

PLANNING
RETIREMENT
TOGETHER FOR

70
YEARS



MERS[®]
Municipal Employees' Retirement System

SUMMARY ANNUAL
FINANCIAL REPORT
for the fiscal year ending

12.31.2016

ABOUT THIS REPORT

This report provides a summary of the MERS Comprehensive Annual Financial Report (CAFR) for the fiscal year which ended December 31, 2016. The CAFR is prepared in accordance with Generally Accepted Accounting Principles (GAAP) and is subject to external audit. This Summary Annual Financial Report is also prepared in accordance with GAAP. The 2016 CAFR contains more detailed information and can be obtained by contacting MERS:

Website:

www.mersofmich.com

By mail:

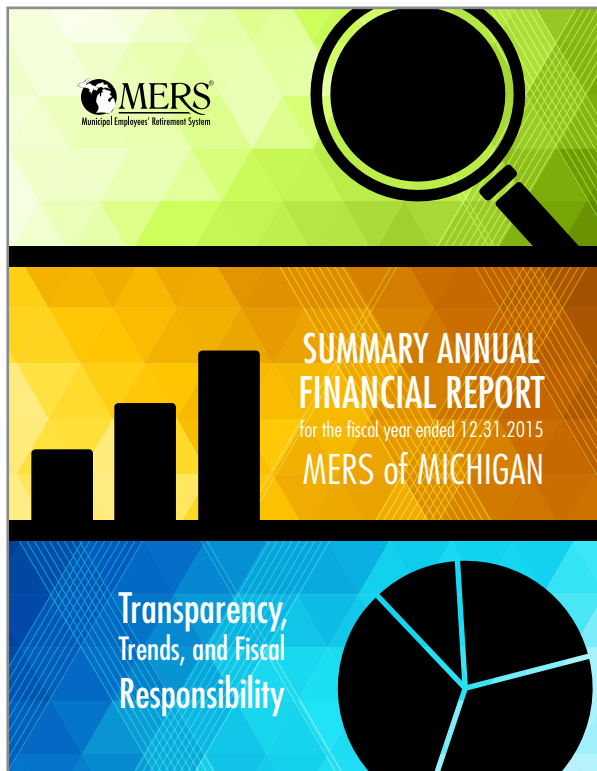
Municipal Employees' Retirement System of Michigan
1134 Municipal Way
Lansing, MI 48917

By phone:

800.767.MERS (6377)

The financial statements were audited by Plante & Moran, PLLC.

CERTIFICATE OF ACHIEVEMENT FOR EXCELLENCE IN FINANCIAL REPORTING



MERS received the Award for Outstanding Achievement in Popular Annual Financial Reporting from the Government Finance Officers Association for the 2015 Summary Annual Financial Report. This marks the 13th consecutive year MERS has received this honor.

AN INDEPENDENT ELECTED BOARD

MERS is a nonprofit governed by an elected board that operates without compensation. Our board is committed to accountability and transparency, holding the line on costs, and watching out for the best interest of our members.

Three Employee Members:

Non-officers of a participating municipality, elected by members

Two Expert Members:

With experience in retirement systems or investment management, appointed by the Board

Three Officer Members:

Officers of a participating municipality, elected by membership



MERS Retirement Board

is responsible for administration of the system with fiduciary responsibility for the investment of assets and oversight.

One Retiree Member:

Retiree of the system, appointed by the Board

MERS LEADERSHIP



From left to right:
Carrie Lombardo, Chief Strategic and External Affairs Officer
Denise Boucke, Chief Customer Service Officer
Chris DeRose, Chief Executive Officer
Jeb Burns, Chief Investment Officer
Leon Hank, Chief Financial Officer

MERS RETIREMENT BOARD AND CHIEF EXECUTIVE OFFICER



Front row from left to right:
Dale Feldpausch, Capital Region Airport Authority; **Sally Dreves**, Grand Traverse County; **John Ogden**, City of Port Huron; **Randy Girard**, Charter Township of Marquette

Back row from left to right:
Amy Deford, County of Saginaw; **James R. Wiersma**, Family Investment & Resource Management LLC, Holland; **Jason Sarata**, Delta Township; **Michael Brown**, Barry County; **Mike Gilmore**, Delta Dental

LETTER OF TRANSMITTAL, MAY 10, 2017

DEAR MERS PARTICIPANTS:

We are pleased to submit the Summary Annual Financial Report (CAFR) for the Municipal Employees' Retirement System (MERS) of Michigan for the fiscal year ending December 31, 2016.

