabilities. The bulk of MERS liabilities at year-end are related to investment purchases that did not settle until early in 2011, accrued administrative and investment expenses, and securities' lending collateral.

## Investment Activities

Performance for the Total Market Fund on a comparative basis to the benchmarks was favorable. The gross return of 14.12% was above the 8% actuarial return assumption target for the year. For both the five- and ten-year periods, the gross returns were 4.20% and 5.27% respectively, compared unfavorably to the actuarial return assumption. Net investment gains (net appreciation in fair value, less investment administrative expenses, plus securities lending income) were $817 million for the year. A further detailed analysis of investment returns is in the Investments Section.

MERS investments are managed to control the extent of downside risk that assets are exposed to while maximizing long-term gain potential. This positions the system to limit the impact of adverse market conditions. Portfolio diversification by asset class and style is an important element of investment risk control.

Investment activity is governed by the "prudent person rule." The "prudent person rule" establishes a standard for all fiduciaries that includes anyone who has authority with respect to the system. The "prudent person rule" states that fiduciaries shall discharge their duties solely in the interest of the system participants and beneficiaries with a degree of diligence, care, and skill that a prudent person would ordinarily exercise under similar circumstances.

The "prudent person rule" permits the Board to establish an investment policy based on certain investment criteria, and allows for the delegation of investment authority to professional investment managers. Investment constraints are outlined, including the appropriate degree of risk. Investment managers are hired to execute the investment policy. They have full discretion for investment decisions within statutory authority, Board policy, and their respective guidelines. A list of investment managers under contract with MERS as of December 31, 2010, is in the Investment Section. A summary of the total system's assets, excluding the Defined Contribution Plan is on page 59.

## Historical Trends

Accounting standards require the "Statement of Plan Net Assets" state investment asset values at fair value and include only benefits and refunds due plan members, beneficiaries, accrued investment and administrative expenses as of the reporting date. Information regarding the actuarial funding status of the Defined Benefit Plan is in the "Schedule of Funding Progress." The asset value stated in the "Schedule of Funding Progress" is the actuarial value of assets as determined by calculating the ratio of market value to book value over a ten-year period. The overall funded ratio increased from 75.0% to 75.5% for the 2009 valuation. The actuarial assumptions used in the most recent valuation are identified in the "Notes to the Schedules of Required Supplementary Information."

Annual required employer contributions as determined by the actuary, and the actual contributions made by employers are provided in the "Schedule of Employer Contributions." This schedule indicates that employers are meeting their actuarially required contribution payments.

MERS overall financial condition improved in 2010 due to market gains. The plan continues to remain stable and viable for the years to come. Public pension plans use long-term investment strategies to fund future benefit obligations. The market downturns and upturns are historically considered part of the market cycle in the overall economic process.

## Funding Status

A pension plan is well funded when it has sufficient assets invested to meet all expected future obligations to participants. The greater the level of funding – the larger the ratio of assets to actuarial accrued liability. While the plan is not totally funded, annual contributions are being made at an actuarially determined rate to reach full funding. There is no single all-encompassing test for measuring a retirement system's funding progress and current funded status. However, some common indicators that a retirement system has achieved progress in funding their obligations include: observing the changes over time of the ratio of valuation assets to actuarial accrued liabilities, and the pattern of the unfunded actuarial accrued liability as a percentage of active payroll. These ratios and numbers are in the Required Supplementary Information.

The MERS Retirement Board has adopted a funding methodology for the system in order to achieve the following major objectives:

- Develop level required contribution rates as a percentage of payroll
- Finance benefits earned by present employees on a current basis
- Accumulate assets to enhance benefit security
- Produce investment earnings and interest on accumulated assets to help meet future benefit costs
- Estimate the long-term actuarial cost of proposed amendments for system provisions
- Assist in maintaining the system's long-term financial viability

The actuarial method for calculating the accrued liability for all plans is entry age normal with the objective of maintaining employer contributions approximately level as a percentage of member payroll. A detailed discussion of the funding method is in the Actuarial Section.

Based upon the valuation results, MERS continues to be in sound financial health in accordance with actuarial principles of level percent of payroll financing.

## Statement of Plan Net Assets as of December 31, 2010

| | Defined Benefit | Defined Contribution | Health Care Savings Program |
|---|---|---|---|
| **Assets** | | | |
| Cash and Short-Term Investments | $4,232,008 | $39,285,613 | $157,819 |
| Receivables | | | |
| Employer Contributions | 28,724,691 | | |
| Plan Member Contributions | 6,785,718 | | |
| Sale of Investments | 243,973,829 | | |
| Investment Income | 12,444,670 | | |
| Loans | | 3,281,585 | |
| Interfund Receivables | | | |
| Other | 323,293 | | |
| Total Receivables | 292,252,201 | 3,281,585 | - |
| Investments, at fair value | | | |
| Fixed Income | 1,945,606,614 | 18,016,181 | 15,963,882 |
| Equities | 2,602,776,238 | 76,823,652 | 21,356,018 |
| Private Equity | 594,482,042 | 1,917,067 | 4,877,780 |
| Commodities | 324,348,773 | 1,045,950 | 2,661,312 |
| Cash Equivalents | 172,174,189 | 555,222 | 1,412,705 |
| Balanced Funds | | 156,013,743 | |
| Real Estate | 301,939,890 | 973,686 | 2,477,445 |
| Total Investments | 5,941,327,746 | 255,345,501 | 48,749,142 |
| Securities Lending Collateral | 965,406,902 | | |
| Prepaid Expenses | 173,239 | | |
| Capital Assets, at cost, net of accumulated depreciation | 6,346,492 | | |
| **Total Assets** | **7,209,738,585** | **297,912,699** | **48,906,961** |
| **Liabilities** | | | |
| Purchase of Investments | 252,618,509 | | |
| Securities Lending Collateral | 972,419,765 | | |
| Administrative and Investment Costs | 11,661,471 | | |
| Interfund Payables | | | |
| Other Accounts Payable | | | 51,665 |
| **Total Liabilities** | **1,236,699,745** | **-** | **51,665** |
| **Net Assets Held in Trust for Pension and Health Benefits and Investment Accounts Held for Others** | **$5,973,038,840** | **$297,912,699** | **$48,855,296** |

The "Schedule of Funding Progress" is presented in the Required Supplementary Information in the Financial Section of this report.

The accompanying notes are an integral part of these Financial Statements.

| Retiree Health Funding Vehicle | Investment Services Program | Total Year Ended Dec. 31, 2010 | Total Year Ended Dec. 31, 2009 |
|---|---|---|---|
| $125,353 | $6,488 | $43,807,281 | $47,440,502 |
| | | 28,724,691 | 23,468,405 |
| | | 6,785,718 | 4,371,936 |
| | | 243,973,829 | 323,955,188 |
| | | 12,444,670 | 14,766,272 |
| | | 3,281,585 | 2,195,639 |
| | | - | 953,983 |
| | | 323,293 | 1,395,683 |
| - | - | 295,533,786 | 371,107,106 |
| 84,340,186 | 2,194,584 | 2,066,121,447 | 1,733,098,312 |
| 112,827,859 | 2,935,852 | 2,816,719,619 | 2,645,519,145 |
| 25,770,228 | 670,557 | 627,717,674 | 543,219,655 |
| 14,060,208 | 365,855 | 342,482,098 | 278,921,927 |
| 7,463,586 | 194,207 | 181,799,909 | 48,194,466 |
| | | 156,013,743 | 121,643,378 |
| 13,088,805 | 340,579 | 318,820,405 | 331,348,122 |
| 257,550,872 | 6,701,634 | 6,509,674,895 | 5,701,945,005 |
| | | 965,406,902 | 1,001,205,736 |
| | | 173,239 | 703,273 |
| | | 6,346,492 | 4,963,358 |
| 257,676,225 | 6,708,122 | 7,820,942,592 | 7,127,364,980 |
| | | 252,618,509 | 354,943,179 |
| | | 972,419,765 | 1,017,278,740 |
| | | 11,661,471 | 9,735,724 |
| | | - | 953,983 |
| 42,900 | | 94,565 | 54,778 |
| 42,900 | - | 1,236,794,310 | 1,382,966,404 |
| $257,633,325 | $6,708,122 | $6,584,148,282 | $5,744,398,576 |

