

# **State of Michigan 457 Plan**

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**Financial Report  
September 30, 2014**

# **State of Michigan 457 Plan**

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## **INDEPENDENT AUDITOR'S REPORT**



# OAG

Office of the Auditor General

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Doug A. Ringler, CPA, CIA

Auditor General

**Independent Auditor's Report on the Financial Statements  
and Other Reporting Required by *Government Auditing Standards***

Mr. David B. Behen, Director  
Department of Technology, Management, and Budget  
and  
Mr. Phillip J. Stoddard, Director  
Office of Retirement Services  
Department of Technology, Management, and Budget

Dear Mr. Behen and Mr. Stoddard:

**Report on the Financial Statements**

We have audited the accompanying financial statements of the State of Michigan 457 Plan as of and for the fiscal year ended September 30, 2014 and the related notes to the financial statements, which collectively comprise the Plan's basic financial statements as listed in the table of contents.

***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

***Auditor's Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audit. 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.



Mr. David B. Behen, Director  
Mr. Phillip J. Stoddard, Director  
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*Opinion*

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the fiduciary net position of the State of Michigan 457 Plan as of September 30, 2014 and the changes in fiduciary net position for the fiscal year then ended in accordance with accounting principles generally accepted in the United States of America.

*Emphasis of Matter*

As discussed in Note 1, the financial statements present only the State of Michigan 457 Plan and do not purport to, and do not, present fairly the financial position of the State of Michigan or its pension (and other employee benefit) trust funds as of September 30, 2014 and the changes in financial position for the fiscal year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

*Other Matter*

*Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 6 through 9 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.

*Other Reporting Required by Government Auditing Standards*

In accordance with *Government Auditing Standards*, we will also issue a report on our consideration of the Plan'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* in considering the Plan's internal control over financial reporting and compliance.

Sincerely,

Doug Ringler  
Auditor General  
December 29, 2014

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

# **State of Michigan 457 Plan**

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## **Management's Discussion and Analysis**

This section presents our discussion and analysis of the State of Michigan 457 Plan's (the Plan's) financial performance and provides an overview of the Plan's financial activities for the fiscal years ended September 30, 2014, and September 30, 2013. This section should be read in conjunction with the Plan's basic financial statements.

### **Using This Annual Financial Report**

This annual financial report consists of two parts: (1) management's discussion and analysis (this section) and (2) the Plan's basic financial statements. The Plan's basic financial statements are comprised of a Statement of Plan Fiduciary Net Position, a Statement of Changes in Plan Fiduciary Net Position, and Notes to the Financial Statements. The Statement of Plan Fiduciary Net Position reports the assets and liabilities of the Plan and the net position that is held on behalf of participants as of the end of the fiscal year. The Statement of Changes in Plan Fiduciary Net Position reports the additions and deductions to the Plan that occurred during the fiscal year. The notes explain some of the information in the financial statements and provide more detailed data.

### **Condensed Financial Information**

The table below compares key financial information in a condensed format between the current and prior year:

<b>Plan Net Position</b>	<b>Fiscal Years Ended September 30 (in thousands)</b>	
	<b>2014</b>	<b>2013</b>
<b>Plan Net Position</b>	<b>\$ 1,856,627</b>	<b>\$ 1,784,539</b>
Net investment gain (loss)	\$ 137,447	\$ 174,447
Contributions - Employees	75,097	62,323
Contributions - Employers	423	557
Contributions - Transfers from other systems	1,091	778
Benefits paid	(66,349)	(66,250)
Refunds and payments to other systems	(69,891)	(72,154)
Other income and expenses - net	(5,729)	(4,569)
<b>Net Increase (Decrease) in Plan Net Position</b>	<b>\$ 72,089</b>	<b>\$ 95,132</b>

# **State of Michigan 457 Plan**

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## **Management's Discussion and Analysis (Continued)**

### **Overall Fund Structure and Objectives**

The Plan was originally established by the State of Michigan in 1974 for the exclusive benefit of eligible State of Michigan employees and their beneficiaries. The Plan has been amended and restated since the Plan's original adoption and retitled as the "State of Michigan 457 Plan". It was last amended and restated in its entirety, effective January 1, 2012.

