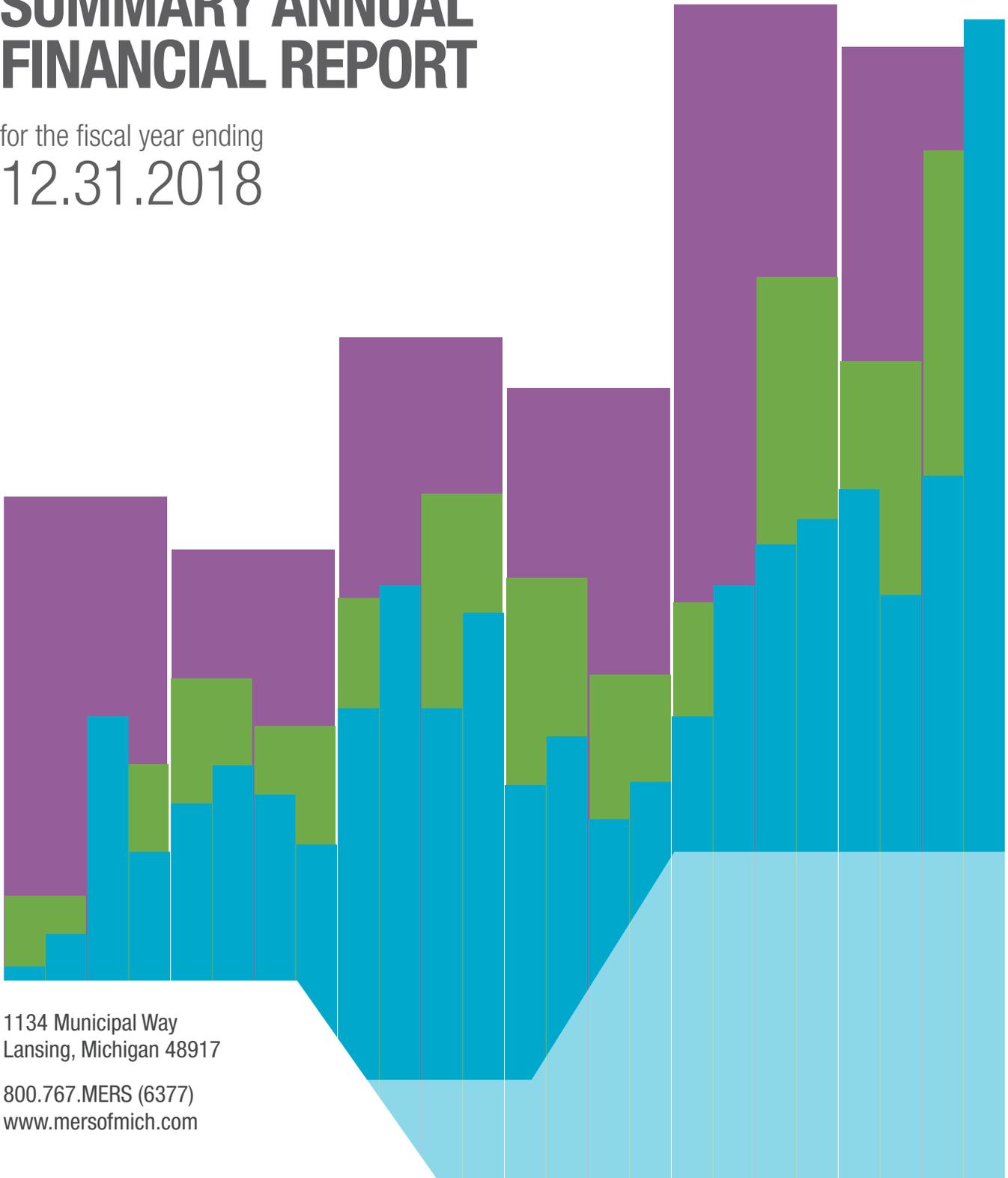




# SUMMARY ANNUAL FINANCIAL REPORT

for the fiscal year ending  
12.31.2018



1134 Municipal Way  
Lansing, Michigan 48917

800.767.MERS (6377)  
[www.mersofmich.com](http://www.mersofmich.com)

## ABOUT THIS REPORT

This report provides a summary of the MERS Comprehensive Annual Financial Report (CAFR) for the fiscal year which ended December 31, 2018. 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 2018 CAFR contains more detailed information and can be obtained by contacting MERS:

**Website:**

[www.mersofmich.com](http://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 2017 Summary Annual Financial Report. This marks the 15th consecutive year MERS has received this honor.

