

State of Michigan 401K Plan

**Financial Report
September 30, 2022**

State of Michigan 401K Plan

Table of Contents

Independent Auditor's Report	2
Management's Discussion and Analysis	6
Basic Financial Statements	
Statement of Plan Fiduciary Net Position	14
Statement of Changes in Plan Fiduciary Net Position	15
Notes to the Financial Statements	16

INDEPENDENT AUDITOR'S REPORT



OAG

Office of the Auditor General

201 N. Washington Square, Sixth Floor • Lansing, Michigan 48913 • Phone: (517) 334-8050 • audgen.michigan.gov

Doug A. Ringler, CPA, CIA
Auditor General

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

Ms. Michelle Lange, Director
Department of Technology, Management, and Budget
Elliott-Larsen Building
Lansing, Michigan
and
Mr. Anthony J. Estell, Director
Office of Retirement Services
Stevens T. Mason Building
Lansing, Michigan

Dear Ms. Lange and Mr. Estell:

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of the State of Michigan 401K Plan (Plan), a fiduciary fund of the State of Michigan, as of and for the fiscal year ended September 30, 2022 and the related notes to the financial statements as listed in the table of contents.

In our opinion, the accompanying financial statements referred to above present fairly, in all material respects, the fiduciary net position of the State of Michigan 401K Plan as of September 30, 2022 and the changes in its fiduciary net position for the fiscal year then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS) and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Plan and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter

As discussed in Note 2, the financial statements present only the 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, 2022, the changes in its financial position, or, where applicable, its cash flows for the 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.

Ms. Michelle Lange, Director
Mr. Anthony J. Estell, Director
Page 2

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for 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 Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and, therefore, is not a guarantee that an audit conducted in accordance with GAAS and *Government Auditing Standards* will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS and *Government Auditing Standards*, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit 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 Plan's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.

We are required to communicate to those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, as listed in the table of contents, be presented to supplement the financial statements. Such information is the responsibility of management and, although not a part of the financial statements, is required by the Governmental Accounting



Doug A. Ringler, CPA, CIA
Auditor General

Ms. Michelle Lange, Director
Mr. Anthony J. Estell, Director
Page 3

Standards Board who considers it to be an essential part of financial reporting for placing the 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 financial statements, and other knowledge we obtained during our audit of the 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 dated December 22, 2022 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 solely 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 the effectiveness of the Plan's 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 dark ink that reads "Doug Ringler". The signature is written in a cursive style with a large, stylized "R".

Doug Ringler
Auditor General
December 22, 2022

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, 2022, and September 30, 2021. 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:

	Fiscal Years Ended September 30 (in thousands)	
	2022	2021
Plan Net Position	\$ 8,050,187	\$ 9,477,044
Net Investment gain (loss)	\$ (1,671,997)	\$ 1,659,232
Contributions - Employees	346,213	314,600
Contributions - Employers	418,440	357,303
Contributions - Transfers from other systems	20,517	19,921
Benefits paid	(209,420)	(268,458)
Refunds and payments to other systems	(313,046)	(324,082)
Other income and expenses - net	(17,564)	(17,562)
Net Increase (Decrease) in Plan Net Position	\$ (1,426,857)	\$ 1,740,954

State of Michigan 401K Plan

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, 2020.

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. As of November 1, 2021, these public school employees are permitted to defer compensation to the State of Michigan 457 Plan without the need for their employers to sign up. The deferred compensation option extends the opportunity to invest in the 457 Plan, and it also allows rollovers to the 401K Plan.

On April 25, 2017, the EAA Executive Committee approved a Resolution Authorizing Dissolution of the Education Achievement Authority of Michigan. The EAA ceased to exist as a legal entity on June 30, 2017. No new contributions were made to the Plan since August 18, 2017.

State of Michigan 401K Plan

Management's Discussion and Analysis (Continued)

On July 13, 2017, the Governor signed Public Act 92 of 2017 into law. The legislation requires public school employers to make a 4% non-matching contribution to the 401(K) Plan effective October 1, 2017 for all Michigan Public School Employees' Retirement System (MPSERS) Defined Contribution participants hired on or after September 4, 2012 and changed the matching contribution formula for all MPSERS Defined Contribution participants hired on or after September 4, 2012 to a dollar-for-dollar match up to 3% of compensation effective February 1, 2018. Further, the legislation closed the current hybrid plan (Pension Plus) to newly hired employees as of February 1, 2018 and created a new optional revised hybrid plan (Pension Plus 2) with similar plan benefit calculations but containing a 50/50 cost share between the employee and the employer, including the cost of future unfunded liabilities.