The Plan was established as a means for State employees to save for retirement. Employees of the State of Michigan and judges are eligible to participate in the Plan as of the first day of employment and may voluntarily contribute a portion of their compensation up to the established Internal Revenue Code limits. The Plan was expanded in 2010 and 2012 to benefit eligible Michigan public school employees and their beneficiaries. Then in 2012, the Plan was further expanded to benefit eligible Michigan State Police and their beneficiaries, and to employees of the Education Achievement Authority and their beneficiaries.

Effective August 11, 2014, public school employers were provided the option to sign up to offer public school employees a deferred compensation option through the State of Michigan 401K and 457 Plans. Public school employees enrolled in the defined benefit pension plan who were hired prior to July 1, 2010 and also elected to retain their premium subsidy health care are eligible to participate. The deferred compensation option extends the opportunity to invest in the 457 Plan, and it also allows rollovers to the 401K Plan.

### **Asset Allocation**

Except as required under auto-enrollment in the State of Michigan 457 Plan Document, all participants have the ability to direct the investments of their accounts under the Plan, in accordance with the investment choices made available by the trustee and those policies or procedures determined by the administration from time to time. The Plan has no control over investment decisions made by the participants. Plan assets may be invested and reinvested in various instruments as deemed appropriate by the trustee and Plan management. Several investment tiers have been developed and made available to participants. A summary of the types of investments is listed in Note 3.

## **State of Michigan 457 Plan**

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### **Management's Discussion and Analysis (Continued)**

#### **Investment Results**

During 2014, both the Dow Jones Industrial Average and S&P 500 established a series of new record highs during the third quarter before being dragged back down to earth with moderate gains of 1.9% and 1.1%, respectively. The NASDAQ hit a new multiyear high of its own during the period and ultimately delivered a result of 1.9%. Seven of the ten S&P 500 sectors generated positive performances in the third quarter, led by health care, technology and telecommunications.

The Commerce Department's third and final estimate of second quarter U.S. GDP growth came in at 4.6%, combined with the first quarter's 2.1% contraction, the U.S. economy expanded just about 1% in the first half of 2014. Although the second quarter may represent the high-watermark for the year, data in recent months continues to signal moderate economic expansion, in sharp contrast to many economies outside the U.S.

Manufacturing remains brisk, and the trade gap has been narrowing as exports set new record highs. Consumer-related metrics like retail sales and consumer sentiment have rebounded from the long winter, and consumer borrowing has spiked of late, suggesting increased confidence in both households and the banks that lend to them. Trends in the housing recovery remain positive, if somewhat uneven.

Perhaps most notably, the job market trajectory remains intact. Nonfarm payrolls returned to form in September after August's initially disappointing report; the U.S. added 248,000 jobs in September handily beating the consensus forecast, and the results for July and August were restated higher by a combined 69,000 jobs. The unemployment rate fell to 5.9% from 6.1% - the first time it has come in below 6% since July 2008.

There has been increasing concern about weak overseas growth. Europe, for example, reported flat GDP growth for the second quarter and the European Central Bank's efforts to spur the region's economy thus far have fallen short. Asia's trajectory remains similarly uncertain. A recent raft of data out of China disappointed, as industrial output in August

## **State of Michigan 457 Plan**

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### **Management's Discussion and Analysis (Continued)**

slipped to lows not seen since the financial crisis, while measures of real estate, investment and retail sales also suggested sluggish growth.

Just as autumn slowly turns to winter, changes in U.S. monetary policy will be gradual. Weak global economic conditions combined with the rock-bottom U.S. labor market participation rates, a stronger U.S. dollar and the absence of any domestic wage pressures will allow the Fed to remain “exceptionally patient” as it moves to raise interest rates.

### **Contacting Management**

This report is designed to provide the retirement board, Plan participants, taxpayers, investors, and creditors with a general overview of the Plan's finances and to demonstrate the Plan's accountability for the money it receives. If you have any questions about this report or need additional information, contact the Office of Retirement Services, P.O. Box 30171, Lansing, MI 48909-7671.

