

PLANNING
RETIREMENT
TOGETHER FOR

70
YEARS



70th Annual Business Meeting

MERS ANNUAL CONFERENCE

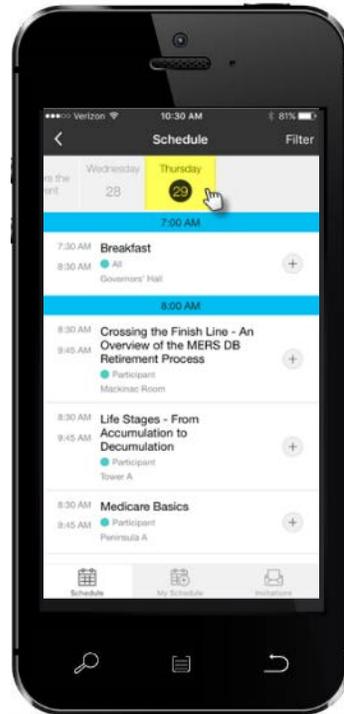
SEPTEMBER 29, 2016

GRAND TRAVERSE RESORT

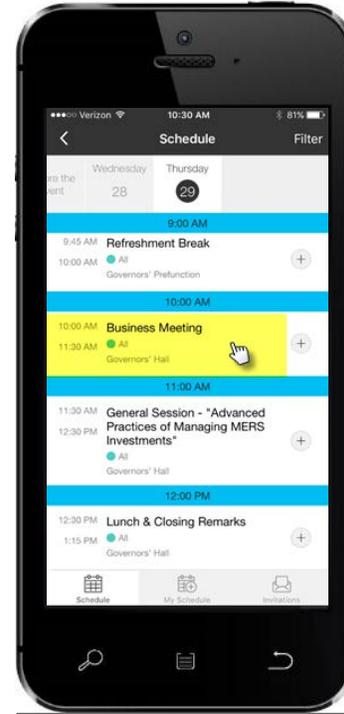
Locating Business Meeting Documents in the App



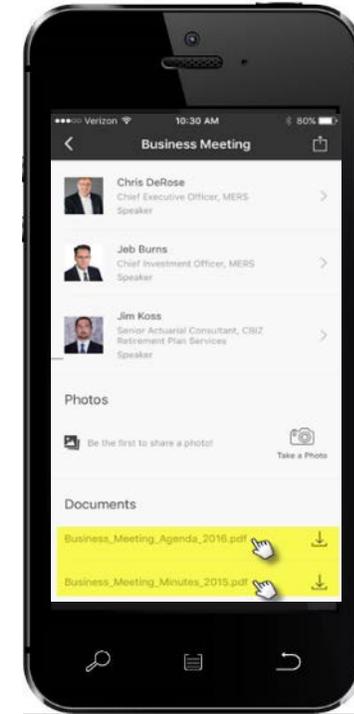
Step 1:
Select the **Schedule** icon



Step 2:
Select **Thursday** at the top of the screen



Step 3:
Select **Business Meeting**



Step 4:
Scroll down and select the **Agenda** or **Minutes**

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MERS at 70 Years

Chris DeRose, MERS CEO

MERS Vision

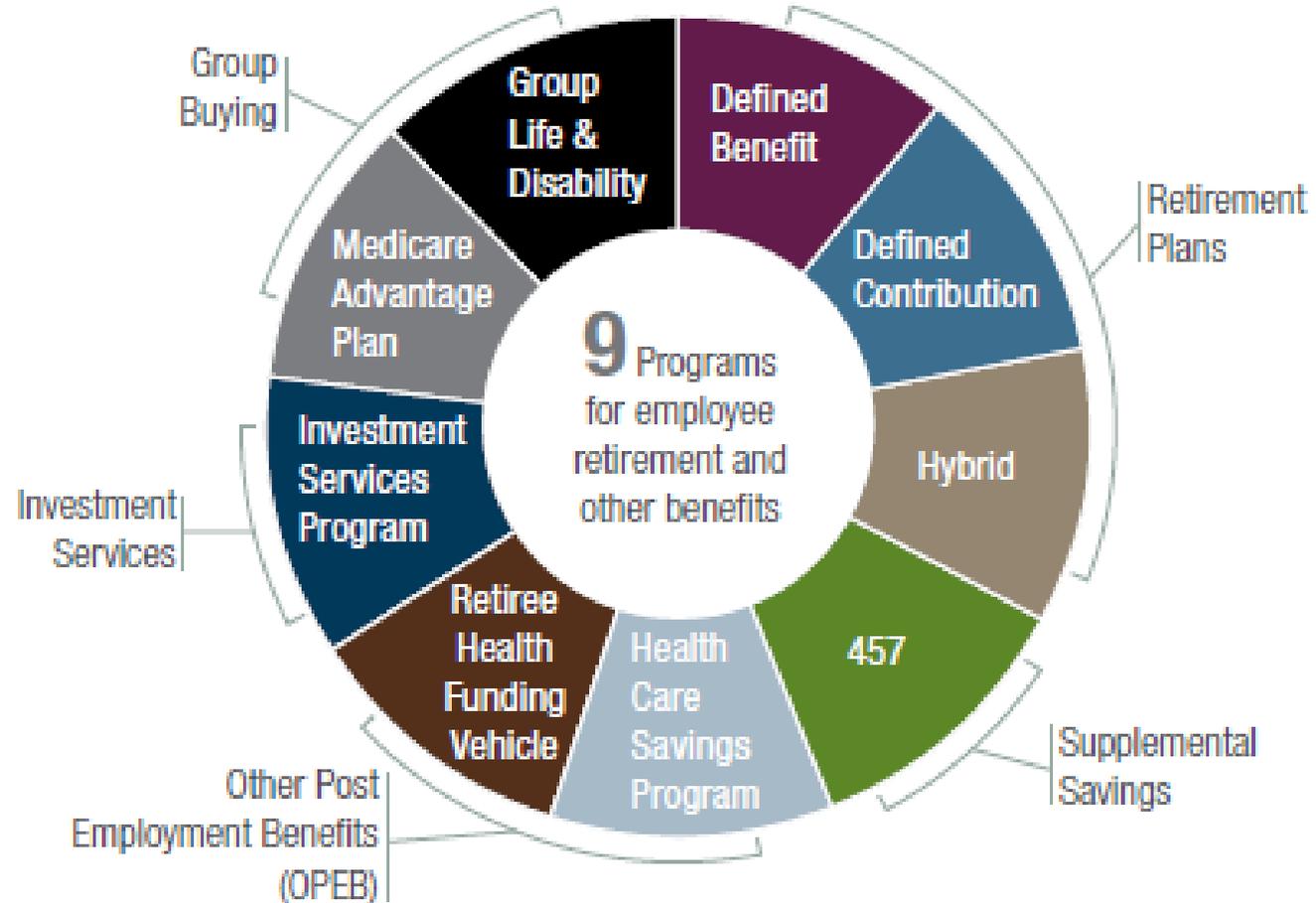
By 2020, MERS will deliver superior value to our customers by:

- Achieving a deeper understanding of their needs and connection with them
- Consistently delivering services through intuitive processes and systems
- Proactively partnering with employers by providing options and information that help meet their unique workforce and financial needs
- Significantly increasing resources and awareness that help participants improve financial wellness to be ready for retirement

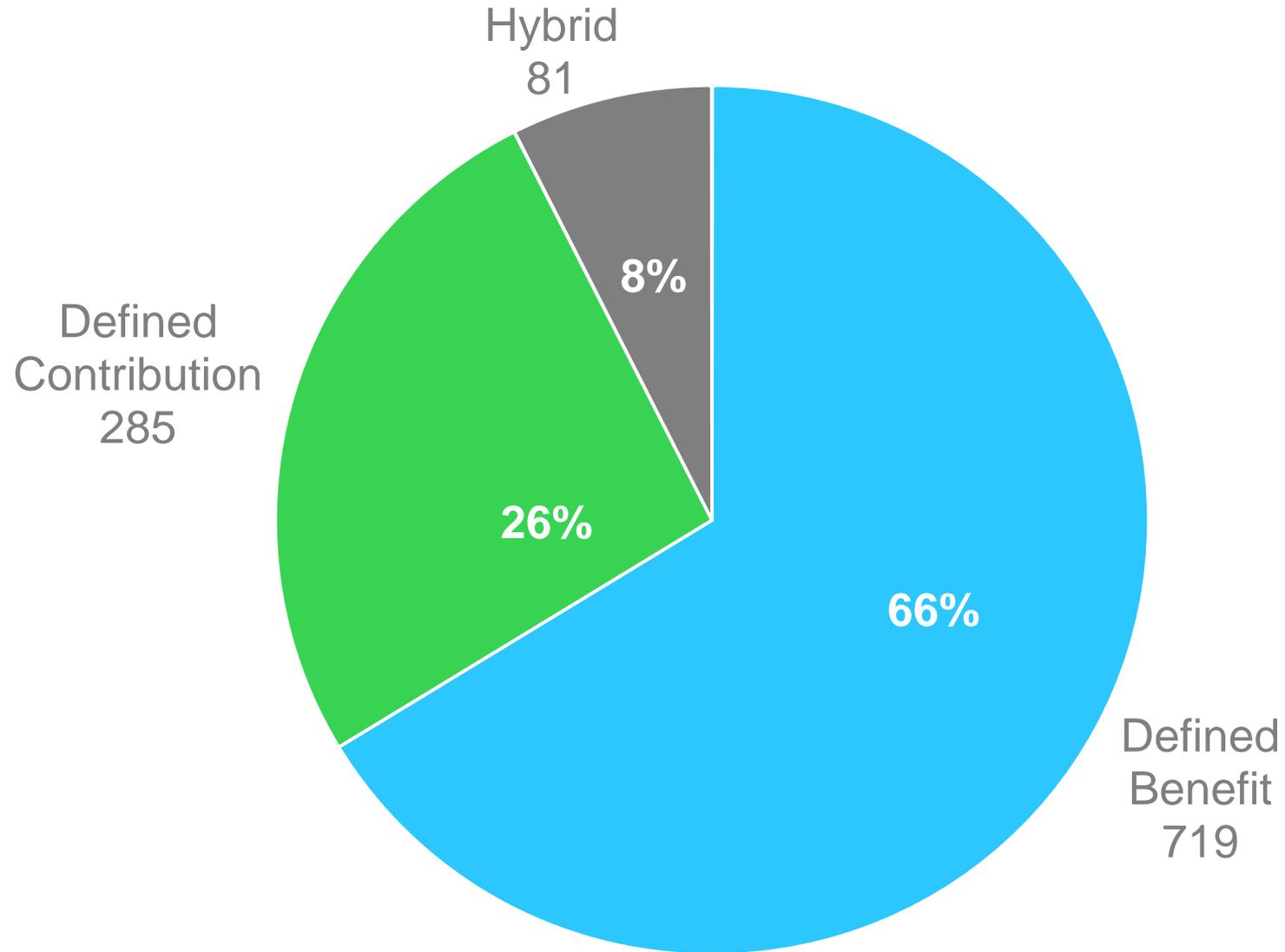
Understanding MERS Role

- MERS is an independent, professional retirement services company that was **created to administer** the retirement plans for Michigan municipalities on a not-for-profit basis
- Our elected board is responsible for the administration of the system with **fiduciary responsibility** for the investment of assets and oversight
- Today MERS represents  84% of Michigan's municipalities