## Statement of Changes in Plan Net Assets for the Year Ended December 31, 2010

| | Defined Benefit | Defined Contribution | Health Care Savings Program |
|---|---|---|---|
| **Additions** | | | |
| Contributions and Transfers In | | | |
| Employer Contributions and Other | $341,354,194 | $21,699,622 | $11,650,739 |
| Plan Member Contributions | 83,573,046 | 8,666,000 | |
| Employer Transfers In | | 977,346 | |
| Plan Member Transfers In | | 28,259 | |
| Transfers from Other Plans and Other Items | | 3,696,142 | |
| Total Contributions and Transfers In | 424,927,240 | 35,067,369 | 11,650,739 |
| Investment Income | | | |
| Net Appreciation/Depreciation in Fair Value | 668,406,835 | | 4,055,298 |
| Interest Income | 60,043,753 | | |
| Dividend Income | 41,036,649 | | |
| Real Estate Operating Income | 859,500 | | |
| DC Plan Investment Income/Loss | | 28,971,482 | |
| | 770,346,737 | 28,971,482 | 4,055,298 |
| Less Investment Expense | 20,093,406 | | |
| Net Investment Income Before Securities Lending Activities | 750,253,331 | 28,971,482 | 4,055,298 |
| Security Lending Activities | | | |
| Security Lending Income | 5,545,534 | | |
| Security Lending Expenses | | | |
| Borrower Rebates | 1,427,296 | | |
| Management Fees | 823,457 | | |
| Total Securities Lending Expenses | 2,250,753 | - | - |
| Net Income from Security Lending Activities | 3,294,781 | - | - |
| Total Net Investment Income/Loss | 753,548,112 | 28,971,482 | 4,055,298 |
| Miscellaneous Income | 462,612 | | 377,183 |
| **Total Additions** | **1,178,937,964** | **64,038,851** | **16,083,220** |
| **Deductions** | | | |
| Benefits | 453,186,778 | 10,902,604 | |
| Refunds of Contributions | | | |
| Employer | 5,823 | | |
| Plan Member | 7,005,859 | | |
| Special Expenses and Fees | 389,025 | | 373,441 |
| Transfers to Defined Contribution Plan | | | |
| Employer | 977,346 | | |
| Plan Member | 28,259 | | |
| Medical Disbursements Paid to Members | | | 889,941 |
| Disbursements Paid to Municipalities | | | |
| Forfeited Employer Contributions | | | 85,142 |
| Administrative Expenses | 20,951,372 | | (439,689) |
| **Total Deductions** | **482,544,462** | **10,902,604** | **908,835** |
| **Net Assets** | | | |
| Net Increase/Decrease | 696,393,502 | 53,136,247 | 15,174,385 |
| Net Assets Held in Trust for Pension and Health Benefits and Investment Accounts Held for Others Balance Beginning of Fiscal Period | 5,276,645,338 | 244,776,452 | 33,680,911 |
| **Balance End of Fiscal Period** | **$5,973,038,840** | **$297,912,699** | **$48,855,296** |

*The accompanying notes are an integral part of these Financial Statements.

| Retiree Health Funding Vehicle | Investment Services Program | Total Year Ended Dec. 31, 2010 | Total Year Ended Dec. 31, 2009 |
|---|---|---|---|
| $52,613,370 | $ - | $427,317,925 | $436,992,385 |
| | | 92,239,046 | 70,739,498 |
| | | 977,346 | 175,246 |
| | | 28,259 | 23,483 |
| | | 3,696,142 | 1,555,390 |
| 52,613,370 | - | 524,258,718 | 509,486,002 |
| 28,418,986 | 839,094 | 701,720,213 | 720,096,143 |
| | | 60,043,753 | 71,103,261 |
| | | 41,036,649 | 39,892,229 |
| | | 859,500 | 860,500 |
| | | 28,971,482 | 39,951,479 |
| 28,418,986 | 839,094 | 832,631,597 | 871,903,612 |
| | | 20,093,406 | 18,020,598 |
| 28,418,986 | 839,094 | 812,538,191 | 853,883,014 |
| | | 5,545,534 | 7,002,898 |
| | | 1,427,296 | 1,224,308 |
| | | 823,457 | 1,155,585 |
| - | - | 2,250,753 | 2,379,893 |
| - | - | 3,294,781 | 4,623,005 |
| 28,418,986 | 839,094 | 815,832,972 | 858,506,019 |
| 858,770 | 27,625 | 1,726,190 | 1,387,459 |
| **81,891,126** | **866,719** | **1,341,817,880** | **1,369,379,480** |
| | | 464,089,382 | 418,734,712 |
| | | 5,823 | - |
| | | 7,005,859 | 9,510,225 |
| 858,770 | 27,624 | 1,648,860 | 1,341,348 |
| | | 977,346 | 175,246 |
| | | 28,259 | 23,483 |
| | | 889,941 | 511,902 |
| 5,564,350 | | 5,564,350 | 39,681,182 |
| | | 85,142 | 64,171 |
| 1,039,649 | 221,880 | 21,773,212 | 19,009,298 |
| **7,462,769** | **249,504** | **502,068,174** | **489,051,567** |
| 74,428,357 | 617,215 | 839,749,706 | 880,327,913 |
| 183,204,968 | 6,090,907 | 5,744,398,576 | 4,864,070,663 |
| **$257,633,325** | **$6,708,122** | **$6,584,148,282** | **$5,744,398,576** |

# NOTES TO BASIC FINANCIAL STATEMENTS

*Year ended December 31, 2010*

## 1. Reporting Entity and Plan Description

The Municipal Employees' Retirement System (MERS) is an agent multiple-employer, statewide, public employee pension plan created under Public Act 135 of 1945, repealed and replaced by successor Municipal Employees' Retirement Act of 1984 (PA 427), as last amended by 2004 PA 490, embodied in the MERS Plan Document (as revised). MERS was established to provide a pooled program for retirement, survivor and disability benefits on a voluntary basis to the State of Michigan's local government employees.

On August 15, 1996, pursuant to 1996 PA 220, MERS became an independent statutory public nonprofit corporation, which is an instrumentality of the participating municipalities and courts. Prior to that time, MERS was a component unit of the State of Michigan and operated within the Department of Management and Budget. Since 1996, MERS is solely administered by a nine-member Retirement Board. It consists of the following members, each of whom, except for the retiree member and the Retirement Board appointees, shall be from a different county at the time of election:

- Two members, appointed by the Retirement Board, who have knowledge or experience in retirement systems, administration of retirement systems, investment management or advisory services.
- One member, a retiree of the system, is appointed by the Retirement Board.
- Three members of the system, officers of a participating municipality or of a participating court, who are elected as officer Board members by the delegates at the MERS Annual Meeting.
- Three employee members of the system, who are not officers of a participating municipality or of a participating court, who are elected as employee Board members by the delegates at the MERS Annual Meeting.

The regular term of office for members of the Retirement Board is three years. Members of the Retirement Board serve without compensation with respect to their duties, but are reimbursed by the system for their actual and necessary expenses incurred in the performance of their duties.

MERS provides a Defined Benefit Plan, Defined Contribution Plan, Hybrid Plan, Investment Services Program, Health Care Savings Program, Retiree Health Funding Vehicle and MERS Group Buying Solutions.

MERS Defined Benefit is a traditional pension plan that promises employees a lifetime retirement benefit. At retirement, members receive a specific monthly benefit calculated using a predetermined formula based on salary and service. The plan is funded by the municipality (with or without pre-tax employee contributions). We also allow municipalities non-membership access to the MERS Total Market Fund through our Investment Services Program. Groups benefit from our professionally managed fund and economies of scale, while maintaining local control of their pension administration.

MERS Defined Contribution Plan became operative July 8, 1997, under Section 401(a) of the Internal Revenue Code. On this date, the MERS Plan Document of 1996 was first determined by the Internal Revenue Service Letter of Favorable Determination to meet qualifications as a "governmental plan" trust under Code Section 401(a), and tax exempt under Section 501(a). MERS has contracted with a third party administrator for recordkeeping and administrative functions. The plan is available to all MERS participating municipalities and may be adopted on a division-by-division basis. Plan provisions and requirements are specified in the MERS Plan Document.

MERS Defined Contribution Plan provides employees with an account they manage. At retirement, benefits are based solely on the amount contributed by the employee and employer, and the performance of investments. We offer access to MERS investments.

The MERS Hybrid Plan is an option for members that includes both a Defined Benefit and a Defined Contribution component. The Defined Benefit component (Part I) is employer funded, with benefit multipliers of 1.0, 1.25, and 1.5%. The Defined Contribution component (Part II) is a combination of employer and employee contributions that are invested in funds selected by the individual participant.

On January 13, 2004, MERS received a Private Letter Ruling allowing establishment of an Internal Revenue Code Section 115 "Integral Governmental Trust." MERS created two programs from this Trust – the Health Care Savings Program, and the Retiree Health Funding Vehicle.

The MERS Health Care Savings Program became operational in June 2004 and was made available to all municipalities in Michigan. The employer-sponsored program provides medical reimbursement accounts to participating employees. Medical expenses are reimbursed, as defined in Code Section 213(d), once employees terminate employment, are on medical leave for six months or longer, or are on disability from any public pension plan.

There are four types of contributions that may be used in the program: 1) Basic Employer (tax-favored), 2) Mandatory Salary Reductions (tax-favored), 3) Mandatory Leave Conversions (tax-favored), and 4) Voluntary Employee Contributions (post-tax).

As a result of the Private Letter Ruling, Code Section 213(d), reimbursements are tax-exempt for the employee, their spouse, and/or Code Section 152 dependent(s). The Health Care Savings Program accounts are invested in the MERS core investment portfolio options, and earnings are tax exempt as a result of the MERS Private Letter Ruling. Plan provisions and requirements are specified in the MERS Health Care Savings Program and Retiree Health Funding Vehicle Plan Document and Trust.