## BASIC FINANCIAL STATEMENTS

## **Statement of Plan Fiduciary Net Position (in thousands)**

**As of September 30, 2014**

	<b>State of Michigan Deferred Compensation Fund</b>	<b>Public School Deferred Compensation Fund</b>	<b>Education Achievement Authority - Deferred Compensation Fund</b>	<b>Total</b>
<b>Assets</b>				
Equity in Common Cash	\$ 725	\$ 3,619	\$ 3	\$ 4,347
Participant-directed investments, at fair value/contract value (Note 3):				
Mutual funds	249,026	665	25	249,716
Common trust funds	598,808	57,674	3,070	659,552
Tier III investments	46,084	44		46,128
Stable Value Fund	621,488	44	1	621,533
Voya Small Cap Growth Strategy Fund	35,430	92	6	35,528
Jennison Large Cap Growth Equity Fund	58,334	81		58,415
Artisan Mid Cap Fund	24,091	88	1	24,180
Dodge & Cox Stock Fund	148,952	236	5	149,193
Participant loans	10,252	92	106	10,450
Other receivable	56	728	1	785
<b>Total assets</b>	<b>\$ 1,793,246</b>	<b>\$ 63,363</b>	<b>\$ 3,218</b>	<b>\$ 1,859,827</b>
<b>Liabilities</b>				
Accounts Payable	\$ 786	\$ 2,414		\$ 3,200
<b>Total liabilities</b>	<b>\$ 786</b>	<b>\$ 2,414</b>		<b>\$ 3,200</b>
<b>Plan Net Position</b>	<b>\$ 1,792,460</b>	<b>\$ 60,949</b>	<b>\$ 3,218</b>	<b>\$ 1,856,627</b>

The accompanying notes are an integral part of the financial statements.

## Statement of Changes in Plan Fiduciary Net Position (in thousands)

For Fiscal Year Ended September 30, 2014

	<b>State of Michigan Deferred Compensation Fund</b>	<b>Public School Deferred Compensation Fund</b>	<b>Education Achievement Authority - Deferred Compensation Fund</b>		<b>Total</b>
<b>Additions to Net Position</b>					
Investment income (loss):					
Interest and Dividends	\$ 27,784	\$ 26	\$ 1	\$ 27,811	
Net increase (decrease) in fair value of investments	<u>105,716</u>	<u>3,711</u>	<u>209</u>		<u>109,636</u>
Total investment income (loss)	<u>\$ 133,500</u>	<u>\$ 3,737</u>	<u>\$ 210</u>		<u>\$ 137,447</u>
Contributions:					
Employees	\$ 42,008	\$ 31,399	\$ 1,690	\$ 75,097	
Employers	<u>423</u>				<u>423</u>
Transfers from other systems	<u>1,018</u>	<u>73</u>			<u>1,091</u>
Total contributions	<u>\$ 43,449</u>	<u>\$ 31,472</u>	<u>\$ 1,690</u>		<u>\$ 76,611</u>
Miscellaneous income	<u>\$ 621</u>	<u>\$ 128</u>	<u>\$ 4</u>		<u>\$ 753</u>
Total additions	<u>\$ 177,570</u>	<u>\$ 35,337</u>	<u>\$ 1,904</u>		<u>\$ 214,811</u>
<b>Deductions from Net Position</b>					
Benefits paid to participants	\$ 65,178	\$ 930	\$ 241	\$ 66,349	
Administrative and investment expenses	<u>4,852</u>	<u>1,603</u>	<u>27</u>		<u>6,482</u>
Refunds and payments to other systems	<u>69,562</u>	<u>267</u>	<u>62</u>		<u>69,891</u>
Total deductions	<u>\$ 139,592</u>	<u>\$ 2,800</u>	<u>\$ 330</u>		<u>\$ 142,722</u>
<b>Net Increase (Decrease) in Net Position</b>	<b><u>\$ 37,978</u></b>	<b><u>\$ 32,537</u></b>	<b><u>\$ 1,574</u></b>		<b><u>\$ 72,089</u></b>
<b>Plan Net Position</b>					
Beginning of fiscal year	\$ 1,754,482	\$ 28,412	\$ 1,644	\$ 1,784,538	
<b>End of fiscal year</b>	<b><u>\$ 1,792,460</u></b>	<b><u>\$ 60,949</u></b>	<b><u>\$ 3,218</u></b>		<b><u>\$ 1,856,627</u></b>

The accompanying notes are an integral part of the financial statements.