A Program For Every Need

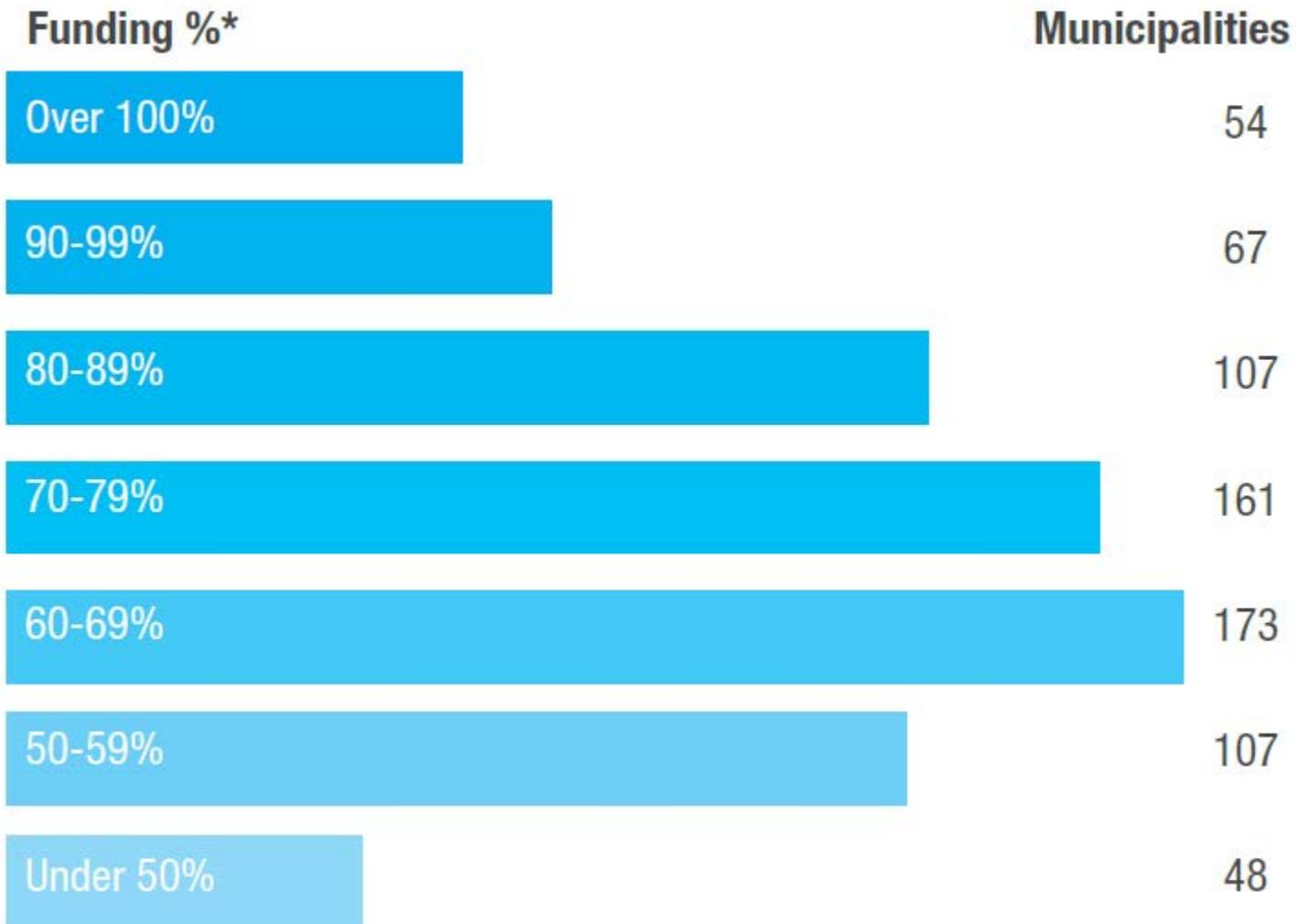


MERS Retirement Plan Customers



As of 8/31/2016

Distribution of Funding



As of 12/31/2015

Adequate Funding

- Pension plans should have a strategy in place to reach or maintain a 100% funded level or greater over a reasonable time frame
- Understanding a pension plan's funding progress should not be reduced to a single point in time
- Since across the state each municipality determines benefits and sets assumptions at the local level, it's misleading to compare average funding levels
- MERS has a successful track record of improving the financial health of our member's plans

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Experience Study & National Trends

Experience Study

- Part of MERS' fiduciary responsibility
- Conducted with our actuarial firm every five years
- Compares actual experience of the plan with the current assumptions to determine if changes are necessary

Key Changes from Last Experience Study

- 
- 1 Assumed investment return was reduced from 8% to 7.75%
 - 2 Mortality table was adjusted to reflect longer lifetimes
 - 3 Amortization was moved to a fixed period

Investment Assumption

- The investment return assumption determines the portion of benefits that is assumed to be provided by investment income
- Considerations:
 - A long-term historical perspective
 - Whether recent history fundamentally changed the future economic outlook
 - Analysis and forecasts from experts and governmental sources
 - Evaluation of economic assumptions against comparably sized public retirement systems

Impact to MERS

- Historically, MERS has met the 8.0% investment return assumption over the long term
- Our 35-year rate of return is 9.43%
- We think it is still too soon to conclude that recent economic conditions have permanently changed future long-term financial markets
- The MERS Retirement Board determined that it would be prudent to reduce the long-term investment return assumption to 7.75%

Mortality Table Assumption

- As with all our assumptions, the mortality assumption is reviewed every five years
- Both of the two previous 5-year experience studies showed that MERS retirees were living **shorter** lifetimes than projected by the present mortality assumption
- The new study confirms that MERS retirees are now experiencing **longer** lifetimes
 - There has been sufficient increase in the longevity of retirees to warrant a new mortality table that projects longer lifetimes

Background on MERS Funding Policies

MERS has addressed Unfunded Accrued Liability (UAL) in numerous ways over the past decade including policy decisions and expanding product offerings to assist you with options to manage and/or reduce UAL

Amortization Policy

- The amortization policy sets the process for making payments on a plan's unfunded accrued liability (UAL)
- The amortization policy doesn't make the benefits cheaper or more expensive; it simply impacts the pattern of contributions
- Historically, public pension plans like MERS, used a rolling amortization period of 30 years and had a focus of contribution stability

Fiscal Responsibility Policies

- MERS was ahead of the curve by requiring an actuarial report before a benefit enhancements
- Minimum funding requirement of 60%, was later increased to 80%, then 100% for benefit enhancements
- Three times minimum funding policy was updated to include all divisions
 - Policy is a safeguard that prevents plans from running out of assets to pay accrued benefits

Fixed Amortization

- In an effort to be proactive on GASB 68 changes, as well as in support of adequacy and intergenerational equity, in 2014 MERS moved to a fixed amortization policy
- This is a fundamental shift in policy that gives plans a specific date by which all known obligations will be fully funded

Helping You Move Forward

- Added budget projection scenarios to annual actuarial valuations to assist with long-term planning
- Significant strides to reduce and stabilize administrative costs
- Developed new plan design options
- Provided Retirement Readiness Snapshot reports for the second year

“
**We all need people
who will give us
feedback.
That’s how we improve**
Bill Gates, Microsoft



Listening To Your Feedback

Increasing costs to your plan, driven by the adjustments to the longer life expectancies and volatile investment markets, are a key concern for some of you and your ability to balance your budgets and maintain key essential services to your community

New Amortization Options Available

- While the amortization policy changes are not a driver of the increasing costs, it has been an area where we have continued to receive feedback
- While our current policies are in alignment with our funding goals, some customers need flexibility with the timeframe in which we are getting them to full funding
- A one-time extension of amortization periods for open and closed plans is now available
- Since all plans have unique funded levels and demographics, approval would be provided by MERS following a sustainability analysis

Other Policy Changes

- The Board has also listened to feedback regarding the minimum funding requirement for closing a defined benefit plan and transitioning to a defined contribution plan
- Moving forward there will no longer be a funding requirement to close your plan, rather a sustainability analysis will indicate what amortization period is needed and what the contribution requirements will be

Michigan Funding Observations



- By state law pension plans are required to be prefunded
- Every single MERS municipality has made their required contributions
- In our 70-year history we have never missed a pension payment to retirees

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Pension Reform

MYTH  **FACT**

MYTH:

Underfunding in the MERS system is caused by overly generous assumptions about future investment returns and mortality rates.

FACT:

- Underfunding occurs for many reasons including, historical benefit enhancements and the once in 100 year market downturn of 2008
- As a voluntary system, many plans joined MERS underfunded
- To ensure assumptions are sound, we perform an Experience Study every five years

MYTH: MERS investments have dismal performance.

FACT:

- As retirement plans operate over long-term time horizons it's important to focus on long-term investment rates rather than focus on one specific year
- MERS consistently outperforms its benchmarks and market averages



For more than 20 years, more than half of retirement benefits have come from MERS investment earnings

MYTH:

There is less accountability, and responsibility is more dispersed and less direct with MERS, compared to an entity that manages its own pension system.

FACT:

- MERS follows industry standards for transparency, accountability and fiduciary responsibility
- We are governed by an elected board that doesn't receive compensation
- As the plan fiduciary, we put our members first

MYTH:

Closing all public pensions and mandating everyone to a 401(k) would create savings for taxpayers.

FACT:

- Closing a plan doesn't reduce costs or unfunded liability
- If all plans in MERS were to be closed, the investment allocation would need to be recalibrated to ensure adequate cash is on hand to pay the remaining retirees
- This likely means higher contributions are needed from employers/taxpayers

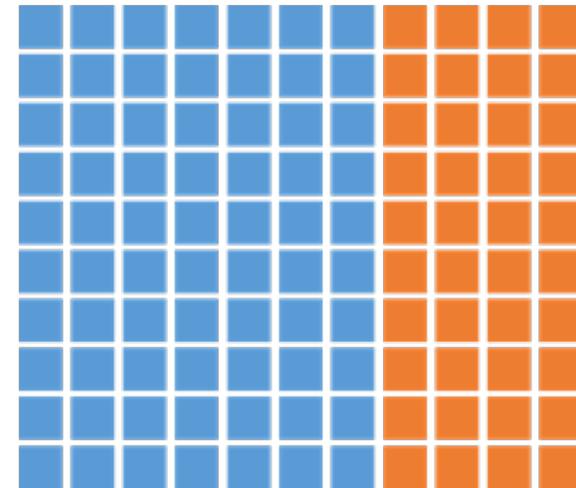
MYTH:

If the state doesn't fix the pension crisis, all municipalities will go bankrupt.