The MERS Retiree Health Funding Vehicle became operational in the fall of 2004 and was made available to all municipalities in Michigan. Participating municipalities can contribute monies to the Trust and no contribution method other than "pay as you go" cash funding is required or imposed on the participating employer. These funds constitute a health care fund, which enable municipalities to accumulate funds to provide or subsidize health benefits for retirees and beneficiaries as defined by Code Section 213. The Retiree Health Funding Vehicle accounts are invested in the MERS core investment portfolio options, and earnings are tax exempt as a result of the MERS Private Letter Ruling. Plan provisions and requirements are specified in the MERS Health Care Savings Program and Retiree Health Funding Vehicle Plan Document and Trust.

The Investment Services Program (ISP) is an investment trust fund that is available to all municipalities to invest funds through the MERS portfolio while maintaining administrative functions at the municipal level. Assets are pooled with the existing $6.6 billion currently in MERS Defined Benefit Plan, resulting in reduced costs and increased investment return opportunities for municipalities. The program was established by the MERS Board in March 2006 and began operations in June 2006.

MERS offers any "municipality" (Plan Section 2b(4); MCL 38.1502b(2) pension, "ancillary benefits, health and welfare benefits, and other post-employment benefit programs" (Plan Section 36(2)(a); MCL 38.1536(2)(a)). The Investment Services Program trust fund complies with all the requirements imposed by the Public Employee Retirement System Investment Act, 1965 Public Act 314. Participation in the Investment Services Program does not qualify as membership in MERS pension plans, and the participating employer does not have a vote at the MERS Annual Meeting.

The MERS Group Buying Solutions include MERS Group Life and Disability Insurance Program, and MERS Premier Advantage. MERS Group Life and Disability Insurance is an employer-sponsored program that preserves the affordability of Life, Accidental Death and Dismemberment, Short Term Disability, and Long Term Disability Insurance. MERS partners with The Standard Insurance Company to offer competitive benefit features, a variety of plan designs and family-friendly provisions.

MERS Premier Advantage is a Medicare Advantage program, designed exclusively for MERS members and their spouses who are eligible for Medicare. The plan is provided through our partner, Humana.

Premiums and benefits under the MERS Group Buying Solutions are not reflected in the accompanying financial statements.

## MERS Participating Municipalities as of December 31, 2010

| | Defined Benefit | Defined Contribution | Health Care Savings Program | Retiree Health Funding Vehicle | Investment Services Program |
|---|---|---|---|---|---|
| Counties | 66 | 30 | 29 | 11 | 0 |
| Cities and Villages | 265 | 77 | 59 | 49 | 1 |
| Townships | 93 | 16 | 13 | 17 | 0 |
| County Road Commissions | 59 | 7 | 14 | 13 | 0 |
| Authorities, Districts and Others | 219 | 65 | 40 | 26 | 0 |
| Closed Groups | 15 | 0 | 0 | 0 | 0 |
| **Total** | **717** | **195** | **155** | **116** | **1** |

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.

## MERS Membership as of December 31, 2010

| | Defined Benefit | Defined Contribution | Health Care Savings Program |
|---|---|---|---|
| **Retirees and Beneficiaries Currently Receiving Benefits** | | | |
| Retirement annuities | 21,635 | | |
| Survivor annuities | 4,012 | | |
| Disability annuities | 1,308 | | |
| Total | 26,955 | 0 | 0 |
| Vested former members | 6,615 | 1631 | |
| Current active members | 35,829 | 7005 | 7340 |
| **Total Membership** | **69,399** | **8,636** | **7,340** |

The Retirement Board establishes the benefit plans and provisions that are available for adoption. The local municipality's governing body adopts all benefits of the plan. The various plans are discussed in the Actuarial Section.

Pursuant to Article 9, Section 24 of the Constitution of the State of Michigan: "The accrued financial benefits of each pension plan and retirement system of the state and its political subdivisions shall be a contractual obligation thereof which shall not be diminished or impaired thereby. Financial benefits arising on account of service rendered in each fiscal year shall be funded during that year and such funding shall not be used for financing unfunded accrued liabilities."

Employee contribution rates vary depending on the benefit plan adopted by the local government. If an employee leaves employment or dies before becoming eligible for retirement benefits, accumulated employee contributions (plus interest) are refunded to the employee or designated beneficiary upon application.

The MERS programs have been determined to be a governmental plan that is a tax-qualified trust under Internal Revenue Code (the Code) Section 401(a), and tax exempt under Section 501(a). The Internal Revenue Service issued the most recent Letter of Favorable Determination for MERS on June 15, 2005. MERS also applied for an updated application for a Letter of Favorable Determination on September 30, 2008, following Board approval at the September Board meeting. This updated application is part of the Internal Revenue Service's Cycle C program for governmental plan Letters of Favorable Determination. The benefits of tax-qualified status include the preferential deferred taxability of contributions, accumulated earnings, pensions, rollovers, annual compensation limits, and benefit limitations.

Under the Code, the major portion of a retiree's pension becomes taxable upon periodic distribution. Pursuant to IRC Section 72(d), any "after tax contributions" are recovered tax-free over the life expectancy of the retiree (or beneficiary, if applicable).

IRC Section 401(a)(17) limits the amount of compensation an active employee can receive for pension benefit calculation purposes and, correspondingly, limits the amount of employer and employee contributions. Compensation in excess of the 401(a)(17) limit ($245,000 for 2010 and 2011) will not be credited by MERS. Contributions in excess of the Internal Revenue Service limit will not be collected or accepted, nor figure into final average compensation for benefit purposes.

In addition, IRC Section 415 (b)(1)(A) imposes certain limitations on pension benefit payments from the MERS qualified trust. Any amounts that exceed the limitations shall be paid from a Qualified Excess Benefit Arrangement (QEBA), as authorized by IRC Section 415(m) and Michigan Compiled Law 38.1686. The QEBA shall be a separate plan, and is annually cash funded by the affected participating municipality or court. The Retirement Board established the MERS QEBA in 2003 solely for the purpose of providing retirees and beneficiaries, that portion of the retirement allowance exceeding the Section 415 limits, and otherwise not payable by the trust under the terms of the MERS qualified plan. The Internal Revenue Service approval of the QEBA was pursuant to Private Letter Ruling issued December 15, 2003. Retirees and beneficiaries do not have an election, directly or indirectly, to defer compensation to the QEBA.

## 2. Summary of Significant Accounting Policies

### Reporting Entity

The Retirement Board is responsible for the administration of the Retirement System, has fiduciary responsibility for the investment of assets, and oversees all funds included in these financial statements. The Retirement Board appoints the Chief Executive Officer who manages and administers the system under the supervision and direction of the Board.

Since MERS is an independent public corporation, MERS financial statements are not included in the financial statements of any other organization. MERS is the only entity included in this financial report.

### Cost Allocation

The costs of administering the Defined Benefit Plan are allocated to the municipalities along with investment gains and losses on a quarterly basis. The funding and accounting for each municipality is separate. The liabilities of each member municipality remain with that municipality, and the assets of one municipality cannot be used to pay the liabilities of another municipality. Additionally, the assets are combined for investment and administrative purposes, but maintained separately for accounting purposes.

The costs of administering the Defined Contribution Plan, Health Care Savings Program, Retiree Health Funding Vehicle, and Investment Services Program are allocated out to the municipalities and members based on an administrative expense percentage for each municipality and member.

### Basis of Accounting

The financial statements for MERS are prepared on the accrual basis in accordance with Generally Accepted Accounting Principles (GAAP). Employer and employee contributions are recognized when due pursuant to formal commitments, as well as statutory or contractual requirements. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

The Defined Contribution financial statements are prepared using a cash basis of accounting (which approximates the accrual basis of accounting). Plan investments are presented at fair value.

The Health Care Savings Program's financial statements are prepared using a modified cash basis of accounting (which approximates the accrual basis of accounting). Plan investments are presented at fair value. Contributions are pooled on a combined basis subject to the Public Employee Retirement System Investment Act ("PERSIA"), 1965 PA 314, and pursuant to the Public Employee Health Care Fund Investment Act, 1999 PA 149.

The Retiree Health Funding Vehicle financial statements are prepared using a modified cash basis of accounting (which approximates the accrual basis of accounting). Plan investments are presented at fair value. Contributions are pooled on a combined basis subject to 1965 PA 314, and 1999 PA 149.

The Investment Services Program's financial statements are prepared using a modified cash basis of accounting (which approximates the accrual basis of accounting). Plan investments are presented at fair value. Contributions are pooled on a combined basis subject to 1965 PA 314.

### Use of Estimates

Management of the System has made certain estimates and assumptions relative to the reporting of assets, liabilities, disclosure of contingent assets and liabilities, to prepare these financial statements in conformity with accounting principles generally accepted in the United States. Actual results could differ from these estimates.

### GASB 27

The Governmental Accounting Standards Board (GASB) Statement No. 27, "Accounting for Pensions by State and Local Governmental Employers," requires certain changes in reporting pensions by employers.

The following section is required and pertains to MERS staff only:

Prior to separation from the State of Michigan on August 15, 1996, the pension liability for MERS staff remained the obligation of its official employer, the State of Michigan. Therefore, MERS has no pension liability for staff prior to August 15, 1996, when it began independent payroll processing separate and apart from the State of Michigan.

