

# **State of Michigan 401K Plan**

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**Financial Report  
September 30, 2015**

# State of Michigan 401K 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  
Lewis Cass Building  
and  
Ms. Kerrie L. Vanden Bosch, Director  
Office of Retirement Services  
Stevens T. Mason Building  
Lansing, Michigan

Dear Mr. Behen and Ms. Vanden Bosch:

**Report on the Financial Statements**

We have audited the accompanying financial statements of the State of Michigan 401K Plan as of and for the fiscal year ended September 30, 2015 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.



Doug A. Ringler, CPA, CIA  
Auditor General

Mr. David B. Behen  
Ms. Kerrie L. Vanden Bosch  
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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 401K Plan as of September 30, 2015 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 2, the financial statements present only the State of Michigan 401K Plan and do not purport to, and do not, present fairly the financial position of the State of Michigan or its pension (and other postemployment benefit) trust funds as of September 30, 2015 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,

A handwritten signature in black ink that reads "Doug Ringler". The signature is written in a cursive, flowing style.

Doug Ringler  
Auditor General  
December 30, 2015

## MANAGEMENT'S DISCUSSION AND ANALYSIS

# State of Michigan 401K Plan

## Management's Discussion and Analysis

This section presents our discussion and analysis of the State of Michigan 401K Plan's (the Plan's) financial performance and provides an overview of the Plan's financial activities for the fiscal years ended September 30, 2015, and September 30, 2014. 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 year and prior year:

	Fiscal Years Ended September 30 (in thousands)	
	2015	2014
<b>Plan Net Position</b>	<b>\$ 4,566,252</b>	<b>\$ 4,554,507</b>
Net investment gain (loss)	\$ (63,286)	\$ 363,163
Contributions - Employees	170,709	155,039
Contributions - Employers	189,452	170,836
Transfers from other plans	8,908	
Contributions - Transfers from other systems	13,074	8,021
Benefits paid	(119,143)	(107,852)
Refunds and payments to other systems	(163,785)	(136,301)
Transfers to other plans	(8,908)	
Other income and expenses - net	(15,275)	(12,173)
<b>Net Increase (Decrease) in Plan Net Position</b>	<b>\$ 11,746</b>	<b>\$ 440,733</b>

# State of Michigan 401K Plan

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## Management's Discussion and Analysis (Continued)

### Overall Fund Structure and Objectives

The qualified Deferred Compensation Plan (the "Plan") was originally established by the State of Michigan pursuant to Act 306, P.A. 1976, for the exclusive benefit of eligible employees and their beneficiaries. The State of Michigan originally adopted the Michigan State Employees Deferred Compensation Plan II on September 13, 1985, effective October 1, 1985. The Plan has been amended and restated since the Plan's original adoption and retitled as the "State of Michigan 401K Plan." It was last restated in its entirety, effective January 1, 2014, and the restated Plan Document was amended effective January 1, 2015.

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 (EAA) 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 401K 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

## State of Michigan 401K Plan

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

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.

#### Investment Results

During 2015, the Dow Jones Industrial Averages was the weakest of the major domestic indexes during the third quarter, losing 7.6%, while the National Association of Securities Dealers Automated Quotations (NASDAQ) and Standard & Poor's (S&P) 500 dropped 7.4% and 6.9% respectively. All three indices' are in the red, nine months ended September 30, 2015. All ten S&P 500 sectors reported negative results for the third quarter. Energy, materials, and health care each delivered double digit declining losses. Consumer's staples and consumer discretionary outperformed the broader market.

The capitalization segments were all negative, small caps suffering the greatest losses, followed by mid and large caps in that order. A positive third quarter for domestic equities turned south by Mid-August. During this quarter global growth worries emerged sending the exchange to their worst third quarter performance since 2011.

The uncertain impact of a looming Federal Reserve next tightening cycle is already causing a widespread of discomfort. August's unexpected devaluation of China's currency led to heightened anxiety over the health of the world's second-largest economy and the global growth in general. Despite this ongoing active intervention, the country's equities have been pummeled and the economic data continue to disappoint. Trade, fixed-asset investment, industrial production and real estate investment have all been notably weak in more recent readings.

Meanwhile, the slowing demand for any number of commodities — from coal and oil to gold and iron ore — has contributed to the weakness throughout the economy. Oil prices, for example, fell below \$40 per barrel for the first time since 2009. Due in part to lower oil prices

## **State of Michigan 401K Plan**

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

and a stronger dollar, the central bank also reduced its expectation for the economy's long-run growth potential, to 1.8–2.2% from 2.0–2.3% previously.