## AN INDEPENDENT ELECTED BOARD

MERS is governed by an independent, unpaid board committed to fairness, transparency and accountability for our customers. Our board adheres to strong conflict of interest provisions and best fiscal practices making us a reliable fiduciary agent and a go-to expert for retirement security in Michigan.

### Three Employee Members:

Non-officers of a participating municipality, elected by membership

### 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 OFFICERS



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



Back row (standing left to right): Dale Feldpausch, James Wiersma, Jason Sarata, Michael Brown, Tina Butler  
 Front row (sitting): Amy Deford, John Ogden, Michael Gilmore, Randy Girard

Officer Members: **Michael Brown** (Chairperson), Barry County; **Randy Girard**, Charter Township of Marquette; **Dale Feldpausch**, Capital Region Airport Authority

Employee Members: **Tina Butler**, Cass County; **Jason Sarata**, Delta Township; **Amy Deford**, Saginaw County

Expert Members: **Michael Gilmore**, Red Cedar Investment Management, East Lansing; **James R. Wiersma**, Haworth, Holland

Retiree Member: **John Ogden**, City of Port Huron (Retired)

## LETTER OF TRANSMITTAL, MAY 28, 2019

Dear Board Members:

We are pleased to submit the Summary Annual Financial Report for the Municipal Employees' Retirement System of Michigan (MERS) for the fiscal year ending December 31, 2018.

Having completed the second year of our four-year Strategic Plan, MERS has laid a solid groundwork of goals and measurements by which we evaluate and move toward our vision aimed at delivering superior value to our customers by:

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

To accomplish this, MERS has developed a Balanced Scorecard focusing on four perspectives: Customer, Financial, Process, and Learning & Growth. Specific Projects within each perspective drive business efforts and are measured on an ongoing basis, reported on our Balanced Scorecard and drive team priorities and individual performance company-wide.

In 2018, MERS exceeded overall targets and included highlights such as significant increase in employer satisfaction with their voice being heard, engagement with MERS resources and actions to improve participant financial wellness, solid relative investment performance, holding operational costs in check, and the measurement of key processes. MERS launched two new programs in the year: offering MERS IRA accounts to provide greater saving opportunities at the individual level, and providing Health Care Exchange services to help retiring participants' bridge post-employment healthcare needs. Our customer base continued to expand, as we partnered with 21 new local units of government for the first time, and many continue to enroll in multiple programs – 25% with 1 product, 26% with 2 products, and 49% with 3 products. In addition, participant accounts grew to 145,707.

### **MERS Profile**

MERS is a statutory public corporation that was created to serve members across the state of Michigan on a not-for-profit basis. We are one of the largest, most established and successful shared services stories in Michigan. Our approach to efficiently managing retirement and other post-employment benefit plans allows local governments to focus on their core services. Our comprehensive platform of services includes: plan governance, actuarial services, legal counsel, on-staff auditor, information technology support, administration of benefits, participant education and investment portfolio management. The MERS Retirement Board (Board) provides oversight and serves as the fiduciary of the funds.

### **Financial Summary**

Like many investors, MERS has benefited from the long-running economic business cycle upturn since 2009. The calendar years of 2016 and 2017 were especially good, with MERS earning investment returns on our Defined Benefit (DB) Portfolio of 11.1% and 13.2% respectively (net of investment expenses). Despite these good returns, MERS expects a market correction or downturn as has happened in every business cycle since the early 1900s. In 2018, MERS experienced a market downturn with the DB Portfolio recording an investment loss of -3.51% based on a gross rate of return. While the return for the year was negative, the MERS loss in a down market was much less than many of its peers experienced. MERS designs its investment strategy to perform this way, providing more protection against losses when markets are down.