# **State of Michigan 457 Plan**

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## **Notes to Financial Statements**

### **NOTE 1 – GENERAL DESCRIPTION OF THE PLAN**

The State of Michigan 457 Plan (the Plan) is a deferred compensation plan sponsored by the State of Michigan. The Plan is considered part of the State reporting entity and is included in the *State of Michigan Comprehensive Annual Financial Report* as a pension (and other employee benefit) trust fund. The Office of Retirement Services administers the Plan and the plan administrator has the authority to amend the Plan.

The following description provides only general information. Participants should refer to the Plan Document for a more complete description of the Plan's provisions. The Plan Document is available on the State of Michigan 401K and 457 plan website.

#### **General**

The Plan was established by the Civil Service Commission in 1974. The first enrollment was on April 17, 1975, with contributions starting in May 1975. The Plan Document was last amended and restated effective January 1, 2012 to incorporate all amendments, update changes required by law, and add new sections for changes in provisions made since the previous restatement. As of September 30, 2014, the Plan included 24,812 State of Michigan participants, 72,913 Michigan public school participants (673 participating employers), and 630 EAA participants.

#### **Eligibility**

The following employees are eligible to participate in the Plan on the first day of employment:

- State of Michigan employees,
- Judges,
- Michigan State Police,
- Public school employees, and
- Education Achievement Authority employees.

# **State of Michigan 457 Plan**

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## **Notes to Financial Statements (Continued)**

### **Contributions**

In accordance with Section 457 of the Internal Revenue Code, the Plan limits the amount of an individual's annual contribution, including additional catch-up contributions for those participants age 50 or older. Plan limits are adjusted each year by the IRS based on increases in the Consumer Price Index (CPI).

The Plan provides for the PHF for State of Michigan employees hired on or after January 1, 2012, Public School employees hired on or after September 4, 2012 and Michigan State Police hired after June 10, 2012 to account for employee contributions and an employer match on up to 2% of compensation. State employees hired after March 31, 1997 but prior to January 1, 2012 and who opted out of the graded premium receive an employer match on up to 2% of compensation plus a monetized amount for existing years of service upon terminating employment. Public School employees hired prior to September 4, 2012 and who opted out of the graded premium benefit receive an employer match on up to 2% of compensation.

### **Contributions from Other Systems**

Active employees may roll over money from another governmental 457 plan into their State of Michigan 457 Plan account. Participants may withdraw funds rolled into the Plan at any time.

### **Participant Account**

Each participant's account is credited with his or her contributions and an allocation of the Plan's earnings. Allocations are based on the participant's account balance to reflect the effect of income or losses from the particular investments. The benefit to which a participant is entitled is limited to the benefit that can be provided from the participant's account.

### **Vesting**

Participants are 100% vested in their contributions and related earnings or losses at all times.

# **State of Michigan 457 Plan**

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## **Notes to Financial Statements (Continued)**

### **Loans to Participants**

New in 2014, participants of the plan may borrow from their vested account balances of the Plan in accordance with the loan policy statement.

Loan amounts can range from a minimum of \$1,000 to a maximum of \$50,000. Loans must be repaid within five years, with the exception of residential loans, which may be extended up to thirty years. The interest rate on loans reflects a rate equal to the prime interest rate on the first day of the prior month.

### **Loans to Participants – Defaulted**

Defaulted loans are loans resulting from the failure of a participant to make the required loan repayments on an outstanding loan. These loans are considered a distribution to the participant for which a federal 1099 tax form is issued. During fiscal year 2014 defaulted loans totaled \$65.5 thousand for participants in the State of Michigan 457 Deferred Compensation Retirement Fund and \$3.3 thousand in the Public School Deferred Compensation Fund. There were no defaulted loans related to the EAA Deferred Compensation Fund.