FACT:

Recent studies by the University of Michigan CLOSUP program and the Michigan Citizens Research Council show that the state's municipal finance system is one of the key underlying issues affecting local services

60% of the liability 40% of the liability



859 plans 10 plans

MYTH:

Local municipalities aren't sophisticated enough to manage their retirement benefits.

FACT:

In the last 5 years, **73%** of municipalities within MERS have taken proactive steps to manage their benefit commitments by lowering their costs or closing their funding gap

MYTH:

Pension reform is being pushed by local taxpayers.

FACT:

- Various groups have policy objectives that include a shift all new public employees to a 401(k)-style, defined contribution plan

Monitoring Legislative Consideration

The screenshot shows the MERS (Municipal Employees' Retirement System) website. At the top left is the MERS logo with the text 'Municipal Employees' Retirement System'. To the right are social media icons for Facebook, Twitter, LinkedIn, and YouTube, with the text 'Follow Us' and an arrow. Below this is a navigation menu with links for 'Home', 'Forms', 'Help', 'Contact Us', and 'Login'. A green navigation bar contains tabs for 'EMPLOYEE', 'RETIREE', 'EMPLOYER', 'MEDIA', and 'MERS', along with a search bar. The main content area features a large 'MYTH vs FACT' banner with a 'Click to learn more' button. Below the banner is a row of smaller promotional tiles for various topics like '401(k) Plan', 'Sit. Stay. Roll Over!', 'Retirement Readiness', and 'Experience Study'.

MYTH vs FACT

THE ISSUE

There is misinformation being shared that mandating all public workers and school employees to a 401(k)-style plan would create savings for taxpayers. This is a complex public policy issue that needs to be addressed with great care to safeguard tax dollars and public retiree benefits. The retirement of Michigan's municipal workers is too important to trivialize with broad assumptions, myths and sound bites.

SIGN UP FOR ALERTS

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Readying You for Retirement

MERS Approach to Retirement Readiness

Retirement Readiness Snapshot Reports

- These reports are intended to give participants a “snapshot” of their projected income in retirement using the information that MERS has along with Social Security
- Our goal is to drive participants online to complete their Full Picture



Full Picture Report Builder

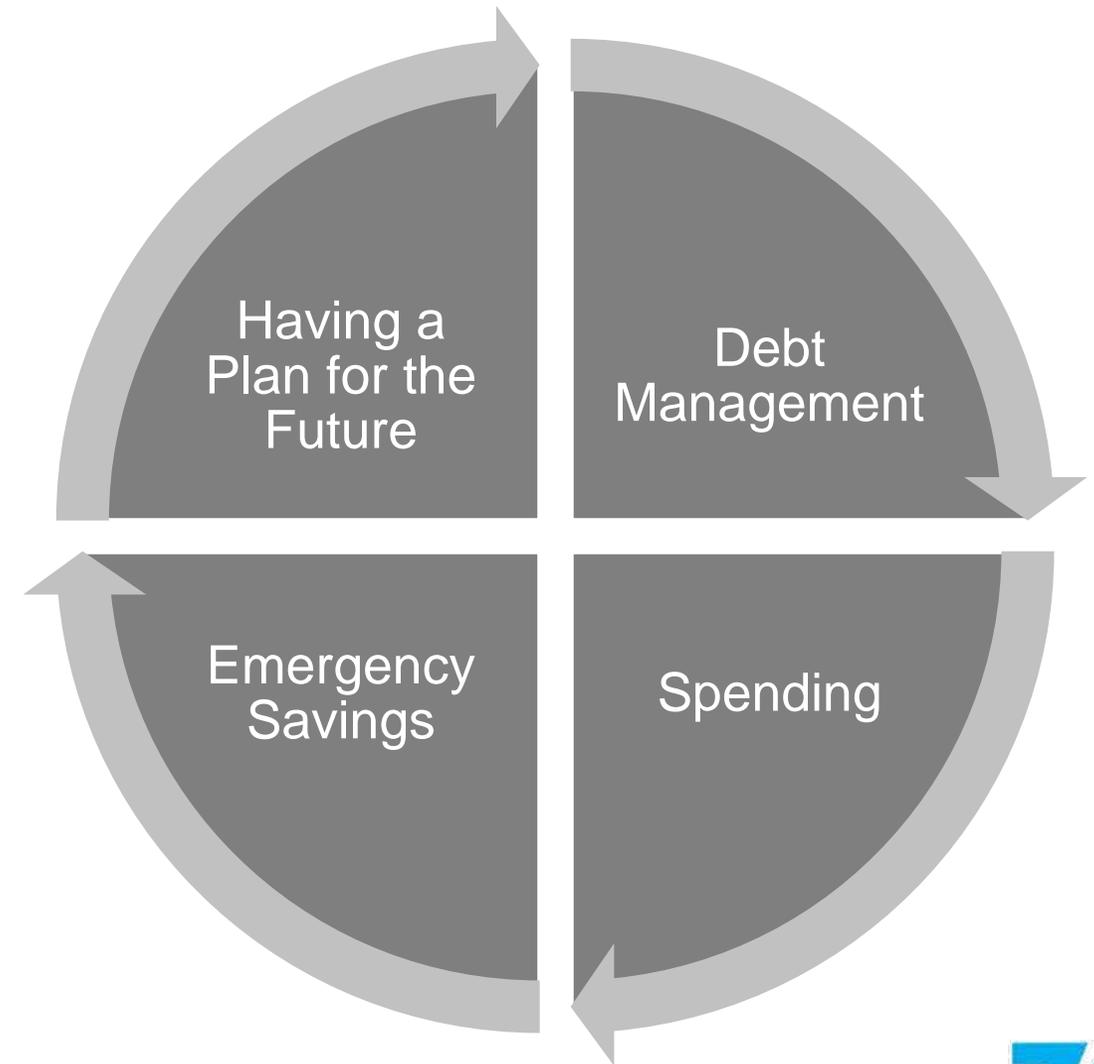
- Through the participant's online account they can build their "full picture"
- In addition there are easy to use action plans that help participants change deferral rates or investment allocations right within the tool



Looking Towards the Future

Financial wellness is a program or set of programs designed to improve employees' **financial** behavior and outcomes while also driving business impact.

For employees, **financial wellness** is holistic and **defined** by health, not wealth.



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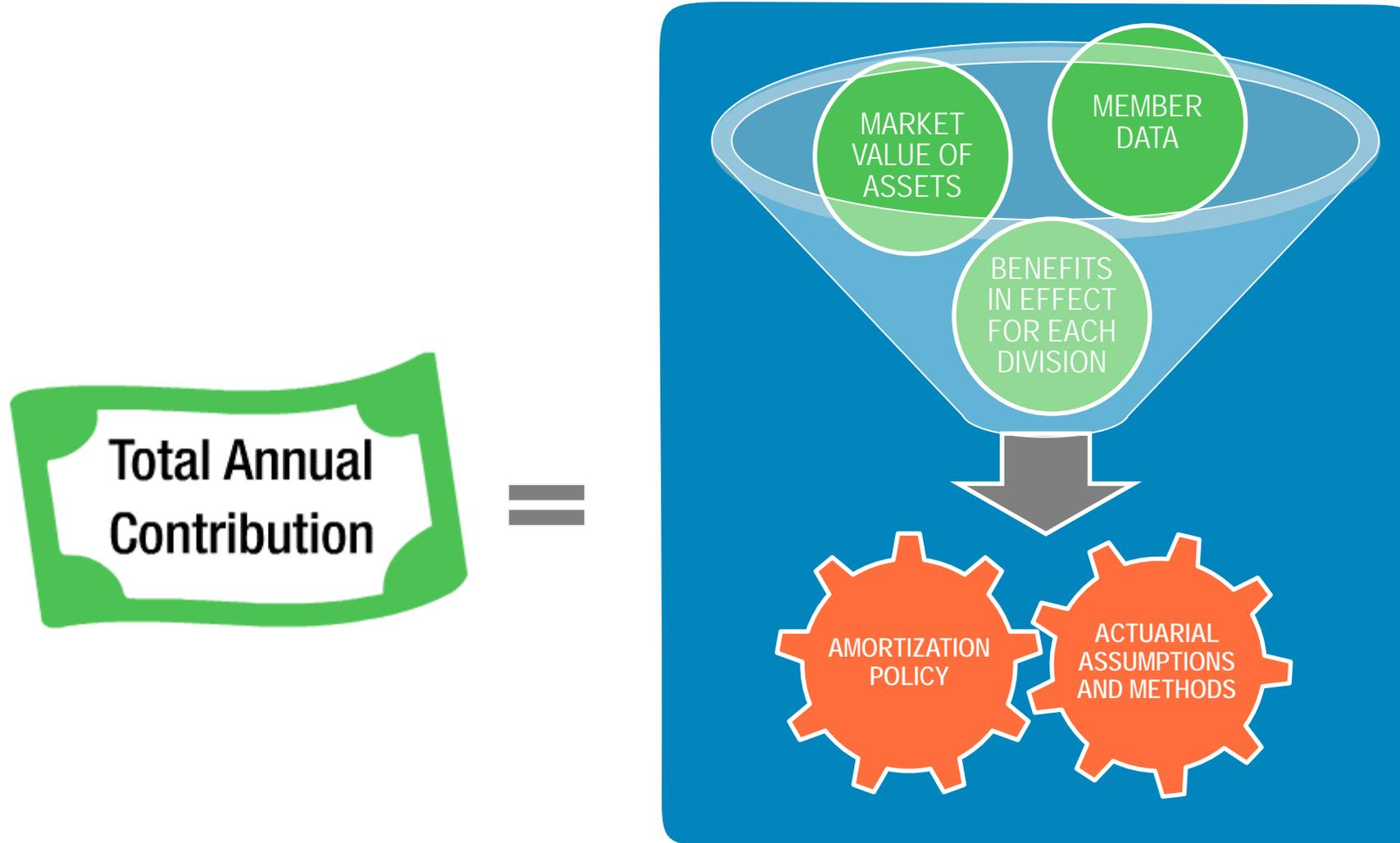
Actuary Report

Jim Koss, Senior Consulting Actuary
CBIZ Retirement Plan Services

Annual Actuarial Valuation

- An important tool to help you **budget** for your municipality's retirement benefits, with information specific to your municipality's retirement plan
- Provides a picture of your MERS Defined Benefit Plan as of December 31 each year
- Provides insight into your plan's liabilities, funding levels, contributions for both the employer and member, and important GASB Information
- Reports the contribution requirements for each member division for your following fiscal year
 - If you are reviewing the valuation for December 31, 2015, the contribution requirements go into effect the first day of your fiscal year starting in 2017