MERS ended the year with a net position of \$10.9 billion for all plan types, down \$477 million from 2017. The reduction in asset size occurred primarily due to the investment loss for the year. Contributions and transfers in from all plan types exceeded \$1 billion for the first time in MERS history. Strong cost control measures helped MERS hold its administrative costs to \$19.1 million, close to last year's costs of \$19.2 million, and comparable to costs going all the way back to its 2009 spending level. Lower administrative costs also have a positive impact on DB and other plan types.

In 2018, the MERS 457 program grew at the highest rate of any product, increasing in asset size by \$26 million to \$108.8 million. As an indicator of how municipalities are more aggressively addressing their other post-employment benefit (OPEB) obligations, the MERS Health Care Savings Program and Retiree Health Funding Vehicle net plan assets grew by \$25 million in 2018.

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 (calculated from the most recent 2017 calendar year valuation data), nearly 59% of MERS' municipalities were funded at 70% or higher (427 municipalities), which is up from 56% (401 municipalities) in 2016.

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 746 local units of government within MERS Defined Benefit and Hybrid Plans, which encompasses 2,915 divisions with unique benefit designs. In 2018, 37 divisions adopted a Hybrid Plan or a lower tier Defined Benefit Plan for new employees and 56 divisions adopted a Defined Contribution Plan for new employees. There were also 130 divisions that increased cost sharing to their employees. In 2018, 330 plans made voluntary contributions, contributing an additional \$263 million to help increase funding levels. These efforts helped strengthen the financial condition of all these plans. In addition, new local units of government joining the MERS Defined Benefit Plan brought in an extra \$2 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, 2018:

- Total fiduciary net position for the Defined Benefit Plan, Defined Contribution Plan, Health Care Savings Program, Retiree Health Funding Vehicle, 457 Program, Investment Services Program, and Individual Retirement Account Program decreased by 4%, primarily due to market decline for the year. MERS finished the year with \$10.9 billion in net fiduciary position. MERS is proud to announce our newest product in 2018, the Individual Retirement Account that is open to MERS members and their spouses.
- Investment returns had a loss for the year of \$498 million. Investment returns have been especially positive in recent years so a correction was not unexpected.
- Contribution revenue increased by 19% from \$858 million in 2017 to \$1 billion in 2018, the first time in history MERS' employers exceeded \$1 billion in contributions. This increase was largely due to an increase in employer voluntary contributions compared to the previous year.
- Total annual benefits, transfers, and withdrawals increased by \$78 million for a total of \$987 million up from \$909 million in 2017.

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

	December 31, 2018	December 31, 2017	\$ Increase (Decrease)	% Increase (Decrease)
<b>Assets</b>				
Cash and Short-Term Investments	\$17,538	\$12,766	\$4,772	37%
Receivables	478,177	367,227	110,950	30%
Interfund Receivables	127	136	(9)	-7%
Loans	6,161	5,774	387	7%
Investments, at fair value	10,833,075	11,315,059	(481,984)	-4%
Invested Securities Lending Collateral	573,927	528,514	45,413	9%
Other Assets/Prepays	4,320	695	3,625	522%
Net Capital Assets	18,246	15,913	2,333	15%
<b>Total Assets</b>	<b>11,931,570</b>	<b>12,246,084</b>	<b>(314,514)</b>	<b>-3%</b>
<b>Deferred Outflow of Resources</b>				
Outflows Related to Pension	3,571	4,288	(717)	-17%
<b>Liabilities</b>				
Purchase of Investments	438,629	324,919	113,710	35%
Securities Lending Collateral	573,997	528,610	45,387	9%
Administrative/Investment Costs/Reserves	10,359	8,633	1,726	20%
Interfund Payables	127	136	(9)	-7%
<b>Total Liabilities</b>	<b>1,023,112</b>	<b>862,298</b>	<b>160,814</b>	<b>19%</b>
<b>Deferred Inflow of Resources</b>				
Inflows Related to Pension	717		717	
<b>Net Position Restricted for Pension and Health Benefits and Investment Accounts Held for Others</b>	<b>\$10,911,312</b>	<b>\$11,388,074</b>	<b>\$(476,762)</b>	<b>-4%</b>

The Statement of Fiduciary Net Position summarizes what MERS owns and owes as of the end of the fiscal year.