During the year, MERS completed its final year of a three-year strategic plan that focused on four broad goals: Enhancing Partnerships with Employers; Meeting the Needs of Participants; Strengthening Growth, Retention, Efficiency and Cost Management; and Operating as an Outcome-Based Culture. Supported by numerous projects and measured by meaningful data, this has resulted in noticeable success at every level of the organization. It also set the stage for continuing to progress through our next four-year strategic plan.

Based on employer and participant feedback, major initiatives for 2016 included several portal enhancements. The MERS Employer Portal added functionality to improve the performance of Defined Benefit reporting, ultimately saving time for employers. New pages were also added to ease the reporting of voluntary contributions. In addition to the portals, forms and processes were also updated to streamline the employer and participant's experience with MERS.

MERS had a large focus on participant education during 2016 to increase our participants' retirement readiness. Communications were sent on a regular basis on relevant issues and benefit information, including explanations of our various retirement investment strategies and tips to help understand investment fees.

With the implementation of the 2015 Experience Study results, MERS directed specific attention to assisting our municipalities in managing their unfunded liabilities. In doing this, we recognize there is no one-size-fits-all approach. MERS has expanded its toolbox of options for municipalities to proactively address their plans, and we're proud of the fact that over the last five years, 73% of MERS members have taken voluntary steps to reduce unfunded liabilities. This approach aligns the unique nature of each municipality with the appropriate strategies to address their specific needs. The majority of these plans are on a schedule to eliminate their unfunded liabilities within a period of 23 years.

MERS Profile

MERS is a statutory public corporation that serves members across the state of Michigan. We are one of the largest, most established, and successful shared services stories in Michigan, providing administration, investment expertise, fiduciary responsibility, and oversight for benefit plans. This allows local governments to focus on core services, leaving day-to-day plan administration to us. Services include: plan governance, on-staff auditor, legal counsel, actuarial services, financial management, information technology support, legislative advocacy, administration of benefits, and investments.

MERS offers a full range of customizable plans and services. We work in partnership with our members to develop the plan that best meets their unique needs. We listen to our members and regularly add new, updated products and tools, such as new options to help manage unfunded liability and enhancements to the Defined Contribution Plan. The MERS Retirement Board (Board) serves as the fiduciary of the funds and has oversight responsibilities.



Financial Summary

Investment returns for the MERS Defined Benefit Portfolio gained 11.10% (gross of fees). This year-end figure exceeds the performance of many of our peer groups in the retirement security services industry and exceeds our actuarial assumption of 7.75%. Our 2016 investment performance ranked MERS second in the country among our peer group of 55 funds with assets greater than \$1 billion and within the Wilshire TUCS (Trust Universe Comparison Services) according to State Street. More information regarding our investment management performance is found in the Investments Section.

MERS also grew its net position held for members to a new record level of \$10.1 billion, the first time exceeding that plateau. The most significant factor in that growth was net revenue of \$1.9 billion. Cost control measures were maintained with MERS holding its administrative costs to \$19.1 million, consistent with last year, and within comparable costs all the way back to its 2009 spending level. As an indicator of how municipalities are more aggressively funding their other post-employment benefit obligations, MERS experienced its most significant growth in the Retiree Health Funding Vehicle, where net plan assets grew by over \$116 million to a total of \$753 million. One other measure of a defined benefit retirement system's financial health is the percentage of its actuarial liabilities owed that is covered by its available actuarial assets. Using this ratio, 389 of MERS' municipalities, were funded at 70% or higher (54% of all municipalities).