After separation from the State in 1996, the MERS Retirement Board (as an employer) elected to become a participating municipality in the MERS Defined Benefit Plan, and to provide pension benefits for MERS staff. Vesting occurs after six years of credited service; normal retirement age is 60, although an employee may retire at age 55 with 30 years of credited service. The annual pension benefit is calculated by multiplying the employee's years of credited service by 2.25%, and then multiplying by the final average compensation based on the highest consecutive three years of compensation.

In 2010 MERS contributed 12.74% of compensation; employees contributed 2% of compensation.

**The following pension information for GASB 27 applies to MERS staff only:**

## Schedule of Funding Progress

| Actuarial Valuation December 31 | Actuarial Value of Assets (a) | Actuarial Accrued Liability (AAL) (b) | Unfunded (Over) AAL (UAAL) (b-a) | Funded Ratio (a/b) | Covered Payroll (c) | UAAL as a % of Covered Payroll ((b-a)/c) |
|---|---|---|---|---|---|---|
| 2007 | $5,681,887 | $7,312,780 | $1,630,893 | 77.70% | $5,879,341 | 27.74% |
| 2008 | 7,094,900 | 9,390,969 | 2,296,069 | 75.55 | 7,802,747 | 29.43 |
| 2009 | 9,202,748 | 9,954,321 | 751,573 | 92.45 | 8,198,952 | 9.17 |

## Actuarial Accrued Liability from December 31, 2009 and December 31, 2008 Actuarial Valuations

| | 2009 | 2008 |
|---|---|---|
| Retirees and beneficiaries currently receiving benefits | $922,787 | $929,963 |
| Vested former members not yet receiving benefits | 277,431 | 240,210 |
| Non-vested, terminated employees (pending refunds of accumulated member contributions) | 28,437 | 14,690 |
| Current employees | | |
| Accumulated employee contributions, including allocated investment income | 1,090,160 | 847,859 |
| Employer financed | 7,635,506 | 7,358,247 |
| **Total Actuarial Accrued Liability** | **9,954,321** | **9,390,969** |
| Net assets available for benefits at actuarial value ($7,352,387 and $5,098,808 at market value for December 31, 2009, and 2008, respectively) | 9,202,748 | 7,094,900 |
| **Unfunded Actuarial Accrued Liability** | **$751,573** | **$2,296,069** |

## Three-Year Trend Information Schedule of Employer Contributions

| Fiscal Year Ended | Annual Pension Cost (APC) | Percentage of APC Contributed | Net Pension Obligation |
|---|---|---|---|
| December 31, 2008 | $668,016 | 100% | - |
| December 31, 2009 | 720,804 | 100 | - |
| December 31, 2010 | 994,080 | 100 | - |

### Post Employment Benefits

The Government Accounting Standards Board (GASB) Statement No. 50, Pension Disclosures – an amendment of GASB Statements No. 25 and No. 27 – more closely aligns the financial reporting requirements for pensions with those for other post employment benefits. This enhances information disclosed in the Notes to Financial Statements or presented as required supplementary information by pension plans and employers.

MERS Retiree Health Funding Vehicle is designed to be an investment choice for municipalities rather than a plan for other post employment benefits. The other post employment benefit plan remains with the municipalities for their administration, and thus implementation of GASB Statement 50 will reside with them.

### Fair Value of Investments

In accordance with GASB 25, plan investments are presented at fair value. Short-term investments are valued at cost plus accrued interest, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Corporate bonds not traded on a national or international exchange are based upon equivalent values of comparable securities with similar yield and risk. Independent appraisals are the basis for valuing the fair value of real estate. Other investments that do not have established markets are recorded at an estimated fair value. Real estate investments typically have a quarter lag in reporting, which is an industry standard.

### Capital Assets

Office furniture, equipment, and software with a value of $5,000 or more are carried at cost, less accumulated depreciation. The capital assets are depreciated using the straight-line method over the estimated useful lives of the related assets varying from three- to five-year spans. The table below is a schedule of the capital asset account balances as of December 31, 2009, and December 31, 2010.

## Capital Assets

| Capital Assets | Office Furniture and Equipment | Software | Total Capital Assets |
|---|---|---|---|
| Balances December 31, 2009 | $3,386,933 | $15,335,764 | $18,722,697 |
| Additions | 388,600 | 3,326,522 | 3,715,122 |
| Deletions and Transfers | (986,460) | (1,406,761) | (2,393,221) |
| **Balances - December 31, 2010** | **$2,789,073** | **$17,255,525** | **$20,044,598** |
| Accumulated Depreciation | | | |
| Balances December 31, 2009 | $2,378,825 | $11,380,514 | $13,759,339 |
| Depreciation Expense | 398,064 | 1,933,924 | 2,331,988 |
| Deletions and Transfers | (986,460) | (1,406,761) | (2,393,221) |
| Balances December 31, 2010 | $1,790,429 | $11,907,677 | $13,698,106 |
| **Net Capital Assets - December 31, 2010** | **$998,644** | **$5,347,848** | **$6,346,492** |

### Total Columns On Statements

The "Total" columns on the "Statement of Plan Net Assets" and "Statement of Changes in Plan Net Assets" are presented to facilitate financial analysis. Amounts in these columns do not present the plan net assets and changes in plan net assets in conformity with GAAP, nor is such data comparable to a consolidation. Transactions between the Defined Benefit Plan, Defined Contribution Plan, Health Care Savings Plan, Retiree Health Funding Vehicle, and Investment Services Program have not been eliminated from the "Total" columns.

## 3. Contributions and Reserves

### Contributions

The Defined Benefit Plan contribution funding requirements are actuarially determined using the entry age normal actuarial cost method, and are based upon the benefit plan adopted by the municipality. Some municipalities fund their entire pension obligations solely from employer contributions. Other municipalities jointly fund pension obligations from employee and employer contributions. Monthly employee contributions are based upon a percentage of actual compensation as determined by an annual actuarial valuation. Employer contributions are based upon projected compensation as determined by an annual actuarial valuation. Employee contributions are held in individual member accounts that are credited with interest annually. Pursuant to Board resolution adopted November 9, 2005, the interest rate for each year beginning in 2005 is the one-year T-bill rate as of December 1 each year for the ensuing December 31 employee interest calculation. It is also used for interest calculations the subsequent year for those employees requesting a refund of their contributions. The municipality determines the employee's contributions.

Contributions to the Defined Contribution Plan are remitted directly to MERS third party administrator by the participating municipalities, and are separate from contributions made to the MERS Defined Benefit Plan. Both employer contributions and employee voluntary and mandatory contributions are governed by the contribution limits under the Internal Revenue Code. Municipalities may elect to have mandatory employee contributions where the member pays a fixed dollar or percentage. If the municipality has a match contribution type, the member will elect the amount of contribution at the time of enrollment and will not be allowed to make any changes. Municipalities may also choose to allow additional after-tax contributions through payroll deduction.

Participating municipalities may, upon adoption of a Defined Contribution resolution for new hires, offer current Defined Benefit employees an opportunity to opt into Defined Contribution. MERS transfers the actuarial present value of the employee's accrued benefit in the Defined Benefit Plan into the employee's Defined Contribution account (at a stipulated funded ratio that shall not exceed 100%). Employees direct their contributions to various investment options offered by the third party administrator, and may transfer their account balances between investment categories or make changes to the percentage allocation on a daily basis.

### Defined Benefit Plan Reserves

Three reserves have been established pursuant to the MERS Plan Document. See "Schedule of Changes in Reserves" in the Statistical Section.

- **Reserve for Employee Contributions**
  Employee contributions and interest are credited to this reserve. Also credited are monies received from the purchase of service credit and monies received in repayment of previously refunded contributions. The reserve is reduced by amounts paid to employees who terminate employment and request refunds, and by amounts transferred into the "Reserve for Employer Contributions and Benefit Payments" upon an employee's retirement. Interest is credited to each employee's account, as provided in the Board's November 9, 2005, Resolution. The reserve's balance at December 31, 2010, was $658,189,773. The "Reserve for Employee Contributions" was fully funded as of the December 31, 2009, MERS Consolidated Actuarial Valuation.

- **Reserve for Employer Contributions and Benefit Payments**
  All employer contributions are credited to this reserve. Net income is allocated to this reserve from the "Reserve for Expenses and Undistributed Income." At retirement, an employee's accumulated contributions, if any, including interest, are transferred into this reserve from the "Reserve for Employee Contributions." Monthly benefits paid to retirees reduce this reserve. The December

31, 2010, balance was $5,314,849,067. The unfunded actuarial liability was $2,091,598,086 (based on the actuarial value of assets) as of the December 31, 2009, MERS Consolidated Actuarial Valuation.

- **Reserve for Expenses and Undistributed Investment Income**
  All investment earnings and other monies received that are not dedicated to other areas are credited to this reserve. All administrative and investment expenses are paid from this reserve. Transfers from this reserve to the "Reserve for Employer Contributions and Benefit Payments" are at allocation rates determined by the Retirement Board. In 2010, the Retirement Board allocated 100% from the "Reserve for Expenses and Undistributed Investment Income" to the "Reserve for Employer Contributions and Benefit Payments," leaving a zero balance at year end.