Conditions in international markets were even more challenging. Developing markets were simply hammered, as the Morgan Stanley Capital International (MSCI) Emerging Markets Index shed more than 18% during the third quarter. Latin America was notably weak, while Eastern Europe provided relative support to the index. For the developed markets, the MSCI Europe, Australia, and Far East (EAFE) Index dropped nearly 11% in the third quarter on broad-based weakness.

Given significant gyrations in China and other emerging markets during the summer, the Fed's decision to remain on hold was reassuring to markets and investors. Moreover, the central bank took a big step by explicitly linking the impact of global economic and financial markets with domestic inflation and inflation expectations. The recent global disruption has tightened financial conditions and slowed economic activity, which will keep downward pressure on inflation and allow the Federal Open Market Committee (FOMC) to remain extremely accommodative.

#### **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, 2015

	State of Michigan Defined Contribution Retirement Fund	State of Michigan 401K Deferred Compensation Fund	Public School Defined Contribution Fund	Education Achievement Authority Defined Contribution Fund	Total
<b>Assets</b>					
Equity in Common Cash	\$ 341	\$ 425	\$ 1,357	\$ 5	\$ 2,128
Participant-directed investments, at fair value/contract value (Note 3):					
Mutual funds	395,519	268,553	856	33	664,961
Common trust funds	1,548,325	680,279	84,680	4,310	2,317,594
Tier III investments	60,063	42,582	22	3	102,671
Stable Value Fund	171,708	329,839	138	9	501,695
Voya Small Cap Growth Strategy Fund	67,800	47,190	142	10	115,142
Jennison Large Cap Growth Equity Fund	91,233	110,250	154		201,637
Artisan Mid Cap Fund	38,784	26,570	130	2	65,485
Dodge & Cox Stock Fund	179,840	214,635	342	6	394,823
Participant loans	151,474	47,897			199,371
Other receivable	149	92	909	1	1,152
<b>Total assets</b>	<b>\$ 2,705,236</b>	<b>\$ 1,768,313</b>	<b>\$ 88,730</b>	<b>\$ 4,381</b>	<b>\$ 4,566,660</b>
<b>Liabilities</b>					
Accounts Payable	\$ 140	\$ 247			\$ 388
Amounts due to other funds	21				21
<b>Total liabilities</b>	<b>\$ 161</b>	<b>\$ 247</b>			<b>\$ 408</b>
<b>Plan Net Position</b>	<b>\$ 2,705,075</b>	<b>\$ 1,768,065</b>	<b>\$ 88,730</b>	<b>\$ 4,381</b>	<b>\$ 4,566,252</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, 2015**

	State of Michigan Defined Contribution Retirement Fund	State of Michigan 401K Deferred Compensation Fund	Public School Defined Contribution Fund	Education Achievement Authority Defined Contribution Fund	Total
<b>Additions to Net Position</b>					
Investment income (loss):					
Interest and Dividends	\$ 17,753	\$ 15,127	\$ 13	\$ 1	\$ 32,894
Net increase (decrease) in fair value of investments	(62,005)	(30,187)	(3,821)	(166)	(96,180)
Total investment income (loss)	\$ (44,252)	\$ (15,061)	\$ (3,808)	\$ (165)	\$ (63,286)
<b>Contributions:</b>					
Employees	\$ 121,778	\$ 48,930			\$ 170,709
Employers	151,991	1,089	\$ 34,623	\$ 1,749	189,452
Transfers from other plans	4,431	4,478			8,908
Transfers from other systems	11,400	834	812	29	13,074
Total contributions	\$ 289,600	\$ 55,331	\$ 35,435	\$ 1,778	\$ 382,143
Miscellaneous income	\$ 579	\$ 475	\$ 527	\$ 5	\$ 1,586
Total additions	\$ 245,927	\$ 40,745	\$ 32,154	\$ 1,618	\$ 320,443
<b>Deductions from Net Position</b>					
Benefits paid to participants	\$ 73,138	\$ 44,901	\$ 934	\$ 170	\$ 119,143
Administrative and investment expenses	9,764	5,140	1,934	23	16,861
Transfers to other plans	4,478	4,431			8,908
Refunds and payments to other systems	77,263	85,406	556	560	163,785
Total deductions	\$ 164,642	\$ 139,877	\$ 3,425	\$ 753	\$ 308,698
<b>Net increase (Decrease) in Net Position</b>	\$ 81,285	\$ (99,133)	\$ 28,729	\$ 864	\$ 11,746
<b>Plan Net Position</b>					
Beginning of fiscal year	\$ 2,623,791	\$ 1,867,198	\$ 60,001	\$ 3,517	\$ 4,554,506
<b>End of fiscal year</b>	\$ 2,705,075	\$ 1,768,065	\$ 88,730	\$ 4,381	\$ 4,566,252