We continue to partner with all municipalities in helping them set fiscal goals and discussing options to find the programs and provisions that best fit each municipality's unique needs. There are 803 municipalities within MERS Defined Benefit and Hybrid Plans, which results in 2,680 divisions with unique benefit designs. Overall, 54% of municipalities have one or more divisions where new hires have either a hybrid plan or a lower tier defined benefit. About 34% of municipalities have one or more divisions where new hires have a defined contribution plan. There were also 36 divisions that increased cost sharing to their employees. Over a quarter of our employers made voluntary contributions to their plan, contributing an additional \$144 million to help increase funding levels. These efforts helped strengthen the financial condition of all these plans. In addition, new municipalities joining the MERS system brought in an extra \$38 million.

Respectfully submitted,

Chris DeRose
Chief Executive Officer

Leon E. Hank, CPA
Chief Financial Officer

FINANCIAL HIGHLIGHTS

The following financial highlights occurred during the year ended December 31, 2016:

- Total fiduciary net position for the Defined Benefit Plan, Defined Contribution Plan, Health Care Savings Program, Retiree Health Funding Vehicle, 457 Program, and Investment Services Program increased by 9%, primarily due to investment gains for the year. MERS finished the year with \$10.1 billion in net fiduciary position, the highest level in our history.
- Defined Benefit investment returns saw a gain of 10.85% net of investment expenses for the year. The 30-year return was 8.26%, which is above the target of MERS expected investment rate of return of 7.75%.
- Contribution revenue decreased by 6% from \$910 million in 2015 to \$851 million in 2016. Most of this decrease happened because MERS brought in fewer new assets for Defined Benefit municipalities than in the previous year.
- Total annual benefits, transfers, and withdrawals increased by \$156 million for a total of over \$1 billion. This is due to the withdrawal of \$108 million for a Defined Benefit employer who terminated its plan with MERS because it privatized.

Comparison Statement of Fiduciary Net Position (Dollars in Thousands)

	Year Ended December 31, 2016	Year Ended December 31, 2015	Increase (Decrease) Amount	Increase (Decrease) Percent
Assets				
Cash and Short-Term Investments	\$131,919	\$24,594	\$107,325	436%
Receivables	214,316	391,250	(176,932)	(45)
Interfund Receivables	81	69	12	17
Loans	5,064	5,004	60	1
Investments, at fair value	9,863,926	9,133,777	730,149	8
Invested Securities Lending Collateral	750,384	773,608	(23,224)	(3)
Other Assets/Prepays	651	2,108	(1,457)	(69)
Net Capital Assets	15,126	14,339	786	5
Total Assets	10,981,468	10,344,749	636,719	6%
Outflows Related to Pension	5,130	2,424	2,706	112
Liabilities				
Purchase of Investments	171,383	329,126	(157,743)	(48)
Securities Lending Collateral	750,429	774,753	(24,324)	(3)
Administrative/Investment Costs/Reserves	10,763	14,041	(3,278)	(23)
Interfund Payables	81	69	12	17
Total Liabilities	932,656	1,117,989	(185,333)	(17%)
Net Position Restricted for Pension and Health Benefits and Investment Accounts Held for Others	\$10,053,942	\$9,229,184	\$824,758	9%

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

- Administrative expenses remained level at \$19 million while MERS grew significantly and brought in 145 new municipal programs. MERS has continued to keep costs down through the growth of our pool and stronger ongoing budgeting and cost-control measures.
- Investment expenses totaled \$17 million, a decrease from the previous year. Most of these expenses are related to investment manager fees. The decrease in expenses compared to the previous year was due to a performance bonus paid in 2015 and bringing in additional assets to be managed in-house by MERS Office of Investments.
- MERS' most recent actuarial valuation dated December 31, 2015, showed 389 of MERS' 717 Defined Benefit municipalities were funded 70% or better, with 54 municipalities over 100% funded.
- The difference between MERS' actuarial and market value assets remained consistent with last year, as the actuarial calculation for 2016 is 108% of the market value of assets as calculated by the actuaries. Total Defined Benefit Plan actuarial assets and market value of assets were valued at \$9.14 billion and \$8.49 billion respectively at December 31, 2016.