**Other Reserves**

- **Reserve for Defined Contribution Plan**
  All additions to and deductions from the Defined Contribution Plan are recorded in this reserve. MERS maintains the individual member account records.

- **Reserve for Health Care Savings Program**
  All additions to and deductions from the Health Care Savings Program are recorded in this reserve. MERS maintains the individual member account records.

- **Reserve for Retiree Health Funding Vehicle**
  All additions to and deductions from the Retiree Health Funding Vehicle are recorded in this reserve. MERS maintains the separate employer account records for all municipalities.

- **Reserve for Investment Services Program**
  All additions to and deductions from the Investment Services Program are recorded in this reserve. MERS maintains the separate employer account records for all municipalities.

## Maple Syrup

- The production of pure maple syrup is the oldest agricultural enterprise in the United States
- Forty gallons of maple sap are required to make one gallon of syrup
- Michigan ranks fifth in maple syrup production
- Only about one percent of Michigan's maple forest resource is used for syrup production
- Maple syrup is classified as one of nature's most healthful foods
- Maple syrup is one of the few agriculture crops in which demand exceeds supply

## 4. Investments

The Retirement Board has the fiduciary responsibility and authority to oversee the investment portfolio. Various professional investment managers are contracted to manage the system's assets. All investment decisions are subject to statutory regulations imposed under the Michigan Public Employee Retirement System Investment Act, 1965 PA 314, as amended, and the investment policy guidelines established by the Retirement Board. Michigan law allows diverse investment in stocks, corporate and government bonds, mortgages, real estate, and other investments. The Act sets forth prudent standards and requires the assets of the Retirement System be invested solely in the interest of the participants and beneficiaries. Under Plan Document Section 55(6), and 1965 PA 314, and Section 401(a)(2) of the Internal Revenue Code, the investments shall be made for the exclusive purpose of providing benefits to the participants and their beneficiaries, and defraying reasonable expenses of the System.

The Retirement Board's investment policy requires independent performance measurement of investment managers and establishes total return objectives for the total portfolio and major categories of investments. As of December 31, 2010, all securities held met the required statutory provisions and Retirement Board policy. As of the same dates, no investments were in default or subject to bankruptcy proceedings that had not been previously recorded.

### Credit Risk

Credit risk is the financial risk that an issuer or other counterparty will not fulfill its obligations to MERS. Credit risk exposure is dictated by each investment manager's agreement. Other criteria based on MERS Retirement Board's investment policy, includes that if a security is downgraded below investment grade after purchase, a review with a written explanation shall be forwarded to the Investments staff. Board policy also allows that when calculating the average rating of the portfolio, the manager may use the highest rating of the major rating agencies to calculate the average. Board policy, in regards to global fixed income securities, is that no more than 10% of the portfolio may be invested in corporate bonds or sovereign bonds rated below investment grade, as defined by Moody's and Standard & Poors. Board policy for global fixed income securities is that the average weighted credit of the portfolio will be a minimum of A-. When calculating the average rating of the global portfolio, the manager may use the highest rating of the major agencies to calculate the average. Board policy in regards to global, non-investment grade fixed income securities includes criteria that credit quality must maintain a minimum of 10% of the portfolio in investment grade fixed income with at least two ratings of BBB-/Baa3 or higher (as assigned by Standard & Poors or Moody's). Each portfolio is managed in accordance with investment guidelines that are specific as to permissible credit quality ranges, exposure levels within individual security quality rating tiers, and/or the average credit quality of the overall portfolio.

As of December 31, 2010, the domestic fixed income portfolio consisted of fixed income investments with respective quality ratings, excluding those obligations of the U.S. government. Investments issued by or explicitly guaranteed by the U.S. government are not considered to have credit risk. The plan's exposure to credit risk as of December 31, 2010, is presented on the following pages, by investment category as rated by Standard & Poors.

## Credit Ratings Summary - December 31, 2010

| Quality Rating | U.S. Agencies | Asset Backed | Corporate Bonds | Commingled Limited Part | Convertible Bonds | Foreign |
|---|---|---|---|---|---|---|
| AAA | $219,987,818 | $16,658,368 | $29,110,788 | | | |
| AA+ | | 1,309,511 | 41,400,280 | | | |
| AA | 5,088,005 | 3,046,577 | 17,636,917 | | | |
| AA- | 6,664,636 | | 7,782,217 | | | |
| A+ | 28,348,649 | 2,824,605 | 26,655,726 | | $39,738 | |
| A | 22,985,844 | 50,396 | 55,099,974 | | | |
| A- | 980,184 | 4,948,554 | 24,203,636 | | | |
| BBB+ | 233,125 | 4,479,360 | 24,234,330 | | | |
| BBB | 12,131,304 | 58,258 | 12,706,054 | | 133,708 | |
| BBB- | 16,460,575 | 598,742 | 12,545,813 | | 64,665 | |
| BB+ | 687,895 | 1,214,608 | 8,023,647 | | 124,646 | |
| BB | 5,449,820 | 169,387 | 7,835,200 | | 236,136 | |
| BB- | 3,706,728 | | 12,264,482 | | 85,060 | |
| B+ | 251,720 | 475,153 | 24,806,941 | | 174,590 | |
| B | 1,472,949 | 1 | 23,725,558 | | 7,638 | |
| B- | 148,586 | | 16,478,367 | | 70,099 | |
| CCC+ | | | 9,213,981 | | 68,305 | |
| CCC | | 1,776,824 | 3,428,538 | | 42,968 | |
| CCC- | | | 1,340,577 | | | |
| CC | | 280,416 | 87,780 | | | |
| C | | | 101,250 | | | |
| D | | 4,450,431 | 452,000 | | | |
| NA | 37,778,823 | 4,647,903 | 9,952,700 | | 953,316 | |
| NR | 256,921 | | 16,860,346 | $242,698,330 | 3,134,327 | $46,807,083 |
| **Totals** | **$362,633,582** | **$46,989,094** | **$385,947,100** | **$242,698,330** | **$5,135,196** | **$46,807,083** |

* Note: Obligations of the U.S. government or obligations explicitly guaranteed by the government (Government National Mortgage Association) are not considered to have credit risk.

## Asparagus

- Michigan ranks third in the nation for asparagus production
- Michigan asparagus, unlike asparagus from other states, is hand-snapped above the ground. This method yields a more tender and flavorful product
- Michigan processes 95 percent of the U.S. crop

| Mortgages | Municipals | Non-Security Assets | Other | Real Estate Inv. Trust | U.S. Treasuries | Total | % of Portfolio |
|---|---|---|---|---|---|---|---|
| $77,366,169 | $3,177,630 | | | | $379,086,860 | $725,387,633 | 35% |
| | 8,481,403 | | | | | 51,191,194 | 3% |
| 1,779,958 | 3,422,223 | | | | | 30,973,680 | 2% |
| | 3,701,040 | | | | | 18,147,893 | 1% |
| | 7,296,733 | | | | | 65,165,451 | 3% |
| 290,966 | 7,277,413 | | | | | 85,704,593 | 4% |
| 955,935 | | | | $1,183,579 | | 32,271,888 | 2% |
| | | | | | | 28,946,815 | 1% |
| 145,178 | | | | | | 25,174,502 | 1% |
| 342,389 | | | | | | 30,012,183 | 2% |
| | | | | | | 10,050,796 | 0% |
| 286,840 | | | | | | 13,977,383 | 1% |
| | | | | | | 16,056,270 | 1% |
| | | | | 5,119,383 | | 30,827,787 | 2% |
| | | | | 767,249 | | 25,973,395 | 1% |
| 299,107 | | | | 730,399 | | 17,726,558 | 1% |
| | | | | | | 9,282,286 | 0% |
| 1,503,751 | | | | | | 6,752,081 | 0% |
| | | | | | | 1,340,577 | 0% |
| 1,484,734 | | | | | | 1,852,930 | 0% |
| | | | | | | 101,250 | 0% |
| 1,621,736 | | | | | | 6,524,167 | 0% |
| 1,501,242 | | | | 28,790 | | 54,862,774 | 3% |
| 10,468,154 | 6,826,388 | $3,409,509 | $256,956,826 | 180,343,081 | | 767,760,965 | 37% |
| **$98,046,159** | **$40,182,830** | **$3,409,509** | **$256,956,826** | **$188,172,481** | **$379,086,860** | **$2,056,065,051** | **100%** |

### Interest Rate Risk

Interest rate risk is the risk that an investment's value will change due to a change in the absolute level of interest rates. Interest rate risk is controlled through diversification of portfolio management styles. Duration is a measure of interest rate risk. The greater the duration of a bond, or a portfolio of bonds, the greater its price volatility will be in response to a change in interest rates and vice-versa. Sensitivity to changing interest rates may derive from prepayment options embedded in an investment. The Board policy, in regard to interest rate risk, is that the effective duration of the domestic portfolio shall be (+/-) 20% of the Barclays Capital Aggregate Index or the Barclays Universal Bond Index. Board policy in regard to global non-investment grade fixed income securities is that the portfolio's duration is (+/-) 2 years of the benchmark duration. The benchmark for global non-investment grade fixed income securities is 1/3 Barclays Capital U.S. Treasury Inflation Protected Securities Index, 1/3 Citigroup High Yield Market Index, and 1/3 JP Morgan Emerging Markets Global Bond Index. As of December 31, 2010, the plan's exposure to interest rate risk (as measured by the effective duration method summary) is listed on the following page by investment type.