On June 3, 2018, the Governor signed Public Act 169 of 2018 into law. The legislation requires public school employers to make a dollar-for-dollar matching contribution to the 401(K) Plan on up to 3% of gross wages deferred to the 457 Plan effective September 1, 2018 for all MPSERS members who had elected to convert to the Defined Contribution plan.

Asset Allocation

The Bureau of Investments, Department of Treasury, in consultation with the Office of Retirement Services and subject of approval by the State of Michigan Investment Board, selects mutual funds, pooled funds, separate accounts, or other investment vehicles to pursue the Plan's investment objective, which are then made available by the trustee. 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 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 401K Plan

Management's Discussion and Analysis (Continued)

Investment Results

During fiscal year 2022, all indices sustained losses with the Dow Jones Industrial Average (the Dow) declining the least. The Dow was down 13.40% while the S&P 500 lost 15.47% and the NASDAQ lost 26.25%. Other common indices that finished the fiscal year in negative territory included the Russell 2000; Morgan Stanley Capital International (MSCI) Europe, Australasia, and the Far East (EAFE); MSCI Emerging Markets; Bloomberg U.S. Aggregate Bond; and Bloomberg U.S. Corporate High Yield Indices.

Persistent inflation pressures prompted central banks, including the US Federal Reserve, to tighten monetary policy in the third quarter of 2022 and push nominal and real (inflation-adjusted) bond yields to their highest levels in more than a decade.

Nearly all asset categories posted a loss for the third quarter of 2022, with non-US equities suffering some of the worst declines due to the dollar's steep ascent versus foreign currencies. The continued rise in bond yields pushed the prices of most fixed income categories further into negative territory for 2022. Commodity prices experienced declines as well, but they remained a rare bright spot, with positive returns so far this year.

Global manufacturing activity decelerated, ending the quarter in roughly neutral territory. New orders slumping and inventories rising is a leading impending signal of more slowing ahead. The reopening manufacturing boom has now faded, leaving the global economy more dependent on services industries to pick up the slack.

Most major economies experienced maturing trends in their business cycles. The US is in the late-cycle expansion phase, with rising but moderate recession risk. Europe has likely tipped into recession, and China's increased policy stimulus has yet to pull it out of its growth recession. In the US, profit growth continued to decelerate, but remained positive. Expectations for earnings growth among stocks in the S&P 500® index for 2022 stood at about 10%. Estimates for 2023 profit growth have been revised lower this year, but they remain higher than both historical late-cycle and recession averages.

State of Michigan 401K Plan

Management's Discussion and Analysis (Continued)

Labor markets in the US remained extremely tight, with job openings near record levels and the 3.7% unemployment rate near multidecade lows. This, along with a low labor-force participation rate and aging demographic trends, placed pressure on employers to raise wages. Some drivers of inflation, such as manufacturing supply-chain disruptions, abated during the last 3 months. That said, categories where price increases tend to be more persistent, such as food and housing, accounted for a larger proportion of the current inflation drivers by year's end. Most major asset categories sold off in the third quarter of 2022, although shorter duration and more credit-sensitive fixed income categories, such as leveraged loans, eked out gains. In comparison, longer, more interest-rate sensitive sectors—such as long-duration government bonds—suffered the biggest losses.

Credit spreads rose for the first 9 months of 2022 across all major bond categories. Spreads on mortgages, investment-grade bonds, high-yield corporates, and emerging-market debt all stood above their respective historical averages at the end of the quarter. The continued broad equity sell-off caused valuations for all categories of global stocks to fall further in the third quarter of 2022. The price-to-earnings ratios for all major categories of global equities—US, non-US developed markets, and emerging markets—are now below their long-term averages.

Lastly, the potential for a sustained period of higher inflation highlighted the potential benefits of owning inflation-resistant assets, including commodities and commodity-producer equities, as well as Treasury Inflation-Protected Securities, which have provided better diversification than nominal US Treasury bonds.