- Administrative expenses declined slightly by \$157 thousand and ended at \$19.1 million while MERS continues to grow, adding new municipal programs. MERS has continued to keep costs down through the growth of our pool and strong ongoing budgeting and cost-control measures.
- Investment expenses also declined slightly by \$20 thousand and remained level at \$14 million. Most of these expenses are related to investment manager fees. The decrease in investment manager expense was partly due to bringing in additional assets to be managed in-house by MERS Office of Investments staff at a lower cost.
- The difference between the MERS actuarial and fair value assets declined from last year, as the actuarial calculation for 2018 is 109.3% of the fair value of assets as calculated by the actuaries (the ratio was 101.1% as of December 31, 2017). Total Defined Benefit Plan actuarial assets and fair value of assets were valued at \$9.8 billion and \$9.0 billion respectively at December 31, 2018.
- As part of the MERS 2018 Strategic Plan, MERS invested \$5.1 million in capital assets. This includes \$4.1 million for pension administration software and actuarial valuation software. The MERS investment in all capital assets is \$18.2 million, net of accumulated depreciation, up from \$15.9 million in 2017. MERS expects these software improvements will enhance participant access to retirement services and reduce administrative costs for employers.

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

	December 31, 2018	December 31, 2017	\$ Increase (Decrease)	% Increase/ Decrease
<b>Additions</b>				
Contributions/Transfers in	\$1,024,586	\$858,228	\$166,358	19%
Investment Net Income (Loss) Investing Activities	(498,201)	1,404,789	(1,902,990)	-135%
Investment Net Income-Securities Lending	3,152	3,663	(511)	-14%
Miscellaneous Income	221	55	166	302%
<b>Total Additions</b>	<b>529,758</b>	<b>2,266,735</b>	<b>(1,736,977)</b>	<b>-77%</b>
<b>Deductions</b>				
Benefits/Transfers and Withdrawals	987,449	909,116	78,333	9%
Forfeitures, Miscellaneous	6	15	(9)	100%
Special Litigation Expense		4,250	(4,250)	100%
Administrative Expense	19,065	19,222	(157)	-1%
<b>Total Distributions</b>	<b>1,006,520</b>	<b>932,603</b>	<b>73,917</b>	<b>8%</b>
<b>Net Increase/Decrease</b>	<b>(476,762)</b>	<b>1,334,132</b>	<b>(1,810,894)</b>	<b>-136%</b>
<b>Net Position-Restricted for Pension and Health Benefits and Investment Accounts Held for Others</b>				
Balance Beginning of Year	11,388,074	10,053,942	1,334,132	13%
<b>Balance End of Year</b>	<b>\$10,911,312</b>	<b>\$11,388,074</b>	<b>\$(476,762)</b>	<b>-4%</b>