Calculating the Total Annual Contribution



Actuarial Assumptions and Methods are established by the Retirement Board

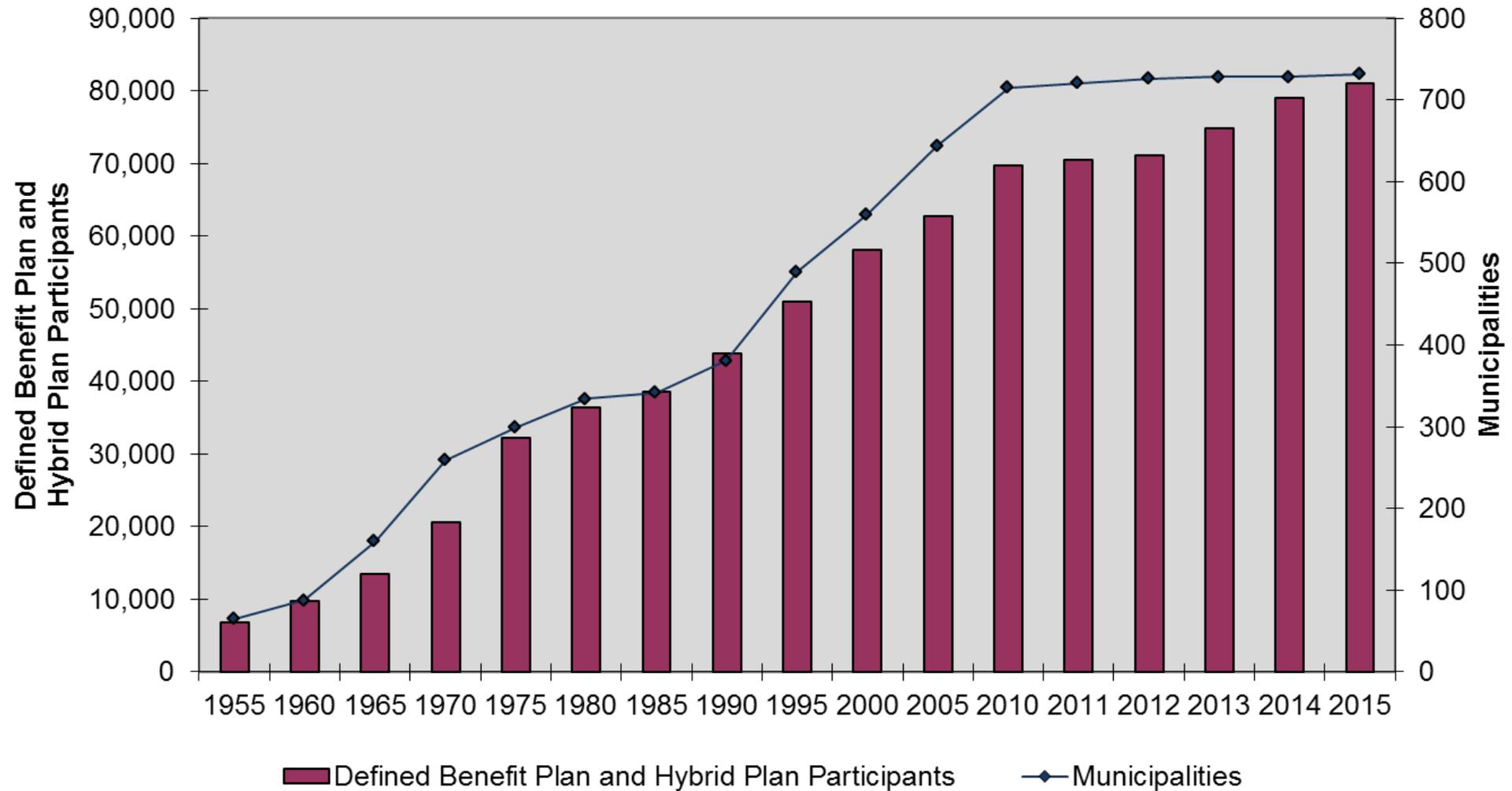
Assumption and Method Changes

- As previously discussed, there were a number of assumption changes reflected in the 2015 valuation reports; those having the largest impact were:
 - The mortality table was changed to reflect longer expected lifetimes
 - The annual long-term rate of investment return was lowered from 8.0% to 7.75%
 - Base wage increase reduced from 4.5%/yr. to 3.75%/yr.
- There were also several method changes (these will first impact the 2016 valuation reports)
 - The asset smoothing period was changed from 10 to 5 years
 - New Unfunded Liability will be amortized over fixed periods, creating “layers” of amortization

Assumption and Method Changes, cont.

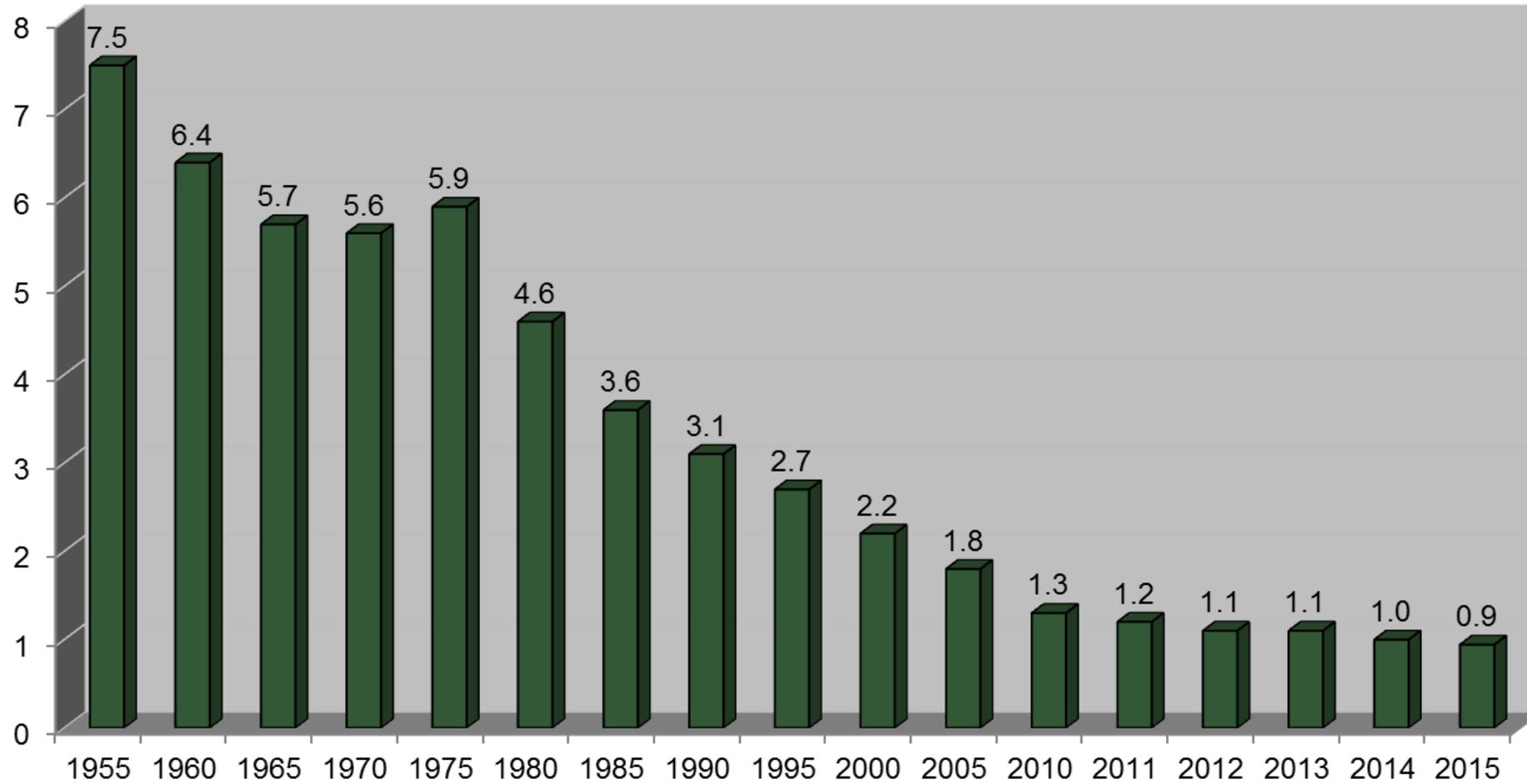
- The assumption changes resulted in lower funded status and higher contribution rates for most municipalities
- An optional 5 year phase-in of the assumption change impact on contributions is available
 - Encourage contributing at least the “Full Impact” rates
- Actual experience, not assumptions, will ultimately determine the cost of the plan
 - Assumptions help determine the contribution pattern over time