## Effective Duration – December 31, 2010

| Investment Type | Market Value | Weighted Effective Duration |
|---|---|---|
| Agency | $117,386,368 | 3.13 |
| Asset Backed | 47,431,555 | 4.28 |
| CMBS | 14,791,764 | 3.10 |
| CMO | 16,466,717 | 4.12 |
| Commingled Fund | 723,478 | 3.78 |
| Corporate | 250,654,060 | 4.96 |
| Foreign | 222,086,632 | 5.80 |
| Mortgage Pass-Through | 51,184,466 | 3.61 |
| Miscellaneous | 290,400 | 4.71 |
| Municipal | 14,588,650 | 4.93 |
| Private Placement | 3,473,745 | 0.60 |
| Swaps | (672,779) | 5.15 |
| U.S. Treasury | 341,248,306 | 7.14 |
| Yankee (Intl bonds in U.S. dollars) | 85,604,507 | 6.67 |
| Total | $1,165,257,869 | |

### Concentration of Credit Risk Debt Securities

Concentration of credit risk is the risk of loss attributed to the magnitude of an entity's exposure in a single issuer. The investment policy states securities representing debt and equity of any one company shall not exceed 5% of the fair value of the plan's portfolio. MERS did not hold a single organization's securities that exceeded 5% of the plan's net assets other than those issued or explicitly guaranteed by the U.S. government as of December 31, 2010.

### Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. MERS currency risk exposure, or exchange rate risk, is primarily derived from its holdings in foreign currency denominated equities, and fixed income investments. MERS Retirement Board investment policy for the global non-investment grade fixed income portfolio, allows currency hedging to mitigate currency exposure. Hedging the non-U.S. dollar currency exposure of the portfolio is permitted. The portfolio will be limited to the maximum net currency exposure of 25% at any given time.

MERS exposure to foreign currency risk in U.S. dollars as of December 31, 2010, is summarized on the following page.

### Custodial Credit Risk

Custodial credit risk is the risk that deposits may not be recovered in the event of failure of a depository financial institution. As of December 31, 2010, the $501.5 million carrying amount of the Plan's cash and cash equivalents was comprised of $457.8 million of short-term investments, $39.2 million of Defined Contribution investments and $4.5 million in deposits. The $4.5 million bank balance of deposits was subject to custodial credit risk because it was uninsured and uncollateralized.

## Foreign Currency Risk in U.S. Dollar Denominations – December 31, 2010

| Currency | Equities | Fixed Income | Cash | Real Estate | Total |
|---|---|---|---|---|---|
| Argentine peso | | $88,121 | | | $88,121 |
| Australian dollar | $10,127,298 | 31,404,511 | $108,897 | | 41,640,706 |
| Brazilian real | 11,252,576 | 13,186,392 | 3,076,737 | | 27,515,705 |
| British pound sterling | 48,181,064 | 18,142,665 | 140,853 | 28,790 | 66,493,372 |
| Canadian dollar | 16,215,091 | 22,575,085 | 483,242 | | 39,273,418 |
| Colombian peso | | 1,687,568 | | | 1,687,568 |
| Czech koruna | | 9,632,219 | | | 9,632,219 |
| Danish krone | 2,656,766 | 10,462,148 | (84,393) | | 13,034,521 |
| Euro | 47,093,165 | 21,659,926 | 2,937,056 | | 71,690,147 |
| Hong Kong dollar | 46,590,620 | | 9,841 | | 46,600,461 |
| Hungarian forint | | | 42 | | 42 |
| Indonesian rupiah | 151,083 | 2,300,264 | 9,800 | | 2,461,147 |
| Israeli shekel | 562,950 | | 5,716 | | 568,666 |
| Japanese yen | 61,844,543 | | 247,523 | 74,724 | 62,166,790 |
| Malaysian ringgit | 1,318,325 | 14,910,049 | 3,731 | | 16,232,105 |
| Mexican peso | | 14,700,395 | 536,497 | | 15,236,892 |
| New Russian ruble | | 790,212 | | | 790,212 |
| New Taiwan dollar | 12,327,038 | | 852,435 | | 13,179,473 |
| New Turkish lira | | | 60,389 | | 60,389 |
| New Zealand dollar | 88,067 | 19,670,277 | 388,225 | | 20,146,569 |
| Norwegian krone | 4,555,880 | 9,162,638 | 103 | | 13,718,621 |
| Philippine peso | 369,479 | | 1,783 | | 371,262 |
| Polish zloty | 1,370,135 | 10,397,490 | 79,712 | | 11,847,337 |
| Singapore dollar | 13,444,319 | | 368 | | 13,444,687 |
| South African rand | 3,331,858 | 534,243 | 53,128 | | 3,919,229 |
| South Korean won | 12,781,286 | 10,946,340 | 152 | | 23,727,778 |
| Swedish krona | 2,342,570 | 14,248,105 | 88,616 | | 16,679,291 |
| Swiss franc | 2,042,304 | | 105 | | 2,042,409 |
| Thai baht | 3,698,079 | | 1,576 | | 3,699,655 |
| Turkish lira | 5,645,811 | | 400 | | 5,646,211 |
| Total International Investment Securities | $307,990,307 | $226,498,648 | $9,002,534 | $103,514 | $543,595,003 |

## Grapes

- Michigan is the fourth-largest grape producing state in the nation
- About 2,000 acres are devoted to wine grapes
- Michigan has more than 70 commercial wineries

### Securities Lending

MERS policy authorizes participation in a securities lending program administered by its global custodian, State Street Bank and Trust Company. MERS receives income as the owner of securities, as well as income from the lending of those securities. There are no dividends or coupon payments owing on the securities on loan. Securities lending earnings are credited to MERS and other participating clients on approximately the fifteenth day of the following month. The securities loans are open contracts and, therefore, could be terminated at any time by either party.

The borrower collateralizes the loan with either cash or securities at 102% of market value plus accrued interest on domestic securities, and 105% of market value plus accrued interest on international securities loaned. Due to the nature of the program's collateralization of U.S. fixed income securities loans at 102% plus accrued interest, MERS management believes that there is no credit risk per GASB 40 since the lender owes the borrower more than the borrower owes the lender. Cash collateral is invested for MERS in a dedicated short-term investment fund consisting of investment grade fixed income securities. The custodian provides for full indemnification to MERS for any losses that might occur in the event of borrower default resulting from negligence or intentional misconduct. Securities on loan are marked to market daily to ensure the adequacy of the collateral. There are no restrictions on the amount of securities that can be loaned at one time. Neither MERS nor the custodian has the ability to pledge or sell collateral securities delivered unless the borrower is in default.

MERS has never experienced a loss on securities lending transactions resulting from the default of a borrower or lending agent since it commenced lending securities in March 1995. As of December 31, 2010, the fair market value of fixed income securities invested in the cash collateral pool was below the original cost, resulting in a cumulative unrealized loss of $7,012,863 that is reflected in the financial statements. Security lending produced a net income of $3,294,781 in 2010 excluding unrealized gains and losses.

### Collateral Held and Fair Value of Securities on Loan – December 31, 2010

| Fair Value of Securities on Loan | Nature of Collateral | Collateral Held |
|---|---|---|
| $948,026,162 | Cash | $972,419,765 |
| - | Non-Cash | - |
| **$948,026,162** | | **$972,419,765** |

### Derivatives

Derivative instruments are financial contracts whose value depends on the values of underlying assets, reference rates, or financial indexes. They include futures contracts, swap contracts, credit-linked notes (CLN) and forward foreign currency exchange. While the Board has no formal policy specific to derivatives, MERS holds investments in futures contracts, swap contracts, credit linked notes, and forward foreign currency exchange. MERS enters into these derivative contracts primarily to obtain exposure to different markets, enhance the performance, and reduce the volatility of the portfolio. It enters swaps and futures contracts to gain or hedge exposure to certain markets, and to manage interest rate risk and forward foreign exchange contracts primarily to hedge foreign currency exposure.

The following tables summarize the various contracts in the portfolio as of December 31, 2010. The notional value associated with these derivative instruments are generally not recorded on the financial statements; however, the amounts for the exposure (unrealized gains/losses) on these instruments are recorded. Interest rate risks associated with these investments are included in the table. MERS does not anticipate additional significant market risk from the swap arrangements.