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

	Year ended December 31, 2016	Year ended December 31, 2015	Increase (Decrease) Amount	Increase (Decrease) Percent
Additions				
Contributions	\$851,270	\$909,983	\$(58,713)	(6%)
Investment Net Income (Loss) Investing Activities	1,000,473	(166,023)	1,166,496	703
Investment Net Income-Securities Lending	5,073	4,037	1,036	26
Miscellaneous Income	101	2,380	(2,279)	(96)
Total Additions	1,856,917	750,377	1,106,540	147%
Deductions				
Benefits/Transfers and Withdrawals	1,013,016	857,335	155,681	18
Forfeitures, Miscellaneous		355	(355)	(100)
Administrative Expense	19,143	19,276	(133)	(1)
	1,032,159	876,966	155,193	18%
Net Increase/Decrease	824,758	(126,589)	951,347	752
Net Position-Restricted for Pension and Health Benefits and Investment Accounts Held for Others				
Balance Beginning of Year	9,229,184	9,355,773	(126,589)	(1)
Balance End of Year	\$10,053,942	\$9,229,184	\$ 824,758	9%

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

The primary uses of MERS assets are the payments of benefits to participants and their beneficiaries, refunds to terminated participants, and the cost of administering the system.

INVESTMENT OBJECTIVES AND ACTIVITY

The primary goal of the MERS investment program is to grow assets at a rate which, when coupled with employer and employee contributions, satisfies promised benefits to MERS' members. This should be done with a high degree of prudence to reduce risk. The following objectives are intended to assist in achieving this goal:

- Exceed the actuarial investment assumption on a long-term basis, which is currently 7.75% annually.
- Maintain adequate liquidity to pay promised benefits.
- Adopt a strategic asset allocation plan that reflects current and future liabilities, minimizes volatility, and maximizes the long-term rate of return.
- Minimize the costs associated with the implementation of the asset allocation through the efficient use of internal and external resources.
- Maintain above median peer rankings for the 3, 5, and 10-year time periods.
- Exceed the return of the Fund's Policy Benchmark.

INVESTING IN RETIREMENT



PERSIA

Law and Regulation

MERS must follow **Michigan state law** and prudent standards of diligence. We maintain strict oversight and management. Our assets are invested in accordance with the **Public Employee Retirement System Investment Act (PERSIA)**. MERS conducts quarterly compliance reviews.



Performance

MERS consistently **outperforms its benchmarks** and market averages, with a prudent, long-term approach designed to provide downside protection and upside market participation.