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

# State of Michigan 401K Plan

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## Notes to Financial Statements

### NOTE 1 – GENERAL DESCRIPTION OF THE PLAN

The State of Michigan 401K Plan (“the Plan”) is a deferred compensation fund and a defined contribution retirement fund sponsored by the State of Michigan. The Plan is considered part of the State's 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 State of Michigan originally adopted the Michigan State Employees Deferred Compensation Plan II on September 13, 1985, effective October 1, 1985, pursuant to Act 306, P.A. 1976, for the exclusive benefit of eligible employees and their beneficiaries. The Plan was amended as of March 31, 1997 to implement a defined contribution retirement fund. The Plan Document was restated effective January 1, 2014 to incorporate all amendments, update changes required by law, and add new sections for changes in provisions made since the previous restatement, and the restated Plan Document was amended effective January 1, 2015. As of September 30, 2015, the Plan included 46,804 State of Michigan participants, 83,528 Michigan public school participants (663 participating employers), and 673 EAA participants.

#### Eligibility

The following employees are eligible to participate in the 401K deferred compensation fund on the first day of employment:

- State of Michigan employees hired before March 31, 1997,
- Judges elected before March 31, 1997,

## State of Michigan 401K Plan

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### Notes to Financial Statements (Continued)

- Public school employees enrolled in the defined benefit pension plan who were hired prior to July 1, 2010 and who did not elect the Personal Healthcare Fund (PHF) retaining premium subsidy health care, and
- Michigan State Police hired prior to June 10, 2012.

The following employees are eligible to participate in the defined contribution retirement fund as of the first day of employment:

- State of Michigan employees hired on or after March 31, 1997,
- State of Michigan employees hired prior to March 31, 1997 who irrevocably elected to forgo participation in the State's defined benefit pension plan,
- Judges elected on or after March 31, 1997,
- Judges elected prior to March 31, 1997 who irrevocably elected to forgo participation in the State's defined benefit pension plan,
- Michigan State Police hired on or after June 10, 2012,
- Public school employees hired on or after July 1, 2010,
- Public school employees hired prior to July 1, 2010 who either elected the PHF or irrevocably elected to forgo participation in the defined benefit pension plan, and
- Education Achievement Authority employees.

### Contributions

In accordance with Section 401(k) 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 Internal Revenue Service (IRS) based on increases in the Consumer Price Index (CPI).

Also, for State of Michigan employees and judges participating in the defined contribution retirement fund and who are not covered by the State's defined benefit pension plans, the Plan provides for the State of Michigan to make a mandatory (i.e., non-matching) contribution of 4.0% plus a matching contribution on up to 3.0% of each participant's compensation. The State

## **State of Michigan 401K Plan**

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

does not make matching contributions for employees in the deferred compensation component of the Plan.

In addition, the Plan provides for public school reporting units and the Michigan State Police to make a mandatory contribution of 50% of eligible participants' voluntary contributions up to 1% of compensation. The Plan also provides for the EAA to make a mandatory contribution of 100% of participants' voluntary contributions up to 7.5% of compensation.

Finally, 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 of Michigan employees who were hired after March 31, 1997 but prior to January 1, 2012 and who opted out of the graded premium benefit 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 who were 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 401k plan, 401a or 403b plans, or from traditional individual retirement accounts (IRAs) into their account in the Plan. Participants may withdraw funds rolled into the Plan at any time.

### **Participant Account**

Each participant's account is credited with his or her contributions; the employer contributions, if applicable; 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.

## **State of Michigan 401K Plan**

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

#### **Vesting**

Participants are 100% vested in their contributions and related earnings or losses at all times. All participants are vested in their employer contributions and related earnings or losses based on years of service over a four-year period. A participant is 100% vested upon attaining four years of service credit. A year of service for State of Michigan participants, judges and Michigan State Police is defined as 2,080 hours whereas a year of service for public school and EAA participants is defined as 1,020 hours.

#### **Loans to Participants**

State of Michigan participants 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 2015 defaulted loans totaled \$8.3 million for participants in the State of Michigan 401K Defined Contribution Retirement Fund and \$3.2 million for participants in the State of Michigan 401K Deferred Compensation Fund.

# State of Michigan 401K Plan

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## Notes to Financial Statements (Continued)

### Payment of Benefits

Participants may withdraw their vested 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 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 vested account balances to other qualified plans or an IRA, or they may use all or a portion of their account balances to purchase preapproved service credit in the State of Michigan's pension trust funds, if applicable.

In fiscal year 2015, \$ 20.5 thousand of employer contributions was transferred to the Michigan State Employees' Retirement System (MSERS) to refund the employer contributions previously made by the State for participants that were incorrectly placed in the State of Michigan defined contribution fund. These participants were moved to the State of Michigan 401K deferred compensation fund.