### Futures Contracts - December 31, 2010

| Futures Contract | Expiration Date | Long/Short | Notional Value | Market Value |
|---|---|---|---|---|
| S&P 500 E-Mini Index | 3/18/11 | Long | $96,345,600 | $96,230,400 |
| US 2-Yr Treasury Note | 3/31/11 | Short | (877,000) | (875,624) |
| US 5-Yr Treasury Note | 3/31/11 | Long | 4,773,760 | 4,708,760 |
| US 10-Yr Treasury Note | 3/31/11 | Short | (2,698,374) | (2,649,636) |
| US Long Treasury Bond | 3/31/11 | Long | 3,264,814 | 3,175,250 |
| US Dollar Put/Japanese Yen Call Option | 2/24/14 | Long | 217,000 | 144,738 |
| US Dollar Call / Euro Put Option | 1/19/11 | Long | 269,700 | 8,309 |

### Swap Contracts and Structured Notes - December 31, 2010

| Index | Maturity Date | Position | Notional | Exposure* | Counterparty |
|---|---|---|---|---|---|
| S&P GSCI Total Return Index | 5/31/11 | Long | $288,485,860 | $28,732,763 | Cargill Risk Mgmt. |
| CLN Russia Govt. | 7/6/11 | Long | 447,411 | 445,592 | JP Morgan Chase |
| CLN Russia Govt. | 12/17/14 | Long | 344,970 | 344,620 | Barclays |
| CDX NA High Yield | 12/20/15 | Long | 503,125 | 427,660 | Citigroup |
| CDX ITRX Europe | 12/20/15 | Short | (699,208) | (588,452) | Citigroup |
| CLN Indonesia Govt. | 9/15/19 | Long | 1,843,857 | 2,019,700 | Barclays |
| Int. Rate Swap (USD) | 12/9/19 | Receive Floating | 2,030,000 | (64,926) | Citigroup |
| CLN Colombia Govt. | 7/27/20 | Long | 584,388 | 614,712 | Citigroup |
| CLN Indonesia Govt. | 11/16/20 | Long | 502,677 | 578,024 | HSBC |
| CLN Brazil Govt. | 1/1/21 | Long | 275,481 | 271,316 | JP Morgan Chase |
| CLN Indonesia Govt. | 9/15/25 | Long | 286,718 | 280,563 | JP Morgan Chase |
| CMBX Index | 2/17/51 | Short | (6,700,000) | (278,186) | Citigroup |

* Swap contracts are governed by International Swaps and Derivatives Association Master Agreements, MERS and counterparties. These agreements require collateral to be posted by either party when exposure exceeds the amount specified in the agreement (usually $250,000 to $5,000,000).

### Foreign Currency Forward Contracts

| | |
|---|---|
| Pending Receivable | $187,768,802 |
| Pending Payable | (187,410,130) |
| **Foreign Currency Forward Contract Asset (Liability)** | **$358,672** |

MERS could be exposed to risk if the counterparties to the contracts are unable to meet the terms of the contracts. MERS and its investment managers seek to control this risk through counterparty credit evaluations and approvals, counterparty credit limits, and exposure monitoring procedures. MERS anticipates that counterparties will be able to satisfy their obligations under the contracts. Investments in limited partnerships and combined funds may include derivatives that are not shown in the derivatives' totals.

### Private Equity and Capital Calls

The MERS Board has approved $862,866,742 for investment in private equity securities. As of December 31, 2010, $828,850,434 was invested in private equity with $62,253,851 recallable return of capital, leaving $96,270,159 available for future investments.

## 5. Commitments and Contingencies

In the normal course of business, benefit claims are in various states of development. Determinations are made through established administrative procedures. The Retirement Board is responsible for making the final judgment but may be subject to judicial review. MERS does not anticipate any material loss as a result of these claims. Furthermore, the cost of a successful benefit claim is ultimately the responsibility of the affected municipality – it becomes a funding obligation. MERS maintains insurance for workers' compensation, owned and leased vehicles, blanket property, fiduciary, fidelity, and faithful performance to cover other risk of loss such as personal injury to employees or others, property damage, or other liability.

## 6. Related Parties

MERS is the majority stockholder of Tegrit Group, and its division Tegrit Administrators. This is an investment in the MERS Strategic Opportunity Fund held within the MERS Total Market Fund. Tegrit is the recordkeeper for the MERS Defined Benefit Plan, Defined Contribution Plan, Hybrid Plan, Retiree Health Funding Vehicle, Investment Services Program, and the Health Care Savings Program. MERS paid Tegrit $2,436,260 in 2010.

## 7. Subsequent Events

In 2011, MERS assumed full control of its Defined Contribution Plan by taking over the development and management of the investment lineup. Additionally, Tegrit Administrators, a MERS majority-owned subsidiary, assumed the Defined Contribution Plan administration, reporting and recordkeeping.

## 8. Funded Status and Funding Progress

The funded status of the MERS Defined Benefit Plan is as follows:

### Schedule of Funding Progress – (Dollars in Millions)

| Actuarial Valuation December 31 | Actuarial Value of Assets (a) | Actuarial Accrued Liability (AAL) (b) | Unfunded (Over) AAL (UAAL) (b-a) | Funded Ratio (a/b) | Covered Payroll (c) | UAAL as a % of Covered Payroll ((b-a)/c) |
|---|---|---|---|---|---|---|
| 2009 | $6,443.1 | $8,534.7 | $2,091.6 | 75.49% | $1,636.5 | 127.8% |

Actuarial assumptions include a 10-year smoothed market asset valuation method adopted December 31, 2005, with prospective application and an investment rate of return of 8%. The December 31, 2009 actuarial valuation reflects changes in actuarial assumptions for a temporary lower wage inflation assumption and revised rates of expected employee retirement.

The Schedule of Funding Progress immediately following the Notes to Basic Financial Statements presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing relative to actuarial accrued liability.

# REQUIRED SUPPLEMENTARY INFORMATION (UNAUDITED)

## Schedule of Funding Progress – (Dollars in Millions)

| Actuarial Valuation December 31 | Actuarial Value of Assets (a) | Actuarial Accrued Liability (AAL) (b) | Unfunded (Over) AAL (UAAL) (b-a) | Funded Ratio (a/b) | Covered Payroll (c) | UAAL as a % of Covered Payroll ((b-a)/c) |
|---|---|---|---|---|---|---|
| 2004 | $4,731.4 | $6,164.8 | $1,433.4 | 76.70% | $1,437.2 | 99.7% |
| 2005 | 5,026.1 | 6,609.1 | 1,583.0 | 76.05 | 1,462.4 | 108.2 |
| 2006 | 5,493.7 | 7,187.7 | 1,694.0 | 76.43 | 1,545.9 | 109.6 |
| 2007 | 5,973.0 | 7,723.9 | 1,750.9 | 77.33 | 1,581.6 | 110.7 |
| 2008 | 6,245.5 | 8,321.9 | 2,076.4 | 75.05 | 1,624.9 | 127.8 |
| 2009 | 6,443.1 | 8,534.7 | 2,091.6 | 75.49 | 1,636.5 | 127.8 |

## Schedule of Employer Contributions – (Dollars in Millions)

| Fiscal Year* | Annual Required Contribution | Percentage Contributed |
|---|---|---|
| 2005 | $170 | 108% |
| 2006 | 199 | 107 |
| 2007 | 258 | 92 |
| 2008 | 224 | 109 |
| 2009 | 228 | 111 |
| 2010 | 258 | 105 |

*See Note 1 in the Notes to the Schedules of Required Supplementary Information on the following page.

## Dry Edible Beans

- Michigan producers grow several classes of dry beans, including: Black Beans, Cranberry Beans, Great Northern Beans, Red Kidney Beans, Navy Beans, Pinto Beans, and Yellow Eye Beans
- Huron County is one of the top dry bean producing counties in the country
- Every day, "Michigan Bean Soup" is served at the U.S. Senate dining room in Washington, DC, dating back to 1904

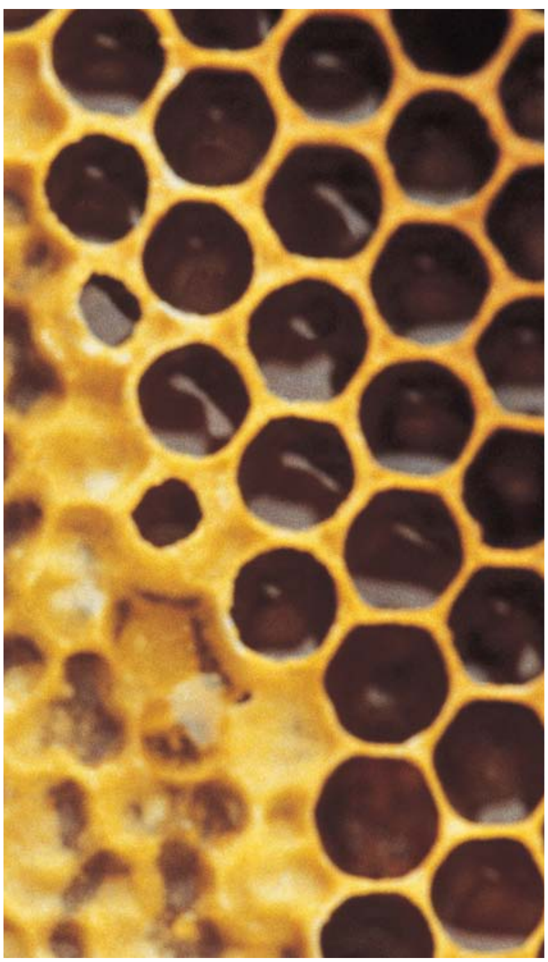
## Notes to the Schedules of Required Supplementary Information (Unaudited)

**1. Actuarial Valuation –** Actuarial valuations are prepared annually as of December 31 for each participating municipality. To facilitate budgetary planning needs, employer contribution requirements are provided for each municipality's unique fiscal year that commences after the following calendar year end. For example, the contribution requirements for fiscal years that began in 2010 were determined by actuarial valuations as of December 31, 2008.