### **Payment of Benefits**

Participants may withdraw their funds upon leaving employment. Withdrawal of participant funds may be by lump sum, monthly payments, annual payments, or rollovers to other qualified plans or an IRA. Payments may occur over a period not to exceed life expectancy from the date that the payments begin. In-service benefit payments are permitted for various reasons as outlined in the Plan Document.

### **Refunds and Payments to Other Systems**

Upon leaving employment, participants may roll over all or a portion of their account balances to other qualified plans or an IRA, or they may use all or a portion of their account balances to

# **State of Michigan 457 Plan**

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## **Notes to Financial Statements (Continued)**

purchase preapproved service credit in the State of Michigan's pension trust funds, if applicable.

### **Other Postemployment Benefits (OPEB)**

The Plan's financial statements reflect the PHF activity for State employees and public school employees participating in the PHF that are not eligible for subsidized health care benefits. The State employees eligible for subsidized health care benefits are included in the OPEB actuarial valuation provided for MSERS and reported in the MSERS financial statements. The public school employees eligible for subsidized health care are included in the OPEB actuarial valuation provided for Michigan Public School Employees' Retirement System (MPSERS) and reported in the MPSERS financial statements. For more information regarding these OPEB, please refer to the separately issued retirement system comprehensive annual financial reports.

### **Tax Status**

The U.S. Department of Treasury made its most recent issuance of a Private Letter Ruling on February 19, 2010, that the Plan constitutes an eligible deferred compensation plan as defined in section 457(b) of the Code and the trust associated with the Plan satisfies all applicable requirements of section 457(g), and will be treated and is, therefore, exempt from federal income tax under section 501(a). Although the Plan may be subsequently amended and restated, management believes that the Plan will continue to operate as an eligible deferred compensation plan and trust.

### **NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

#### **Basis of Presentation**

The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board. The accompanying financial statements present only the State of

# **State of Michigan 457 Plan**

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## **Notes to Financial Statements (Continued)**

Michigan 457 Plan. Accordingly, they do not purport to, and do not, present fairly the financial position and the changes in financial position of the State of Michigan as a whole or its pension (and other postemployment benefit) trust funds in conformity with accounting principles generally accepted in the United States of America.

### **Measurement Focus and Basis of Accounting**

The Plan uses the economic resources measurement focus and the accrual basis of accounting. Employee contributions are recognized in the period in which the contributions are due. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions.

### **Investments**

Investments in the mutual funds, common trust funds, Voya Small Cap Growth Strategy Fund, Jennison Large Cap Growth Equity Fund, Artisan Mid-Cap Fund, Dodge & Cox Stock Fund, and Tier III investments are stated at fair value based on quoted market prices. The Stable Value Fund is stated at contract value (see Note 3 for additional information). Investments in common trust funds are managed by State Street Global Advisors (SSgA), similar to mutual funds though not registered like mutual funds. The value of the Plan's position in the common cash fund is equivalent to the fair value of the common cash fund shares.

### **Participant Loans**

Participant loans are stated at the outstanding principle amount.

### **NOTE 3 – INVESTMENTS**

Except as required under auto-enrollment in the State of Michigan 457 Plan document, all participants have the ability to direct the investments of their accounts under the Plan, in accordance with the investment choices made available by the trustee and those policies or procedures determined by the administration from time to time. The mutual funds are

## **State of Michigan 457 Plan**

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### **Notes to Financial Statements (Continued)**

registered with the Securities and Exchange Commission, and guaranteed investment contracts (GICs) are regulated by state insurance departments.

Three investment tiers have been developed to classify the investments available to participants, based upon the general investment strategy. Tier I contains funds that have a passive investment strategy. These investments are managed to mirror investment performance of an established index. Tier II contains funds that have an active investment strategy. These investments are managed actively by an investment advisor using a specific fund investment objective. Tier III contains accounts with investments that are self-directed by the participant. These are not managed passively or actively by anyone other than the participant. A brief summary of the types of investments included in each tier follows:

**Tier I** - Common trust funds that include SSgA Cash Series Treasury Fund, SSgA U.S. Bond Index Fund, SSgA S&P 500 Index Fund, SSgA S&P Mid Cap Index Fund, SSgA Russell Small Cap Index Fund, SSgA Global All Cap Equity ex-U.S. Index Fund, SSgA Target Retirement Income Fund, and SSgA Target Retirement Funds ranging in retirement dates from 2010 through 2055. Tier I also includes Vanguard Emerging Markets Stock Index Fund, which is a mutual fund.