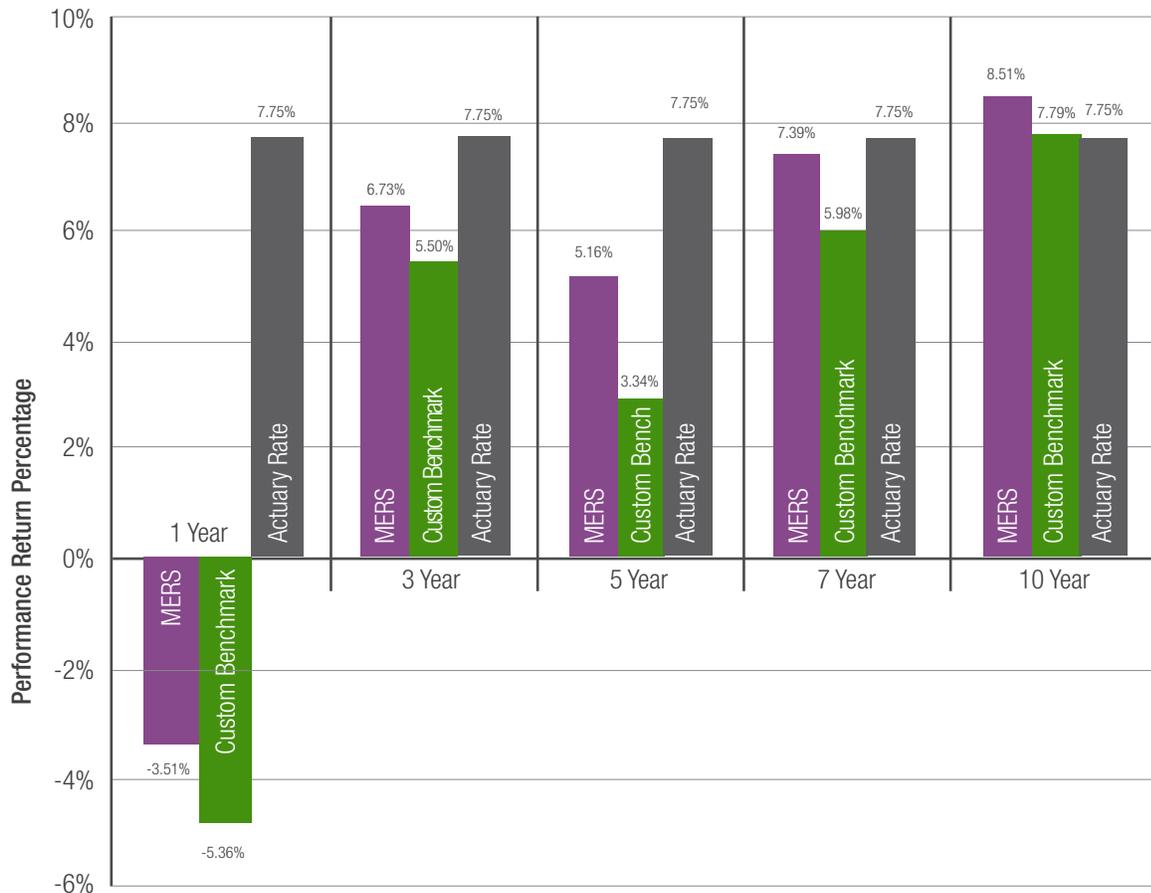
The Statement of Changes in Fiduciary Net Position summarizes the flow of money in and out of the fund throughout the fiscal year. The primary uses of MERS assets are the payments of benefits to participants and their beneficiaries, refunds to terminated participants, and the cost of administering the system.

## INVESTMENT OBJECTIVES AND ACTIVITY

In conformity with state investment law, the primary goal of MERS' investment program is to grow assets at a rate which, when coupled with employer and employee contributions, satisfies promised benefits to MERS members. To achieve this objective, the Investment Committee allocates MERS' assets with a strategic, long-term perspective and a high degree of prudence to reduce risk by:

- Exceeding the actuarial investment assumption on a long-term basis, which is currently 7.75%;
- Maintaining adequate liquidity to pay promised benefits;
- Adopting a strategic asset allocation plan that reflects current and future liabilities, minimizes volatility, and maximizes the long-term total rate of return;
- Minimizing the costs associated with the implementation of the asset allocation through the efficient use of internal and external resources;
- Maintaining above median peer rankings for the 10-year time period; and
- Exceeding the return of the Fund's Policy Benchmark. The Policy Benchmark currently consists of 45% Russell 3000, 25% Bloomberg Barclays Global Aggregate Bond Index, 20% MSCI ACWI IMIex-US, and 10% Bloomberg Barclays Global Aggregate ex US.