State of Michigan 401K Plan

Management's Discussion and Analysis (Continued)

Contacting Management

This report is designed to provide Plan participants 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, 2022

	State of Michigan Defined Contribution and Deferred Compensation Retirement Fund	Public School Defined Contribution Fund	Education Achievement Authority Defined Contribution Fund	Total
Assets				
Equity in Common Cash	\$ 72	\$ 4,852	\$ 35	\$ 4,959
Participant-directed investments at fair value/contract value (Note 3)				
Mutual funds	\$ 393,802	\$ 5,315	\$ 10	\$ 399,127
Common trust funds	4,939,100	639,675	3,665	5,582,440
Tier III investments	173,976	3,511	15	177,501
Stable Value Fund	753,949	4,492	29	758,469
Voya Small Cap Growth Strategy Fund	89,964	1,112		91,075
Jennison Associates Large Cap Growth Equity Fund	287,799	3,790	24	291,612
Artisan U.S. Mid-Cap Growth Strategy Fund	87,485	1,719		89,205
Dodge & Cox Stock Portfolio	443,779	3,778		447,557
Total participant-directed investments	\$ 7,169,854	\$ 663,391	\$ 3,742	\$ 7,836,986
Receivables:				
Participant loans	\$ 132,597			\$ 132,597
Amounts due from employees	15,567			15,567
Amounts due from employer	30,846	\$ 9,349		40,195
Amounts due from employer long term	20,112			20,112
Other receivable	272	237		509
Total receivables	\$ 199,393	\$ 9,586		\$ 208,979
Total assets	\$ 7,369,318	\$ 677,829	\$ 3,778	\$ 8,050,925
Liabilities				
Accounts Payable	\$ 658			\$ 658
Amounts due to other funds	80			80
Total liabilities	\$ 738			\$ 738
Plan Net Position	\$ 7,368,580	\$ 677,829	\$ 3,778	\$ 8,050,187

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, 2022

	State of Michigan Defined Contribution and Deferred Compensation Retirement Fund	Public School Defined Contribution Fund	Education Achievement Authority Defined Contribution Fund	Total
Additions to Net Position				
Investment income (loss):				
Interest and Dividends	\$ 35,904	\$ 219	\$ 1	\$ 36,123
Net increase (decrease) in fair value of investments	(1,545,582)	(161,649)	(889)	(1,708,120)
Total investment income (loss)	\$ (1,509,678)	\$ (161,431)	\$ (888)	\$ (1,671,997)
Contributions:				
Employees	\$ 346,213			\$ 346,213
Employers	261,999	\$ 156,441		418,440
Transfers from other systems	16,523	3,994		20,517
Total contributions	\$ 624,735	\$ 160,435		\$ 785,170
Miscellaneous income	\$ 2,779	\$ 905	\$ 4	\$ 3,689
Total additions	\$ (882,164)	\$ (90)	\$ (884)	\$ (883,138)
Deductions from Net Position				
Benefits paid to participants	\$ 199,054	\$ 10,217	\$ 149	\$ 209,420
Administrative and investment expenses	17,177	4,067	9	21,253
Refunds and payments to other systems	296,208	16,759	78	313,046
Total deductions	\$ 512,440	\$ 31,042	\$ 236	\$ 543,719
Net increase (Decrease) in Net Position	\$ (1,394,604)	\$ (31,133)	\$ (1,120)	\$ (1,426,857)
Plan Net Position				
Beginning of fiscal year	\$ 8,763,184	\$ 708,962	\$ 4,898	\$ 9,477,044
End of fiscal year	<u>\$ 7,368,580</u>	<u>\$ 677,829</u>	<u>\$ 3,778</u>	<u>\$ 8,050,187</u>

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

State of Michigan 401K Plan

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 Annual Comprehensive 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 last restated effective January 1, 2020 to incorporate all amendments, update changes required by law, and add new sections for changes in provisions made since the previous restatement. The restated Plan Document was last amended effective January 1, 2020. As of September 30, 2022, the Plan included 76,884 State of Michigan participants, 139,369 Michigan public school participants (694 participating employers), and 303 participants of the former Educational Achievement Authority (EAA).

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 (except per diem workers who receive no taxable wages, working patients of a mental health facility, and individuals paid on a fee basis or receiving only military subsistence payments),

State of Michigan 401K Plan

Notes to Financial Statements (Continued)

- Judges elected before March 31, 1997, 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 (except the Adjutant General and Assistant Adjutant General, per diem workers who receive no taxable wages, working patients of a mental health facility, and individuals paid on a fee basis or receiving only military subsistence payments),
- 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 Personal Healthcare Fund (PHF) or irrevocably elected to forgo participation in the defined benefit pension plan,
- All other public school employees hired prior to July 1, 2010, but only for discretionary matching contributions or qualified rollover contributions or transfers, and
- Former Education Achievement Authority employees (no new contributions).

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).