MERS Continues to Grow



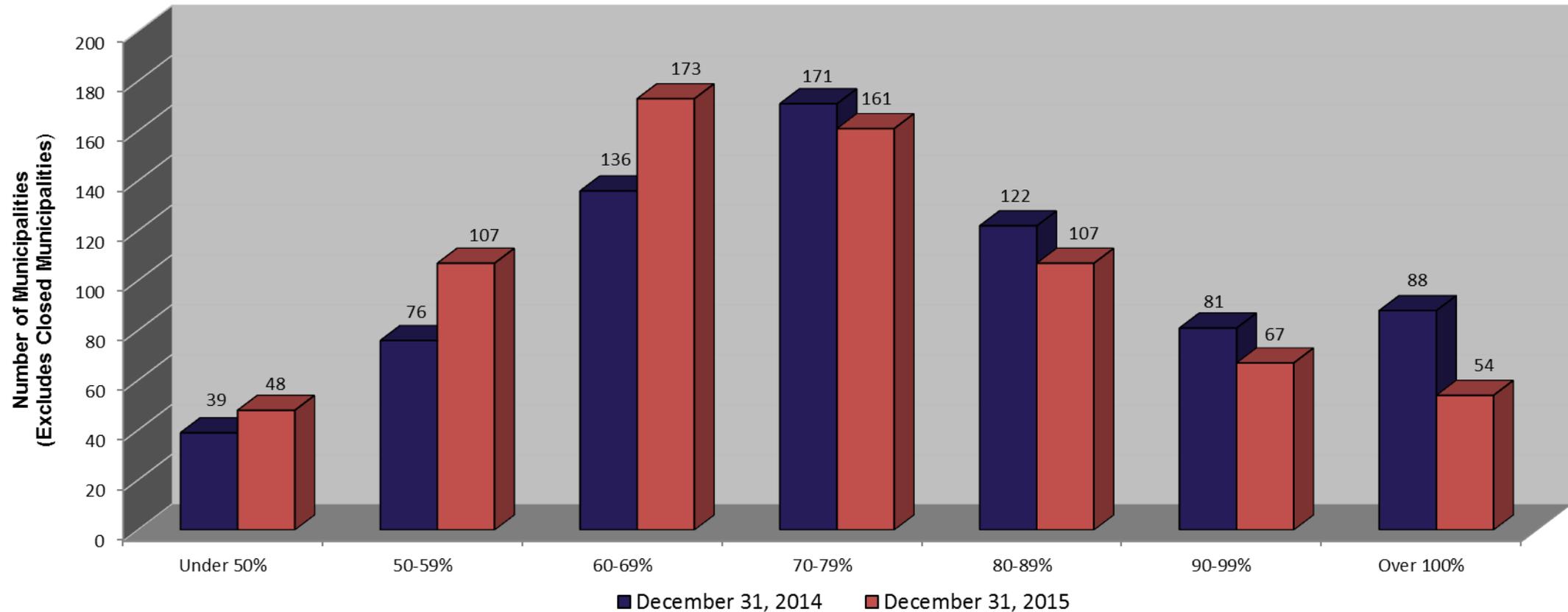
MERS Becoming More Mature

Active Members Per Pension Recipient



Distribution of Funded Percentages

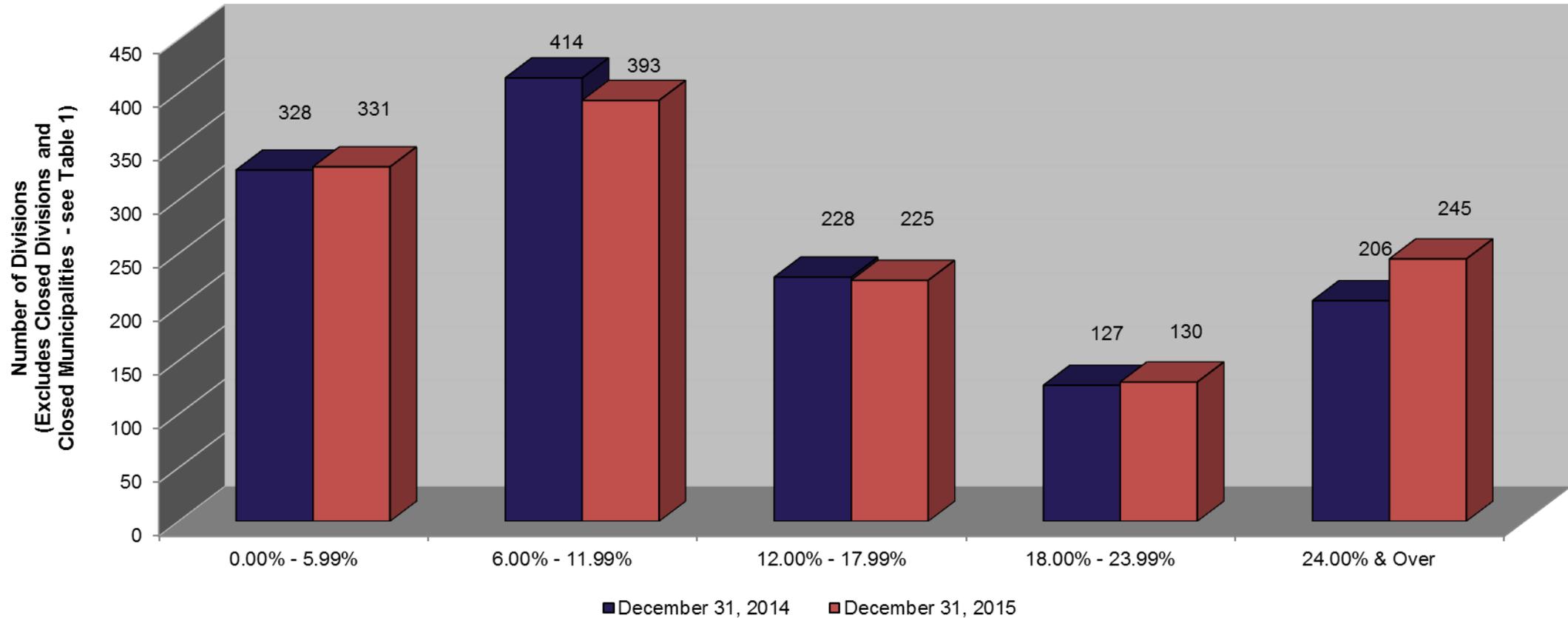
2014 and 2015 Valuations



54% of all municipalities in MERS are funded at 70% or higher

8% of all municipalities are funded at 100% or more

Distribution of Employer Contribution Rates by Division



Employer contribution rates vary between divisions as a result of differences in demographics, benefit provisions, and cost-sharing arrangements

2015 Actuarial Valuation Results

- Every MERS employer stands on its own
- On average employer contributions
 - Increases due to assumption changes
 - Increases due to the financial markets (2008 and 2015 market losses)
 - Increases due to amortization policy
 - Decreases or increases due to changes in active member pays
 - Other changes due to changes in benefit provisions and other experience
 - This average includes all MERS divisions, both open divisions with new hires, closed divisions with no new hires entering the division, and new MERS municipalities

What Does the Future Hold?

- MERS plans remain in a strong financial position
- Annual dollar contributions will continue to increase
 - A function of the level-percent-of-payroll funding method
 - Short-term increases will be steeper if phase-in contributions are used
- A better than 7.75% market return is needed to avoid additional increases in average employer contributions (to make up for past market downturns)
- Small divisions will continue to have more volatile actuarial valuation results
- Very mature divisions (with current benefit payout far exceeding contribution income) will see declining funded percentages before the percentage starts heading toward 100%
- MERS will continue to mature

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MERS Investment Office Update

Jeb Burns, MERS Chief Investment Officer

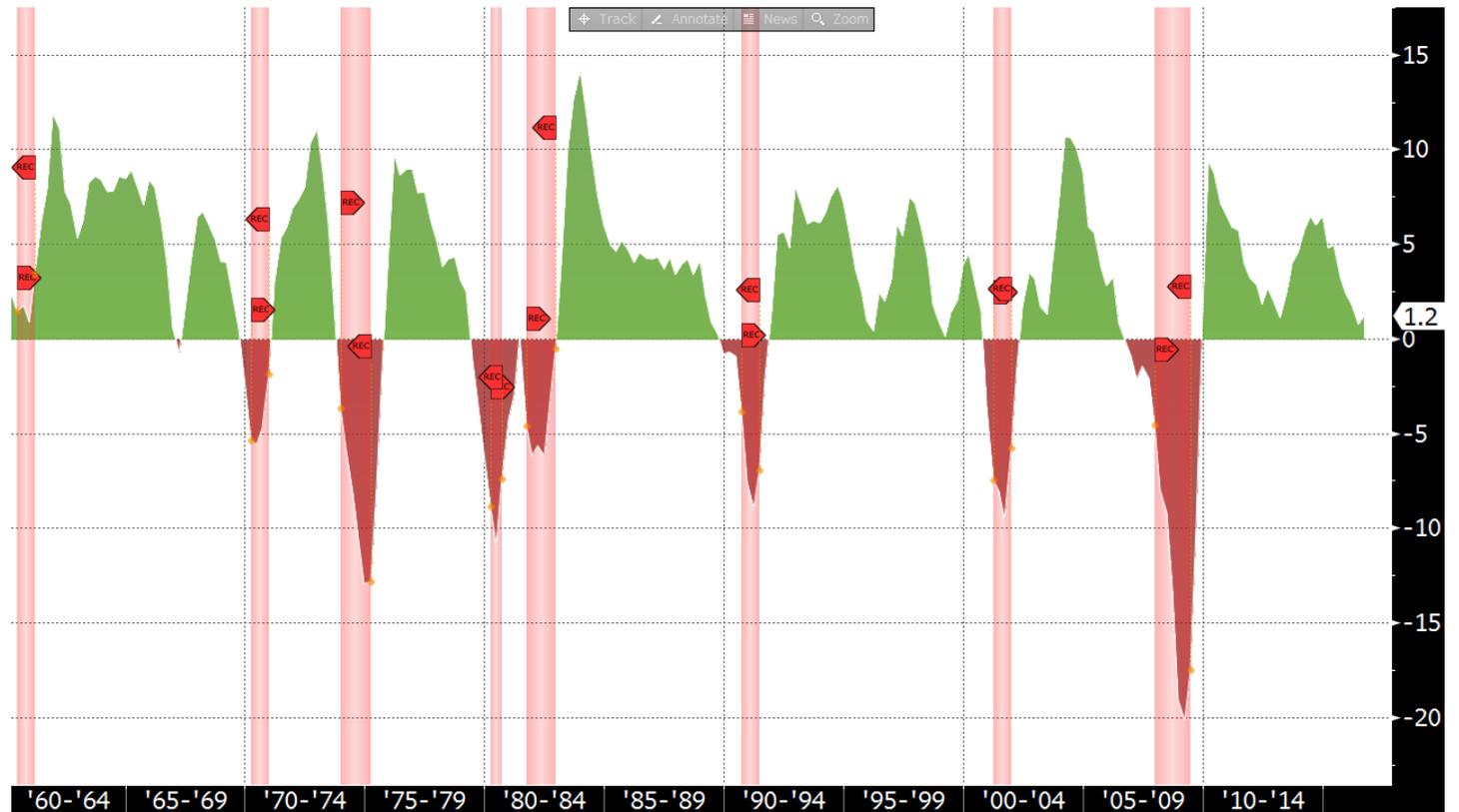
Overview

- Market review
- Fund performance
- Office of Investments operations and governance
- Future trends

U.S. Economy

- U.S. economic growth is slowing
 - No recession yet
 - Growth is vulnerable to shocks from abroad
 - Financial markets expected to remain volatile
- Q2 GDP (YoY) 1.2%

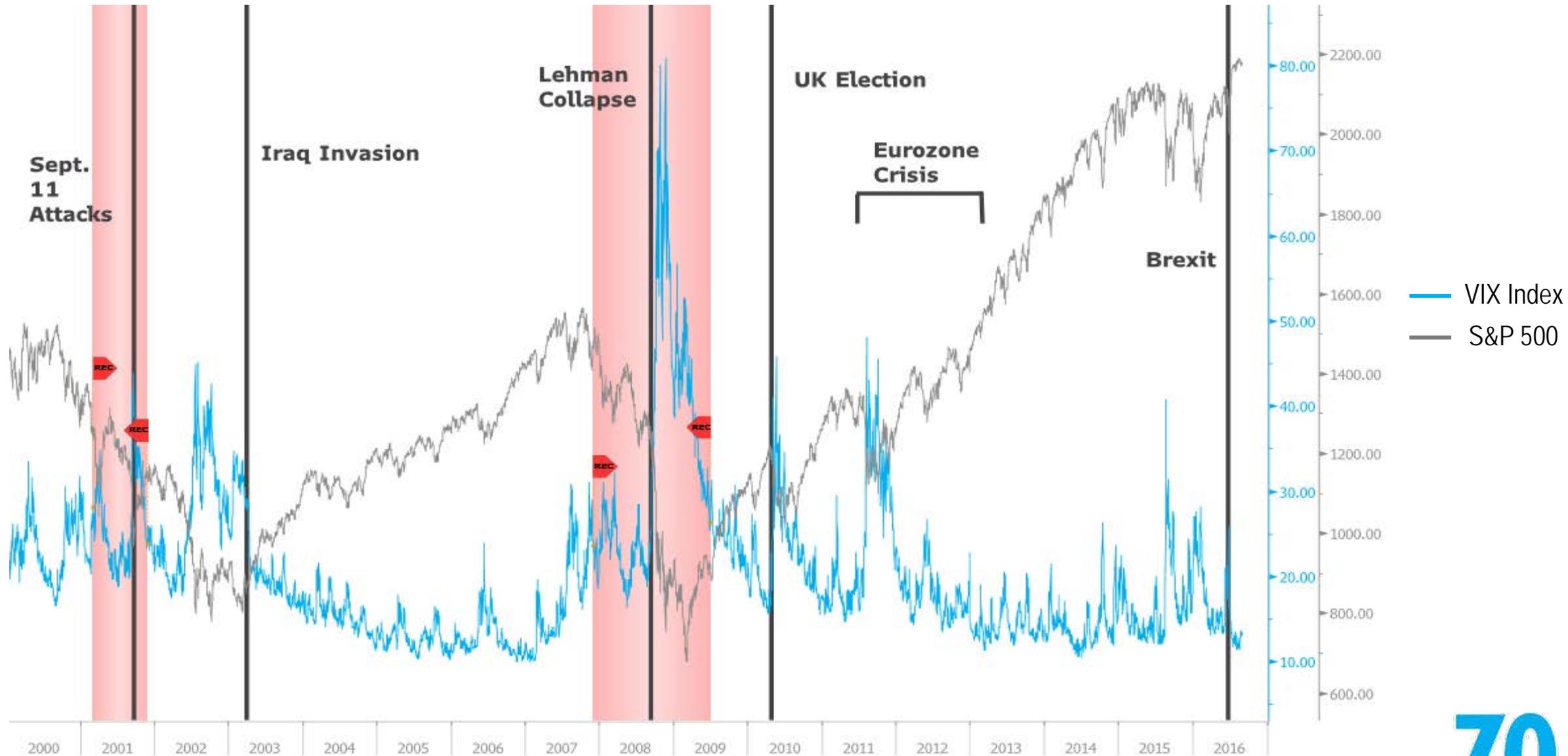
Conference Board Index of Leading Economic Indicators