### Performance Versus Custom Benchmarks as of December 31, 2018 (gross of fees)



## MERS INVESTMENT HIGHLIGHTS

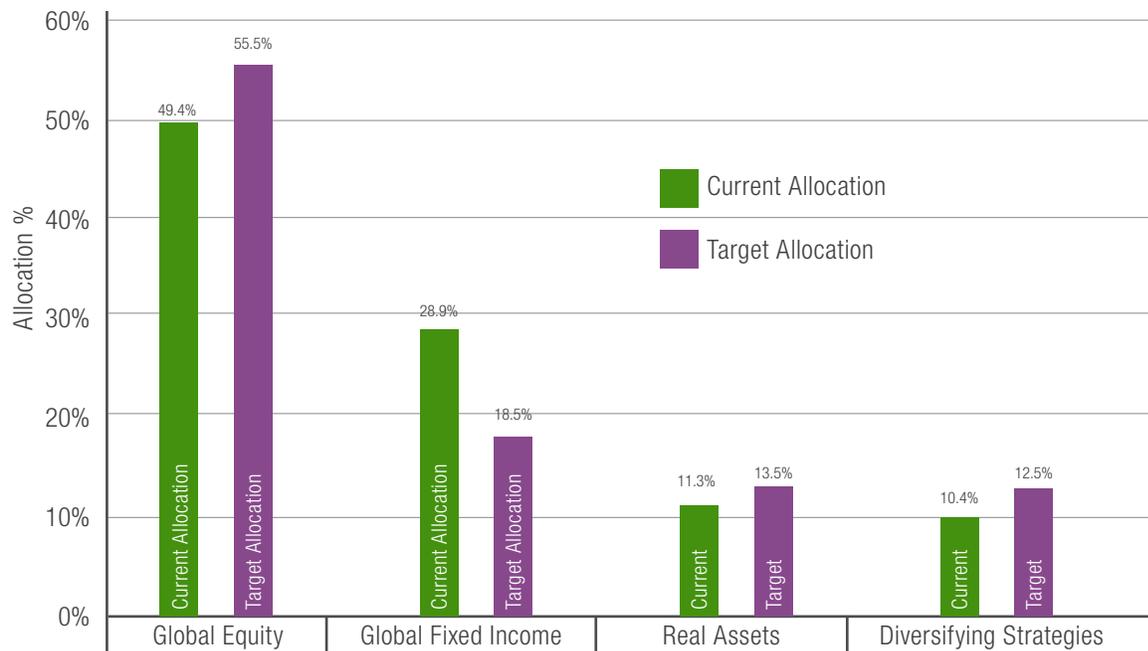
- MERS Total Portfolio returned -3.51% gross of fees for the year, outperforming its policy benchmark by 1.85%. The five year return of 5.16% outperformed the policy benchmark by 1.82% on an annualized basis. The portfolio returned 8.51% at the 10-year mark and has outperformed the policy benchmark in all time periods.
- The Office of Investments completed work on a Valuation Based Allocation approach to its investment program.
- The target asset allocation breakdown is shown below:

Global Equity	55.5%
Global Fixed Income	18.5%
Real Assets	13.5%
Diversifying Strategies	12.5%

- At the broad asset class level, absolute returns gross of investment fees for the year were as follows:

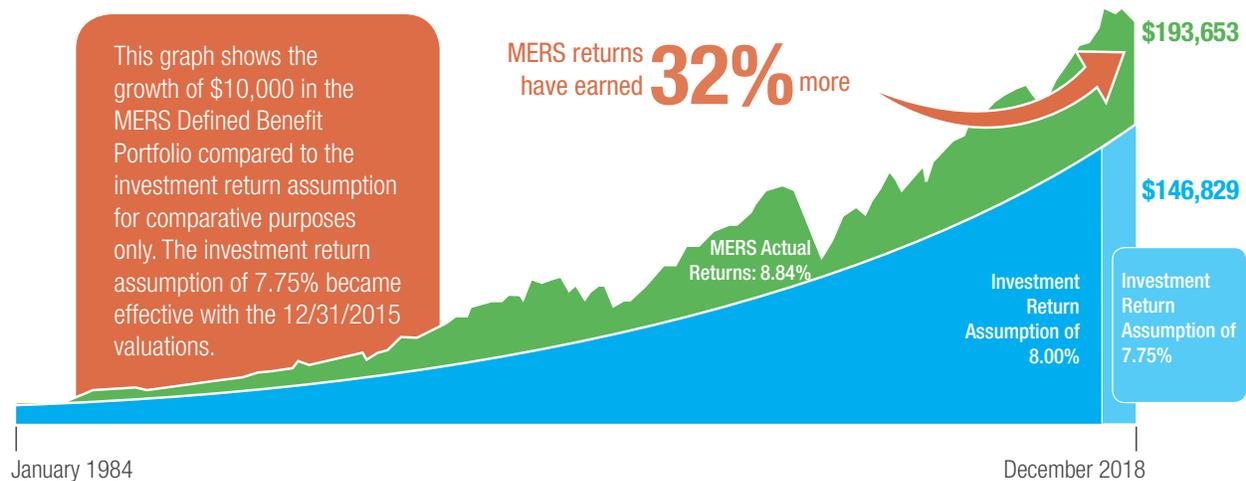
Global Equity	-8.38%
Global Fixed Income	0.69%
Real Assets	3.50%
Diversifying Strategies	1.98%

### Current Asset Allocation versus Target Allocation as of December 31, 2018



## 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 investment return assumption 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.