### Forfeited Accounts

Forfeited non-vested accounts totaled \$ 17.1 million at September 30, 2015. Section 401(a)(2) of the Internal Revenue Code restricts the State from recapturing any contributions made to the Plan. Accordingly, as specified in the Plan Document, these accounts are to be used to restore forfeited assets when applicable, offset future State contributions, and pay administrative expenses of the Plan.

# State of Michigan 401K Plan

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## Notes to Financial Statements (Continued)

### Other Postemployment Benefits (OPEB)

The Plan's financial statements reflect the PHF activity for State employees, Michigan State Police, 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 the Michigan Public School Employees' Retirement System (MPSERS) and reported in the MPSERS financial statements. The Michigan State Police eligible for subsidized health care are included in the OPEB actuarial valuation provided for the Michigan State Police Retirement System (MSPRS) and reported in the MSPRS 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 determination on October 17, 2014, that the Plan constitutes a qualified trust under Section 401(a) of the Internal Revenue Code. Although the Plan may be subsequently amended and restated, management believes that the Plan will continue to operate as a qualified 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 Michigan 401K 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

# State of Michigan 401K Plan

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## Notes to Financial Statements (Continued)

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 are. 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 401K 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 registered with the Securities and Exchange Commission, and guaranteed investment contracts (GICs) are regulated by state insurance departments.

## State of Michigan 401K Plan

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### Notes to Financial Statements (Continued)

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 2060. The SSgA Target Retirement 2010 Fund was transitioned into the SSgA Target Retirement Income Fund effective April 1, 2015. Also effective April 1, 2015, the SSgA Target Retirement Income 2060 fund was introduced. 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 underlying securities of the investment option on a daily basis and, therefore, the commission cost of trading those securities can be minimized.

# State of Michigan 401K Plan

## Notes to Financial Statements (Continued)

**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, 2015, 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, 2015 the weighted average maturities of investments subject to interest rate risk are shown below (in thousands):

<u>Investment Type</u>	<u>Fair Value/ Contract Value</u>	<u>Weighted Average Maturity (Years)</u>
Stable Value Fund:		
Synthetic contracts*	\$ 471,424	3.70
SSgA STIF*	\$ 30,270	0.00
Common trust funds:		
SSgA U.S. Bond Index Fund	\$ 391,925	7.88
SSgA Cash Series Treasury Fund	\$ 168,499	0.08
Mutual Funds:		
PIMCO Total Return Fund	\$ 104,241	7.8

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

## State of Michigan 401K Plan

### 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, 2015 the credit quality ratings of debt securities subject to credit risk (other than U.S. government securities) are shown below (in thousands):

<u>Investment Type</u>	<u>Fair Value/ Contract Value</u>	<u>Rating</u>	<u>Rating Organization</u>
Stable Value Fund:			
Synthetic contracts*	\$ 471,424	BBB to AAA	S&P
SSgA STIF*	\$ 30,270	A1/P1	Moody's
Common trust funds:			
SSgA U.S. Bond Market Index Fund	\$ 391,925	Baa to Aaa	Moody's
SSgA Cash Series Treasury Fund	\$ 168,499	A-1+/P-1	Moody's
Mutual Funds:			
PIMCO Total Return Fund	\$ 104,241	Below B to AAA	S&P
Oakmark Equity and Income Fund**	\$ 89,161	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, 2015 the investments (other than U.S. government securities) on the following page were subject to foreign currency risk (in thousands):

## State of Michigan 401K Plan

### Notes to Financial Statements (Continued)

Investment Type	Foreign Currency	Fair Value
Mutual funds:		
American Funds EuroPacific Growth Fund	Various	\$ 272,996
Oakmark Equity and Income Fund	Various	\$ 89,161
T. Rowe Price Mid-Cap Value Fund	Various	\$ 78,292
Vanguard Emerging Markets Stock Index Fund	Various	\$ 70,417
PIMCO Total Return Fund	Various	\$ 104,241
RidgeWorth Small Cap Value Equity Fund	Various	\$ 49,849
Common Trust funds:		
SSgA Global All Cap Equity ex-U.S. Index Fund	Various	\$ 226,349
Separate accounts:		
Jennison Large Cap Growth Equity Fund	Various	\$ 201,637
Dodge & Cox Stock Fund	Various	\$ 394,823

#### **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 responsive 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 provide for participant withdrawals at contract value (principal plus accrued interest). As of September 30, 2015, the fair values of SGIC are as follows (in thousands):

	Fair Value
SGIC Components:	
Underlying investments	\$ 488,082
Wrap contract	*
Total	\$ 488,082

\* 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>MSPRS</b>	Michigan State Police 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.