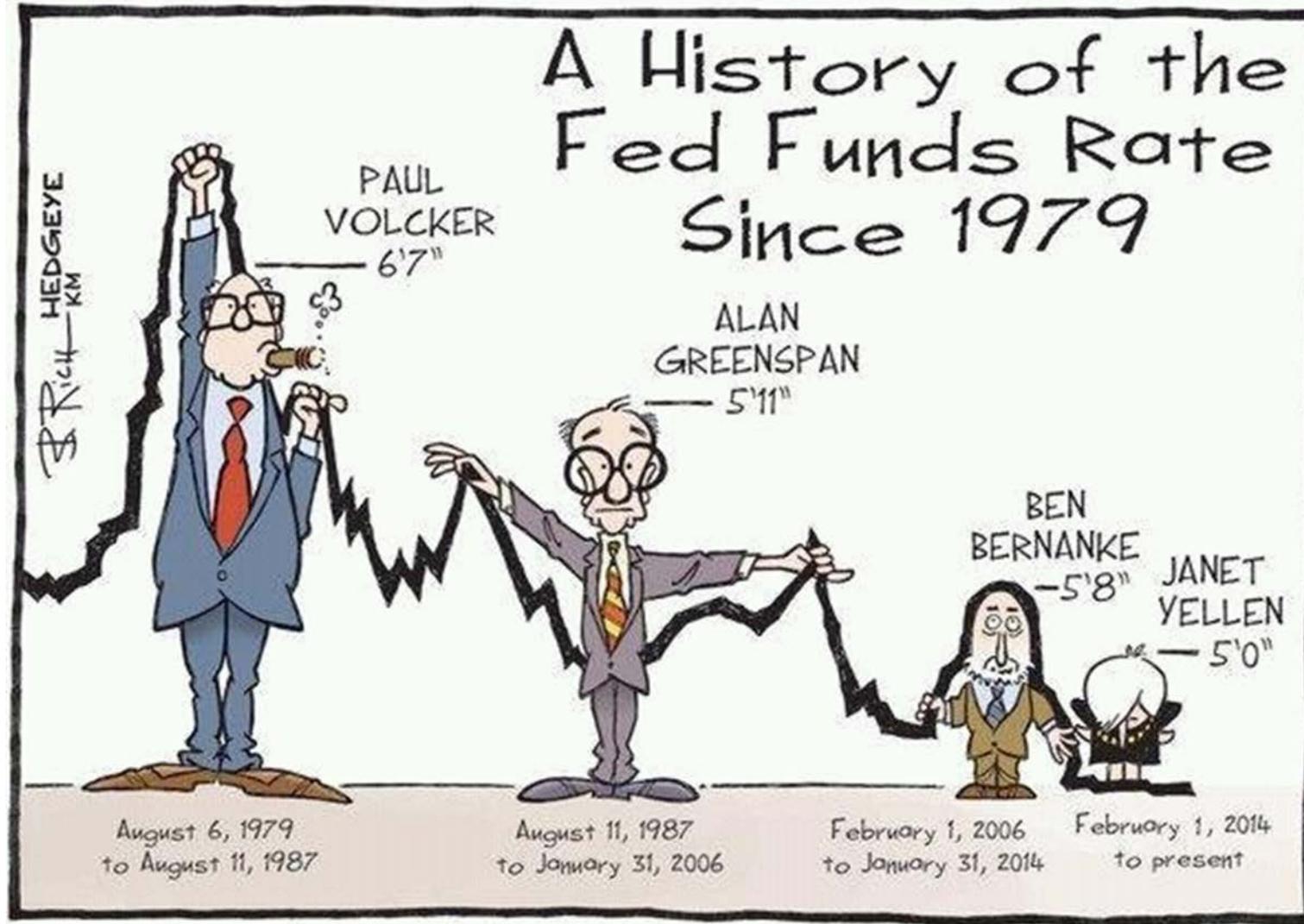
Geopolitical Risks

- Tensions between U.S., China, and Russia
 - South China Sea
 - Syria
 - Ukraine
- Emerging Market domestic politics
 - Political risks in Brazil, Turkey, and South Africa rising
- Developed Market
 - Watching for fiscal policy to turn positive in light of voter revolts
- Eurozone stability
 - Brexit
 - Immigration
 - Banking crisis