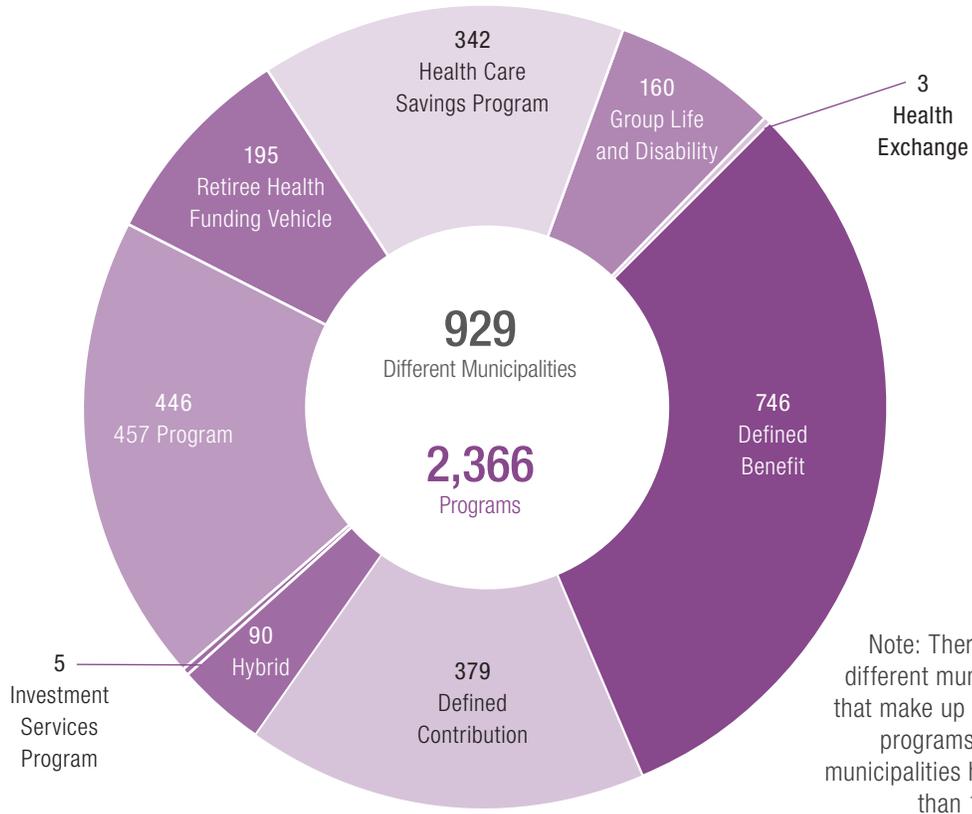
### Year-by-Year Returns (35 years: 1984-2018)

Year	Rate of Return	Year	Rate of Return	Year	Rate of Return
2018	-3.51%	2006	13.61	1994	0.52
2017	13.40%	2005	6.78%	1993	9.67%
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		

**Annualized 35-year rate of return for MERS Defined Benefit: 8.84%**

Performance numbers on this page are gross of fees.

**MERS Participating Municipalities as of December 31, 2018**



**MERS Participants as of December 31, 2018**

	Defined Benefit	Defined Contribution	Hybrid	Health Care Savings Program	457	Health Exchange	IRA	
Active	31,010	13,195	3,199	16,971	4,962	104	6	
Deferred	9,223	NA	233	NA	NA	NA	NA	
Retired	40,972	NA	95	NA	NA	NA	NA	
Contributions not Vested	12,884	NA	8	NA	NA	NA	NA	
Terminated	NA	6,021	NA	6,091	733	NA	NA	
Product Totals	94,089	19,216	3,535	23,062	5,695	104	6	
Total MERS Accounts*							145,707	

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



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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 06/04/2019). 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.*