Approximately 78% of the participating municipalities have fiscal years that begin January 1 or July 1.

The annual required contribution and accelerated funding credit shown in the preceding schedule represent the summation of each participating municipality's contribution requirements for its fiscal year commencing in the year stated. However, the calculations to determine the percentage contributed use contributions recorded during MERS fiscal year.

**2. Summary of Actuarial Methods and Assumptions** – The information presented in the required supplementary schedules was determined as part of the actuarial valuation at the dates indicated. Additional information as of the latest actuarial valuation is in the Actuarial Section.



*Honey*

- **Michigan ranks seventh in the nation for honey production**
- **About 50 percent of Michigan's fruit and vegetable industry is highly dependent on honey bee pollination**

## Summary Information

| | |
|---|---|
| **Valuation Date** | December 31, 2009 |
| **Actuarial Cost Method** | Entry Age Normal |
| **Amortization Method** | Level Percent of Payroll, Open |
| **Remaining Amortization Period** | There are 28 years for positive unfunded liabilities, and 10 years for negative unfunded liabilities. The 28-year period will decline by one year in each of the next annual valuations until it reaches 20 years. At the March 11, 2009, Board meeting, the MERS Board voted to hold the 28-year amortization period for unfunded accrued liabilities in effect for the 2007 valuations, constant for the 2008 and 2009 valuations; then, to let it decline by one year each year with the 2010 and beyond valuations. The amortization for unfunded accrued liabilities will reach 20 years with the December 31, 2017, valuation. For divisions that are closed to new hires, the amortization period for positive unfunded liabilities is decreased annually by 2 years until the period reaches 5 years. |
| **Asset Valuation Method** | A 10-year smoothed market asset valuation method was adopted December 31, 2005, with prospective application. Prior to 2006, a 5-year smoothing method was used. |
| **Actuarial Assumptions** | Investment Rate of Return – 8% |
| **Projected Salary Increases** | A 4.5% for base inflation, plus 0.0% to 8.4% per year attributable to merit and longevity. For the 2009 valuation the base wage inflation assumption was 2% instead of 4.5%. For the 2010 through 2013 valuations the base wage inflation assumption will be 1% instead of 4.5%. |
| **Post-Retirement Benefit** | A 2.5% annual post-retirement benefit adjustment if adopted by individual municipalities. |

## Schedule of Administrative Expenses for the Year Ended December 31, 2010

*Defined Benefit Plan*

| Administrative Expenses | |
|---|---|
| **Personnel Services** | |
| Salaries | $8,504,618 |
| Social Security | 588,046 |
| Retirement | 1,034,235 |
| Insurance | 1,393,177 |
| **Total Personnel Services** | **11,520,076** |
| **Professional Services** | |
| Actuarial Services | 1,167,114 |
| Audit Services | 99,500 |
| Commercial Banking | 128,856 |
| Computer Maintenance | 7,447 |
| Consultants | 226,803 |
| Legal Services | 252,355 |
| Medical Services | 63,349 |
| **Total Professional Services** | **1,945,424** |
| **Communication** | |
| Advertising / Promotional Supplies | 9,045 |
| Annual Meeting | 186,182 |
| Board Travel and Meetings | 21,142 |
| Library and Records Storage | 51,153 |
| Postage / Shipping | 170,649 |
| Printing and Copying Services | 137,910 |
| Telephone / Communications | 136,195 |
| Travel and Meetings | 406,025 |
| **Total Communication** | **1,118,301** |
| **Rentals** | |
| Equipment Rental | 95,267 |
| Office Rental | 859,500 |
| **Total Rentals** | **954,767** |
| **Miscellaneous** | |
| Depreciation | 2,331,988 |
| Equipment Purchases | 162,776 |
| Insurance | 172,876 |
| Building / Equipment Maintenance | 329,128 |
| Office Supplies | 116,544 |
| Operating Expenses | 953,726 |
| Payroll Processing | 16,836 |
| Personnel Support | 217,211 |
| Professional Development & Tuition | 427,979 |
| Software Purchases and Maintenance | 1,063,905 |
| Subscriptions / Memberships | 74,840 |
| Service Fees | (455,005) |
| **Total Miscellaneous** | **5,412,804** |
| **Total Administrative Expenses** | **$20,951,372** |

Note: See accompanying Independent Auditor's Report.

## Schedule of Investment Expenses for the Year Ended December 31, 2010

*Defined Benefit Plan*

| Investment Expenses | |
|---|---|
| **Personnel Services** | |
| Salaries | $904,091 |
| Social Security | 56,724 |
| Retirement | 107,510 |
| Insurance | 107,649 |
| **Total Personnel Services** | **1,175,974** |
| **Professional Services** | |
| Commercial Banking | 1,026,013 |
| Investment Managers | 17,373,045 |
| Investment Performance | 102,000 |
| Other Consultants | 84,556 |
| **Total Professional Services** | **18,585,614** |
| **Communication** | |
| Travel | 48,924 |
| **Total Communication** | **48,924** |
| **Miscellaneous** | |
| Operating Expenses | 17,860 |
| Software Purchases/Maintenance | 265,034 |
| **Total Miscellaneous** | **282,894** |
| **Total Investment Expenses** | **$20,093,406** |

Note: See accompanying Independent Auditor's Report.

# Corn

- About 300 AD, people began planting corn in Michigan
- Michigan corn production ranks 11th in the nation
- Corn adds nearly $1.1 billion to Michigan's economy

## Schedule of Payments for Consultants and Services

| Firm | Nature of Service | Amount |
|---|---|---|
| Tegrit Financial Group, LLC | MAPS & Software and Design Support | $2,165,319 |
| Gabriel, Roeder, Smith & Company | Actuary | 1,317,475 |
| State Street Corporation | Depository Trust | 919,834 |
| Robbins-Gioia Financial Services Group | FileNet System Implementation & Support | 347,477 |
| Crowe Horwath, LLP | MicroSoft Great Plains Implementation | 284,586 |
| Tegrit Administrators | HCSP, RHFV & DC Support | 270,941 |
| Tek Systems | Software Implementation Advisor & Support | 234,744 |
| Ice Miller | Legal Counsel | 168,801 |
| DPM Consulting Services | Software Implementation Advisor & Support | 161,415 |
| Trivalent Group | Software Implementation Advisor & Support | 129,856 |
| Bloomberg Finance L.P. | Investment Financial Data Service | 113,589 |
| Kforce Technology | Software Implementation Advisor & Support | 99,178 |
| New London Management Associates, LLC | Human Resource & Career Advisors | 95,160 |
| Sungard Availability Services | Business Continuity Services | 72,011 |
| Andrews Hooper Pavlik PLC | Auditing Services | 63,550 |
| Consulting Physicians, PC | Medical Advisors | 63,350 |
| Oracle America | PeopleSoft Software Support | 53,712 |
| Daymark Software, LLC | CRM Software Support | 52,309 |
| Global Bridgebuilders | Employee Benefit Advisors | 48,934 |
| Thomson Reuters (Markets), LLC | Investment Financial Data Service | 48,544 |
| Miller Canfield | Legal Counsel | 44,554 |
| Gavekal Capital Management, LTD | Investment Financial Data Service | 40,000 |
| Interactive Business Systems | Software Implementation Advisor & Support | 38,880 |
| Service Express | Software Implementation Advisor & Support | 37,607 |
| MSCI | Software Implementation Advisor & Support | 36,000 |
| CEM Benchmarking | Benchmark Data Production | 35,000 |
| DHR International | Executive Recruiting | 33,333 |
| IBM Corporation | FileNet Software Support | 31,536 |
| Gallagher Benefit Services | Employee Benefit Advisors | 30,000 |
| Karoub Associates | Legislative Advisors | 30,000 |
| Ravenflow | Business Continuity Software Support | 28,743 |
| Davis Mendel and Regenstein | Investment Financial Data Service | 25,000 |
| NuView Systems | Software Implementation Advisor & Support | 23,680 |
| Zephyr Associates | Investment Financial Data Service | 22,688 |
| Presidio Network Solutions | Software Implementation Advisor & Support | 22,053 |
| Perceptive Software | Software Implementation Advisor & Support | 21,969 |
| Eggertsen Consulting | MERS Premier Health Advisor | 21,611 |
| Hedrick Associates | Software Implementation Advisor & Support | 21,200 |
| **Total Payments to Consultants** | | **$7,254,636** |

Note: Fees paid to investment managers are included in the Investment Section. Payments to consultants are already included in the Administrative and Investments Expenses stated in the Statement of Changes in Plan Net Assets.

Note: See accompanying Independent Auditor's Report.