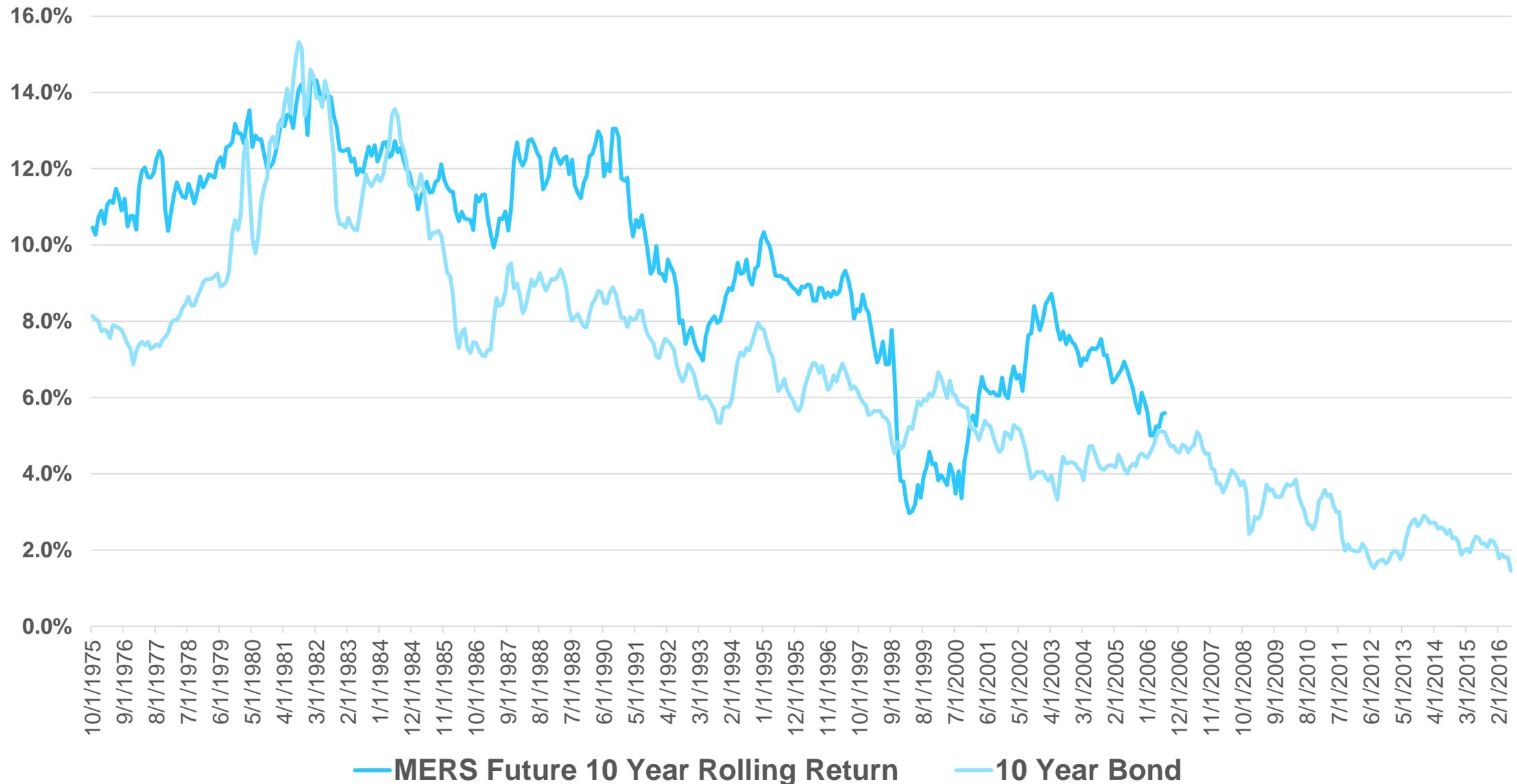
Market Volatility



Interest Rates Making History

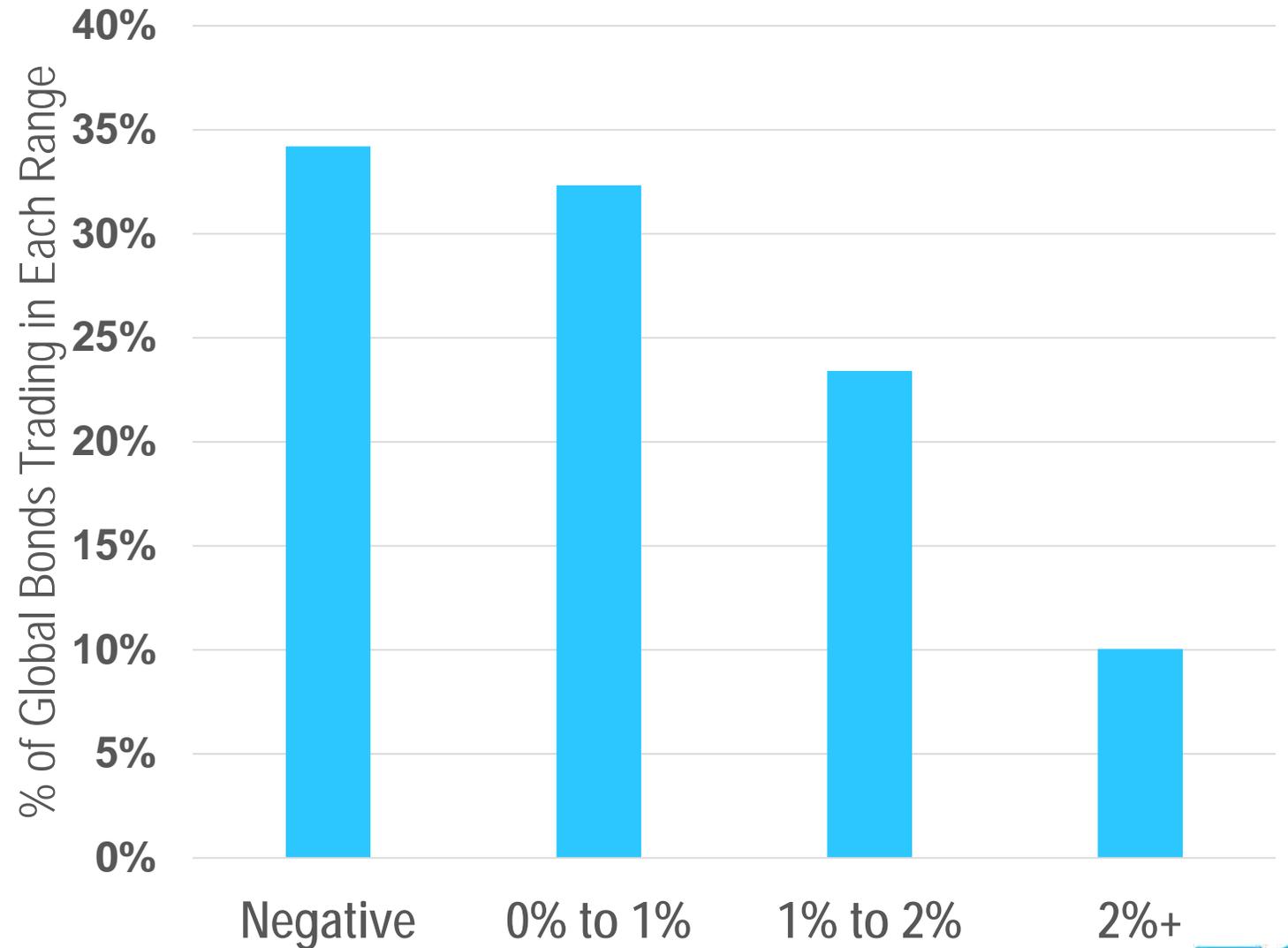


MERS 10 Year Returns vs. 10 Year Treasury



Global Government Bond Yield Ranges

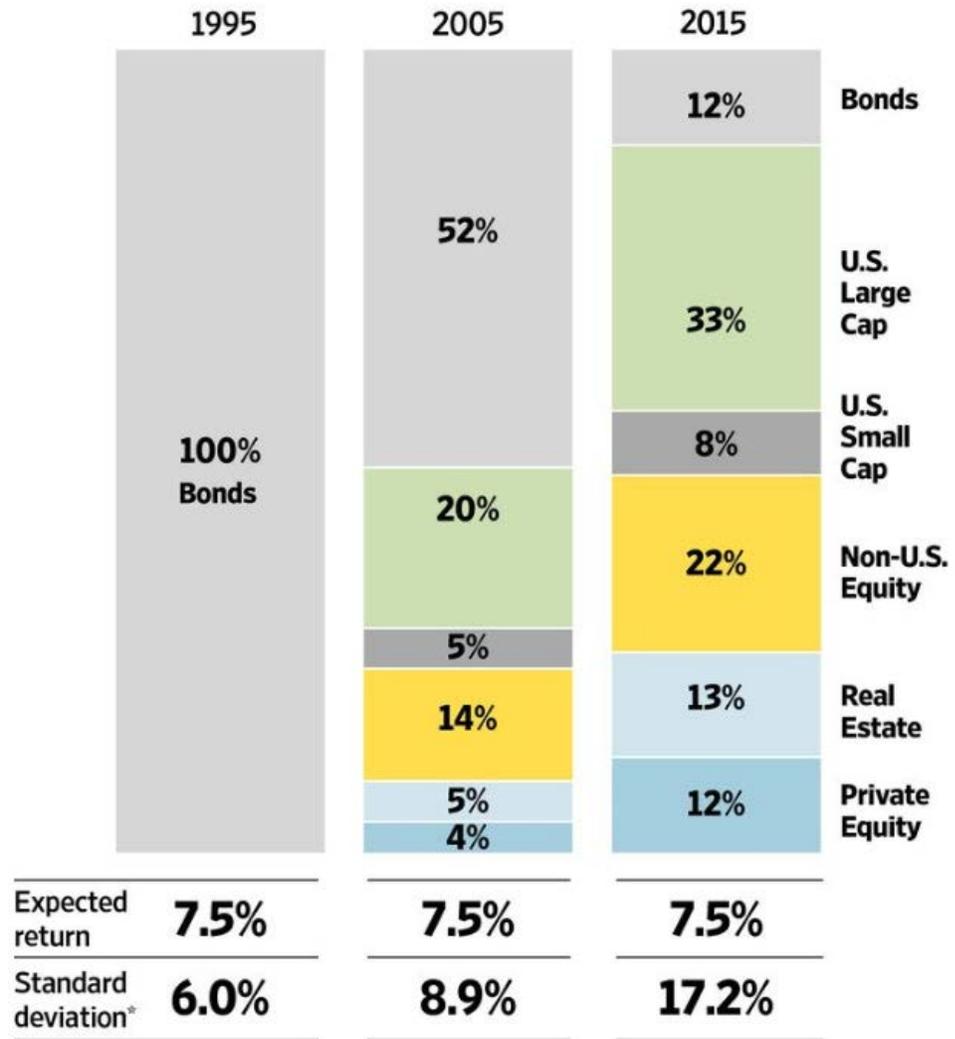
- Over a third of world's bonds trade with a negative yield
- Less than 10% of bonds yield over 2%
- Interest rates are at historical lows