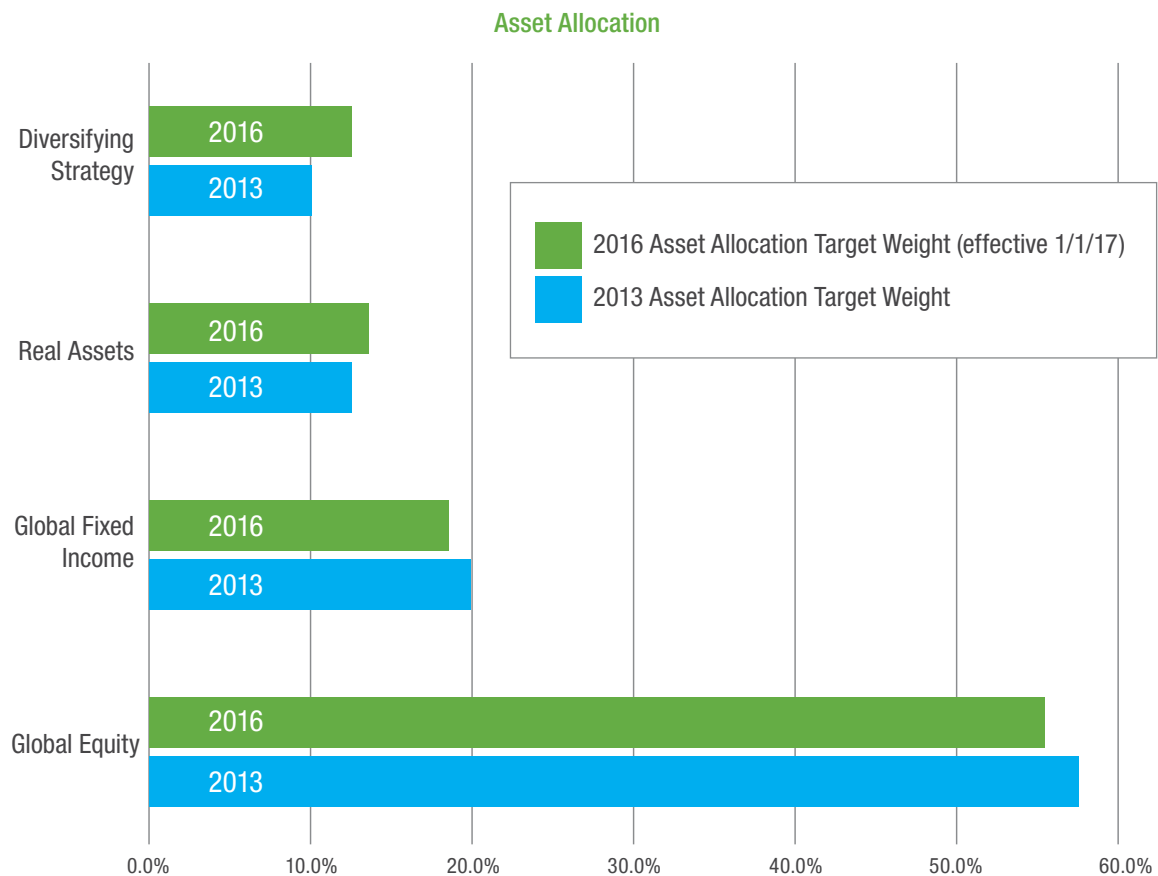
Investment Earnings

For over 20 years, **more than half** of retirement benefits paid have come from MERS' investment earnings, not taxpayer dollars.

MERS INVESTMENT HIGHLIGHTS

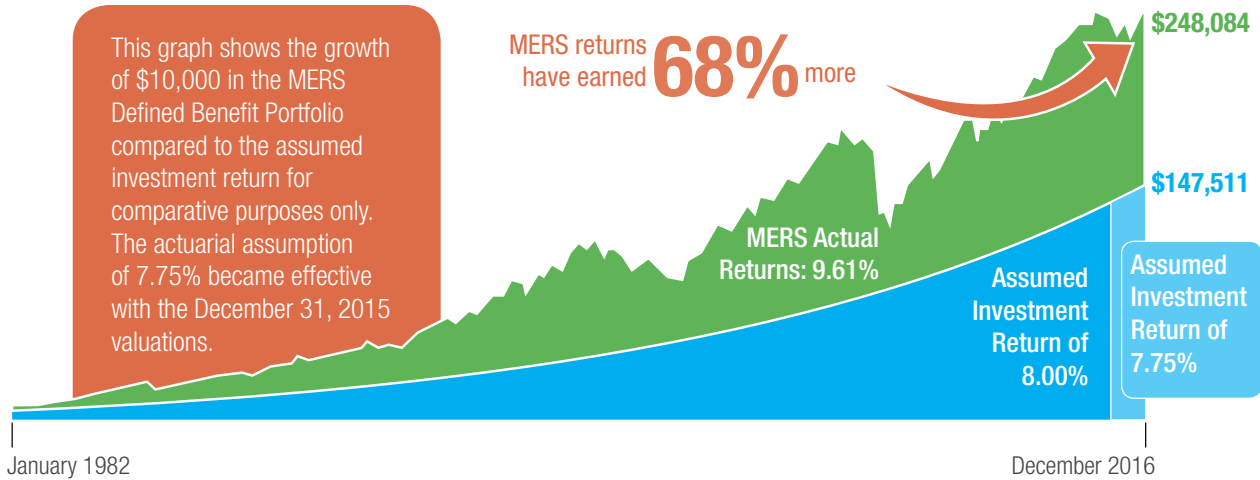
- MERS Total Market Fund return was 11.10%, gross of investment fees, outperforming the policy benchmark by 4.80%
- At the broad asset class level, absolute returns gross of investment fees for the year were as follows:

Global Equity	11.86%
Global Fixed Income	6.71
Real Assets	19.67
Diversifying Strategies	5.21
- MERS Office of Investments conducted an asset allocation study that is required every three years. The Board approved the recommended changes that the Office of Investments presented at the December MERS Board meeting. Below is a table showing the target asset allocation used through 2016 and the new Board approved asset allocation for use starting January 1, 2017.



A TRACK RECORD OF SUCCESS

As retirement plans operate over long-term time horizons, it's important to focus on long-term rates rather than any single year. The actuarial assumed investment return of 7.75% is projected over the lifetime of the participants covered in the plan, typically more than 30 years. For municipalities that wish to project a more conservative approach, MERS provides tools to do so within our annual valuation reports.



Year-by-Year Returns (35 years: 1982-2016)

Year	Rate of Return	Year	Rate of Return	Year	Rate of Return
2016	11.10%	2004	14.90%	1992	8.05%
2015	(0.85)	2003	24.72	1991	22.14
2014	6.68	2002	(8.34)	1990	2.94
2013	15.00	2001	(1.91)	1989	19.10
2012	11.39	2000	(2.76)	1988	11.20
2011	2.30	1999	17.01	1987	5.51
2010	14.43	1998	14.20	1986	13.55
2009	17.31	1997	14.43	1985	24.33
2008	(24.79)	1996	12.68	1984	9.33
2007	8.58	1995	23.95	1983	10.64
2006	13.61	1994	0.52	1982	26.69
2005	6.78	1993	9.67		

Annualized 35-year rate of return for MERS Defined Benefit: 9.61%

Performance numbers on this page are gross of fees.

MERS Participating Municipalities as of December 31, 2016



MERS Participants as of December 31, 2016

	Defined Benefit	Defined Contribution	Hybrid	Health Care Savings Program	457 Program
Active	33,111	10,836	2,273	13,404	2,581
Deferred	8,612	NA	156	NA	NA
Retired	38,412	NA	47	NA	NA
Contributions not Vested	10,990	NA	8	NA	NA
Terminated	NA	3,967	NA	4,125	326
Product Totals	91,125	14,803	2,484	17,529	2,907
Total MERS Accounts*					<u>128,848</u>
Total MERS Participants**					<u>109,120</u>

* Total MERS Accounts represents the total number of accounts within MERS; individuals may be represented multiple times across categories.

** Total MERS Participants represents the number of unique individuals that have a liability in a program. At least one of the individual's employments fell into the following categories: Active Status, Retired Status, Terminated Status Defined Benefit vested, Terminated Status Defined Benefit not vested but has a contribution balance, Terminated Status Hybrid vested, Terminated Status Hybrid not vested but has a contribution balance, Terminated Status Defined Contribution with a contribution balance, or Terminated Status Health Care Savings Program with a contribution balance.

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This publication contains a summary description of MERS benefits, policies or procedures. MERS has made every effort to ensure that the information provided is accurate and up to date (as of the date of publication 06/01/17). If this publication conflicts with the relevant provisions of the Plan Document, the Plan Document Controls. MERS, as a governmental plan, is exempted by state and federal law from registration with the SEC. However, it employs registered investment advisors to manage the trust fund in compliance with Michigan Public Employee Retirement System Investment Act. Past Performance is not a guarantee of future returns. Please make independent investment decisions carefully and seek the assistance of independent experts when appropriate.