**Tier II** - Two of the Tier II funds (PIMCO Total Return Fund and American Funds EuroPacific Growth Fund) are mutual funds that employ the traditional share accounting method in which dividends are directly applied to participant accounts. Three of the Tier II funds (Oakmark Equity and Income Fund, T. Rowe Price Mid-Cap Value Fund, and RidgeWorth Small Cap Value Equity Fund) are mutual funds that employ a unitized accounting method in which dividends are applied to the pooled investment account. Other Tier II investments that include the Stable Value Fund, Voya Small Cap Growth Strategy Fund, Jennison Large Cap Growth Equity Fund, Artisan Mid Cap Fund, and Dodge & Cox Stock Fund, all employ the unitized accounting method and are designed for the exclusive use and benefit of State of Michigan 401K Plan and 457 Plan participants. The funds are unitized to eliminate the impact of revenue sharing on pricing. Unitization also allows the cash holding percentage of each unitized fund to be established between the plan sponsor and the trustee, which reduces the need to trade underlining

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## Notes to Financial Statements (Continued)

securities of the investment option on a daily basis and, therefore, the commission cost of trading those securities can be minimized.

**Tier III** - Individual stocks and bonds and thousands of mutual funds (load, no-load, and no-fee/no-load) from a multitude of fund families are available through the Plan's third party administrator. The various types of investments within Tier III are self-managed by the participants and are not separately classified by type of investment by the Plan's third party administrator. These self-managed stocks, bonds, mutual funds, covered call options and Exchange Traded Funds are presented on the statement of plan net position within the Tier III investments.

### **Investment Risk:**

The Plan's investments are subject to several types of risk. As of September 30, 2014, the Plan did not have any investments subject to custodial credit risk or concentration of credit risk. Other types of risk are examined in more detail below:

#### **a. Interest Rate Risk**

Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. The Plan's investment policy does not restrict investment maturities. As of September 30, 2014 the weighted average maturities of investments subject to interest rate risk are shown below (in thousands):

Investment Type	Fair Value/ Contract Value	Weighted Average Maturity (Years)
Stable Value Fund:		
Synthetic contracts*	\$ 579,405	3.85
SSgA STIF*	\$ 42,127	0.00
Common trust funds:		
SSgA U.S. Bond Index Fund	\$ 117,956	7.75
SSgA Cash Series Treasury Fund	\$ 20,812	0.19
Mutual Funds:		
PIMCO Total Return Fund	\$ 42,306	7.7

\*These investments are reported at contract value as disclosed in Note 2.

## **State of Michigan 457 Plan**

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### **Notes to Financial Statements (Continued)**

#### **b. Credit Risk**

Credit risk is the risk that an issuer or another counterparty to an investment will not fulfill its obligation. The Plan has an investment policy that limits its investment choices. The investment choices offered to participants are defined by tiers as described in the preceding paragraphs. As of September 30, 2014 the credit quality ratings of debt securities subject to credit risk (other than U.S. government securities) are shown below (in thousands):

Investment Type	Fair Value/ Contract Value	Rating	Rating Organization
Stable Value Fund:			
Synthetic contracts*	\$ 579,405	BBB to AAA	S&P
SSgA STIF*	\$ 42,127	A1/P1	Moody's
Common trust funds:			
SSgA U.S. Bond Index Fund	\$ 117,956	Below Baa to Aaa	Moody's
SSgA Cash Series Treasury Fund	\$ 20,812	A-1+/P-1	Moody's
Mutual Funds:			
PIMCO Total Return Fund	\$ 42,306	Below B to AAA	S&P
Oakmark Equity and Income Fund**	\$ 27,808	Not Rated	

\*These investments are reported at contract value as disclosed in Note 2.

\*\*This is a composite fund which is not rated separately by the rating agencies.