As of September 22, 2016

Risk/ Return

Estimates of what investors needed to earn 7.5%

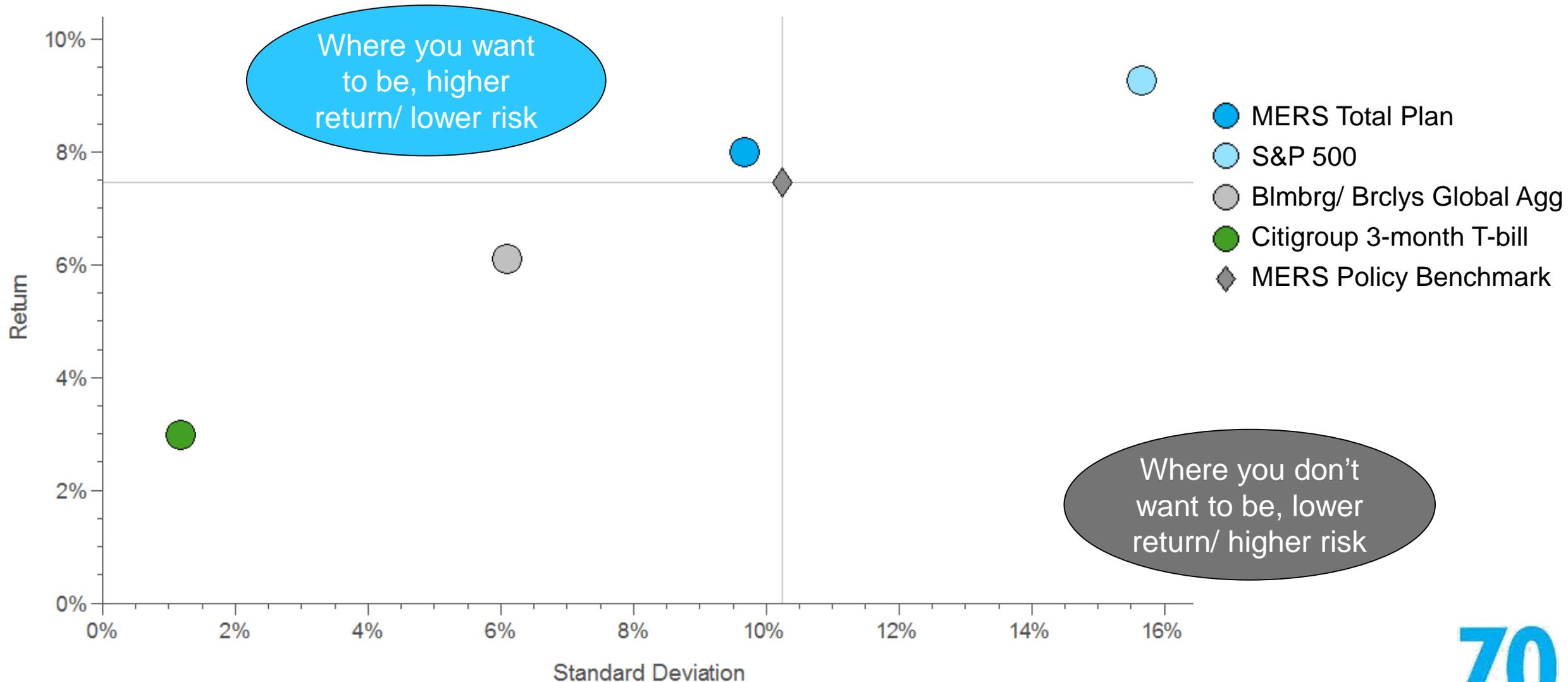


*Likely amount by which returns could vary

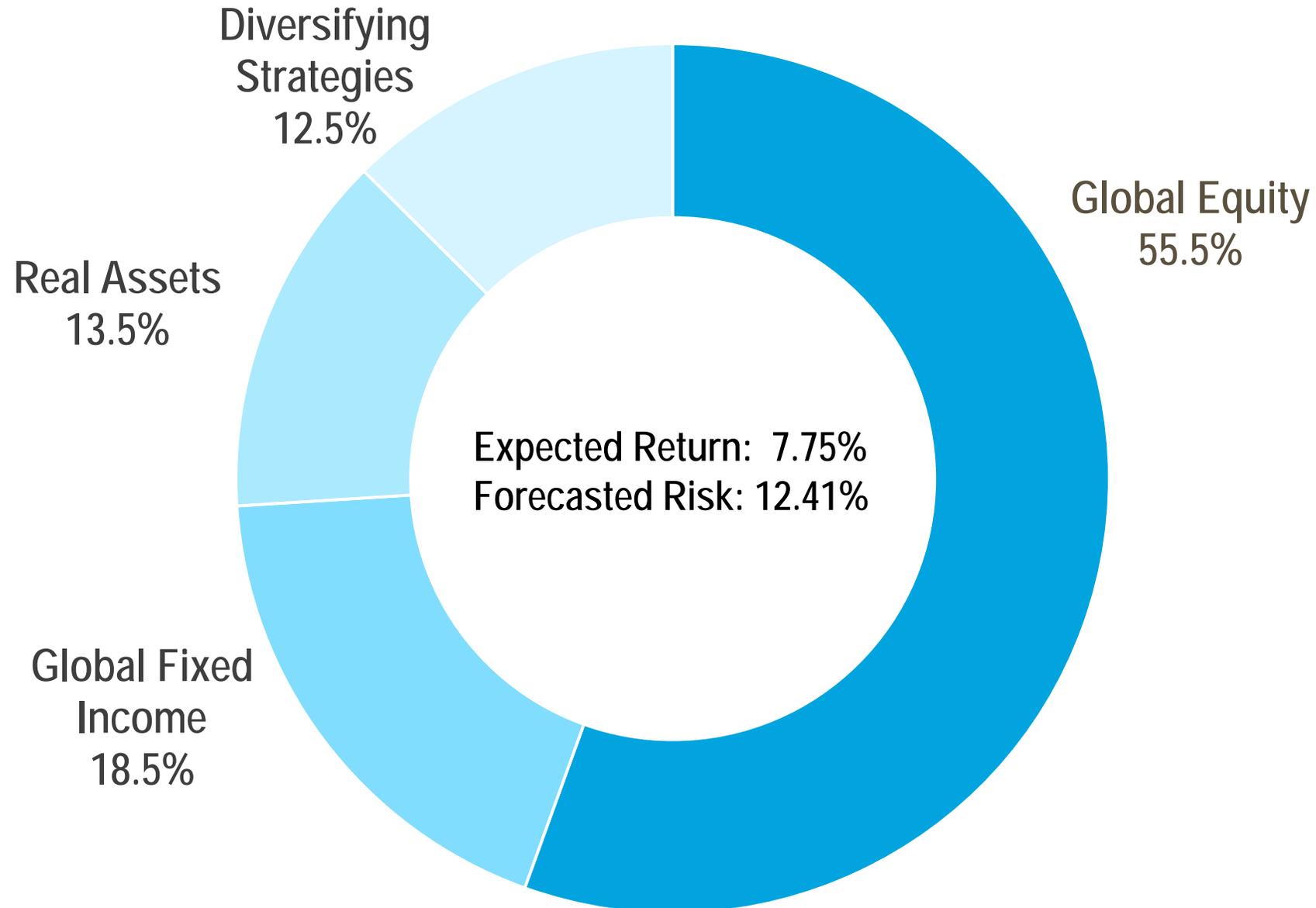
Source: Callan Associates

THE WALL STREET JOURNAL.

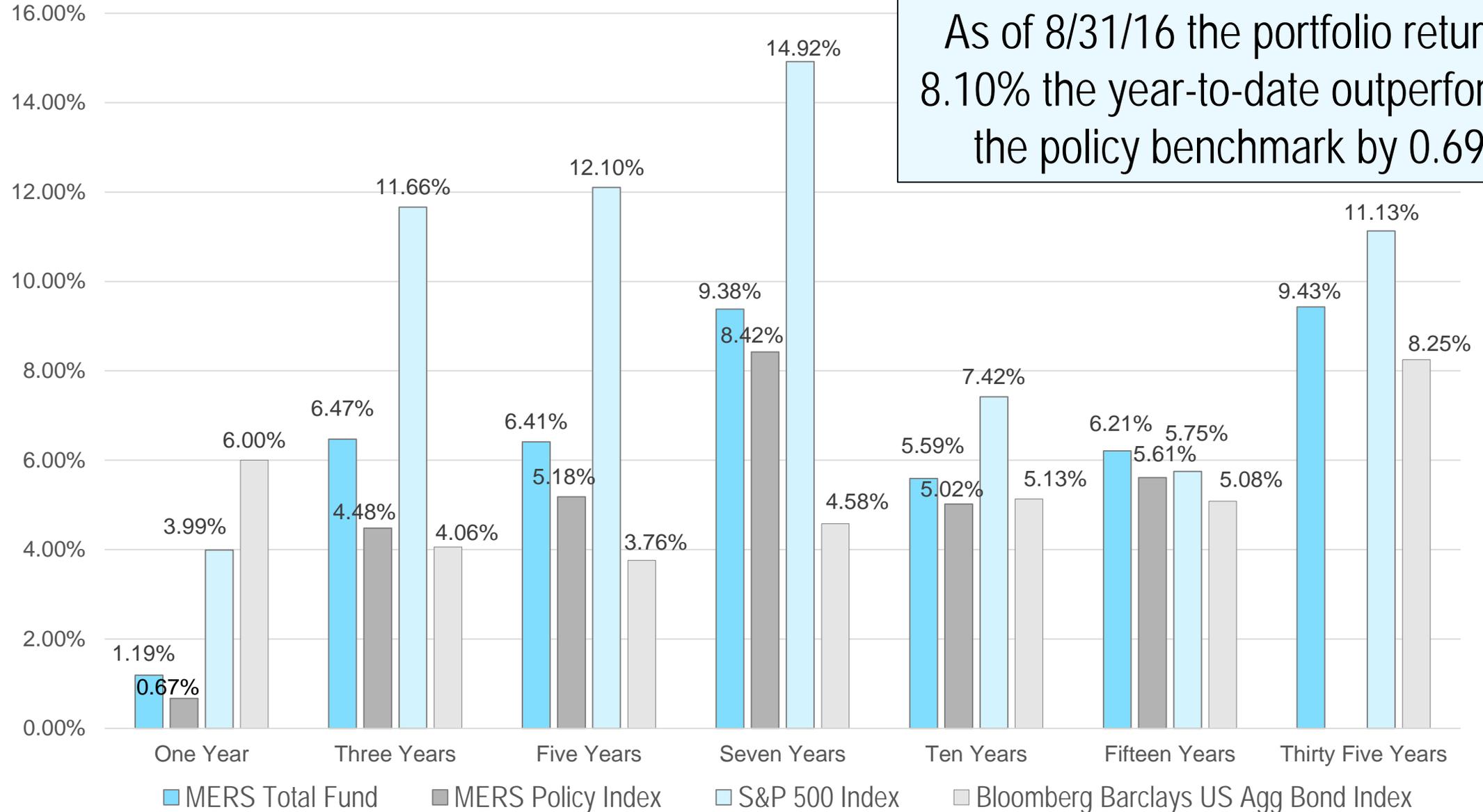
Risk/ Return- January 1990 - June 2016



2016 Asset Allocation Management

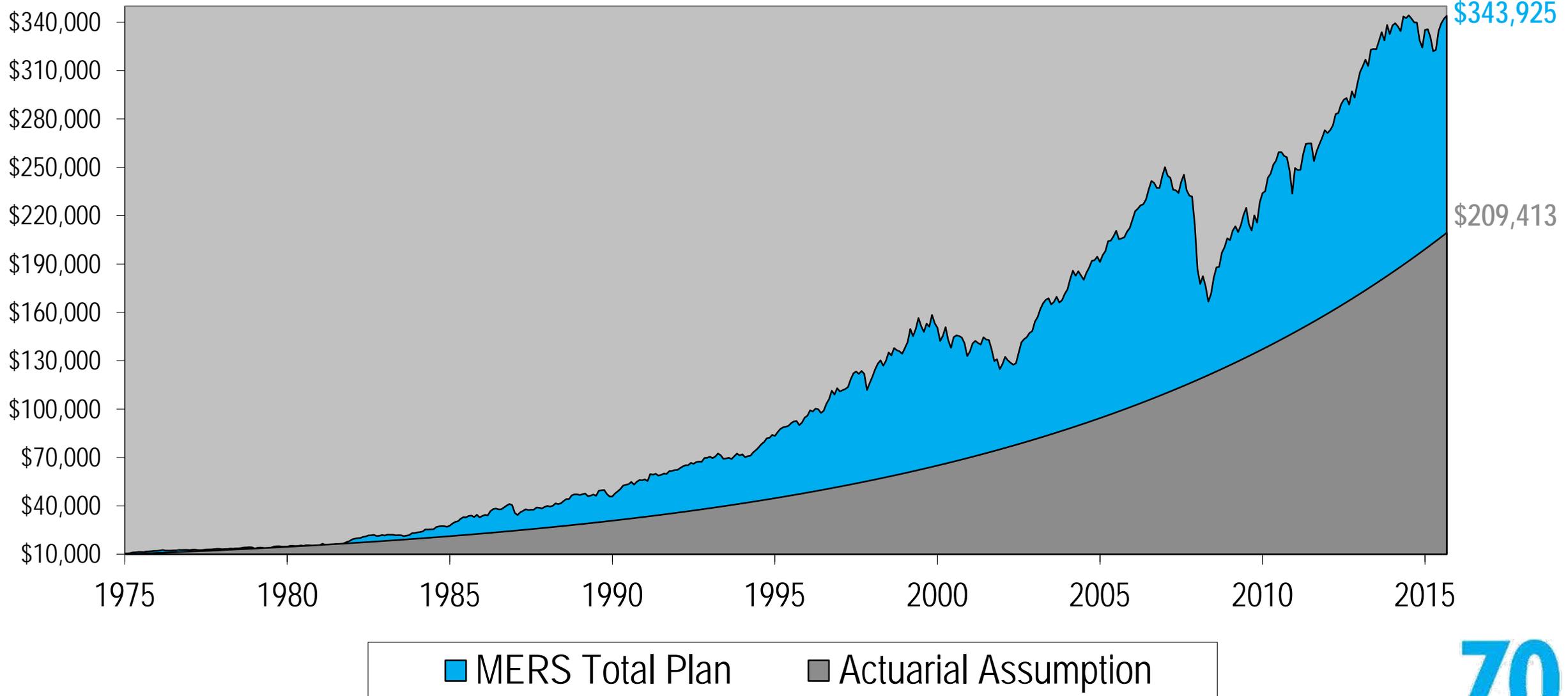


Total Market Fund Performance as of June 30, 2016



Growth of \$10,000

October 31, 1975 - June 30, 2016



MERS Office of Investments Team

- Collectively, over 200 years of experience
 - Pension administration
 - Investment management
 - Business administration
 - Pension and investment law
 - Public policy
 - Commercial banking
 - Legislative affairs
 - Commercial real estate
- Advanced Degrees and Certifications:
 - Multiple MBAs
 - Juris Doctor
 - Multiple CFA Charterholders
 - Finance
 - Actuarial Science
 - Economics
 - International Business
 - Political History

Governance Monitoring of MERS Office of Investments



- Monthly Investment Committee meetings
- Bi-monthly reporting to full MERS Board
- Quarterly MERS Investment Management Risk and Compliance Committee meetings
- Annual external audit
- Continuous monitoring of staff and portfolio performance by:
 - Internal Auditor
 - Chief Executive Officer
 - Internal Operations and Compliance

Summary

- Challenging investment environment
 - Elevated geopolitical and market risk
 - Lower interest rates
- Strong long term performance and risk controls
- Experienced and effective investment management
- Portfolio Trends
 - Internal management
 - Lower costs
- Strong governance and oversight