#### **c. Foreign Currency Risk**

Foreign currency risk is the risk that investments in securities traded in foreign currencies or more directly in foreign currencies may decline in value relative to the U.S. dollar, which may reduce the value of the portfolio. The Plan does not have an investment policy addressing foreign currency risk. As of September 30, 2014 the following investments (other than U.S. government securities) shown on the next page were subject to foreign currency risk (in thousands):

# State of Michigan 457 Plan

## Notes to Financial Statements (Continued)

Investment Type	Foreign Currency	Fair Value
Mutual funds:		
American Funds EuroPacific Growth Fund	Various	\$ 102,536
Oakmark Equity and Income Fund	Various	\$ 27,808
T. Rowe Price Mid-Cap Value Fund	Various	\$ 28,889
Vanguard Emerging Markets Stock Index Fund	Various	\$ 29,971
PIMCO Total Return Fund	Various	\$ 42,306
Common trust funds:		
SSgA Global All Cap Equity ex-U.S. Index Fund	Various	\$ 60,091
Separate accounts:		
Jennison Large Cap Growth Equity Fund	Various	\$ 58,415
Dodge & Cox Stock Fund	Various	\$ 149,193

### **Fully Benefit Responsive Synthetic Guaranteed Investment Contract (SGIC):**

As part of the Stable Value Fund, the Plan uses SGIC investment derivatives that invest in a portfolio of underlying securities and a benefit response wrap contract. The wrap contract produces a floating rate of return that is adjusted periodically, but not below zero, to reflect the underlying investment portfolio and generally provides for participant withdrawals at contract value (principal plus accrued interest). As of September 30, 2014, the fair values of SGIC are as follows (in thousands):

	Fair Value
SGIC Components:	
Underlying investments	\$ 598,919
Wrap contract	*
Total	<u>\$ 598,919</u>

\* The market value of the SGIC's underlying investments was higher than the SGIC's contract value; therefore, the wrap contract does not have a value.

## **GLOSSARY**

## Glossary of Acronyms and Terms

<b>DTMB</b>	Department of Technology, Management, and Budget.
<b>Education Achievement Authority (EAA)</b>	A Michigan Statewide school system for low-performing schools.
<b>financial audit</b>	An audit that is designed to provide reasonable assurance about whether the financial statements of an audited entity are presented fairly, in all material respects, in conformity with the disclosed basis of accounting.
<b>generally accepted accounting principles (GAAP)</b>	A technical accounting term that encompasses the conventions, rules, guidelines, and procedures necessary to define accepted accounting practice at a particular time; also cited as "accounting principles generally accepted in the United States of America."
<b>GICs</b>	Guaranteed Investment Contracts.
<b>Governmental Accounting Standards Board (GASB)</b>	An arm of the Financial Accounting Foundation established to promulgate standards of financial accounting and reporting with respect to activities and transactions of state and local governmental entities.
<b>internal control</b>	A process, effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance about the achievement of the entity's objectives with regard to the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.
<b>material misstatement</b>	A misstatement in the financial statements that causes the statements to not present fairly the financial position or the changes in financial position or cash flows in conformity with the disclosed basis of accounting.

<b>Moody's</b>	Moody's Investors Service, Inc. A credit rating agency that, among other things, provides credit ratings for issuers of certain debt obligations or debt instruments.
<b>MPSERS</b>	Michigan Public School Employees' Retirement System
<b>MSERS</b>	Michigan State Employees' Retirement System.
<b>OPEB</b>	other postemployment benefits.
<b>PHF</b>	Personal Healthcare Fund
<b>PIMCO</b>	Pacific Investment Management Company, LLC.
<b>S&amp;P</b>	Standard & Poor's. A credit rating agency that, among other things, provides credit ratings for issuers of certain debt obligations or debt instruments.
<b>SGIC</b>	Synthetic Guaranteed Investment Contract.
<b>SSgA</b>	State Street Global Advisors.
<b>STIF</b>	Short-Term Investment Fund.
<b>unmodified opinion</b>	The opinion expressed by the auditor when the auditor, having obtained sufficient appropriate audit evidence, concludes that the basic financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.