State of Michigan 401K Plan

Notes to Financial Statements (Continued)

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

The Plan also provides for public school reporting units and the Michigan State Police to make a mandatory contribution of 50% of eligible hybrid plan participants' voluntary contributions up to 1% of compensation. Additionally, effective February 1, 2018, the Plan provides for the public school reporting units to make a matching contribution of 100% of Defined Contribution participants' voluntary contributions up to 3% of compensation. The EAA was dissolved effective June 30, 2017 and the Plan no longer receives new EAA contributions; however, the Plan will remain open as long as former EAA employee balances remain in the Plan.

Finally, the Plan provides for the Personal Healthcare Fund (PHF) for State of Michigan employees hired on or after January 1, 2012, Michigan 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 also receive an employer match on up to 2% of compensation.

Contributions from Other Systems

Active employees or former employees may roll over money from another 401(k) plan, 401(a) plan, 403(b) plan, or traditional individual retirement accounts (IRAs) into their account in the Plan, or from a 457 Plan if severed from employment more than twelve (12) months and have maintained a 401k account balance. Participants may withdraw funds rolled into the Plan at any time.

State of Michigan 401K Plan

Notes to Financial Statements (Continued)

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.

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. A participant is 50% vested upon attaining two years of service credit, 75% vested upon attaining three years, and 100% vested upon attaining four years. 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 in a school fiscal year.

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. An additional loan option was made available for eligible participants under the Coronavirus Aid, Relief, and Economic Security (CARES) Act from April 22, 2020 to September 22, 2020 to a maximum of \$100,000. Loans must be repaid within five years, with the exception of residential loans, which may be extended up to thirty years. However, from April 22, 2020 through December 31, 2020, participants were able to defer loan payments for up to one year under the CARES Act. The interest rate on loans reflects a rate equal to the prime interest rate on the first day of the prior month.

State of Michigan 401K Plan

Notes to Financial Statements (Continued)

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 2022 defaulted loans totaled \$6.8 million for participants in the State of Michigan 401K Defined Contribution Retirement Fund.

Payment of Benefits

Participants may, but are not required to, 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 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, but are not required to, 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.

Forfeited Accounts

Forfeited non-vested accounts totaled \$13.6 million on September 30, 2022. 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 employer contributions, and pay administrative expenses of the Plan.

State of Michigan 401K Plan

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 Michigan State Employees' Retirement System (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 (MPERS) and reported in the MPERS 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 annual comprehensive 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 (GASB). 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 pension (and other employee benefit) trust funds in conformity with accounting principles generally accepted in the United States of America.

State of Michigan 401K Plan

Notes to Financial Statements (Continued)

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 Associates Large Cap Growth Equity Fund, Artisan U.S. Mid-Cap Growth Strategy Fund, Dodge & Cox Stock Portfolio, 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). The mutual funds are registered with the Securities and Exchange Commission, and guaranteed investment contracts (GICs) are regulated by state insurance departments. Investments in common trust funds are managed by State Street Global Advisors (SSgA), BlackRock, and the Prudential Trust Company. Common trust funds are 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.

Investments measured at fair value are determined based on the market approach, which utilizes prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities. The fair value of publicly traded fixed income and equity securities is based upon quoted market prices and exchange rates, when applicable.

Participant Loans

Participant loans are stated at the outstanding principal amount.

State of Michigan 401K Plan

Notes to Financial Statements (Continued)

NOTE 3 – INVESTMENTS

The Bureau of Investments, Department of Treasury, in consultation with the Office of Retirement Services and subject of approval by the State of Michigan Investment Board, selects mutual funds, pooled funds, separate accounts, or other investment vehicles to pursue the Plan's investment objective, which are then made available to participants by the trustee. 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.

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 is shown below:

Tier I - Common trust funds include BlackRock Government Short-Term Investment Fund, State Street U.S. Aggregate Bond Index Strategy Fund, State Street S&P 500 Index Strategy Fund, State Street S&P Mid-Cap 400 Index Strategy Fund, BlackRock S&P Small Cap 600 Equity Index Fund F, State Street MSCI ACWI ex USA IMI Index Strategy Fund, BlackRock Emerging Markets Index Fund F, State Street Target Retirement Funds – Class P, and State Street Target Retirement Funds ranging in retirement dates from 2020 through 2065. All of the BlackRock funds employ the unitized accounting method.

State of Michigan 401K Plan

Notes to Financial Statements (Continued)

Tier II - Two of the Tier II funds (PIMCO Total Return Instl Fund and American Funds EuroPacific Growth Fund R6) are mutual funds that employ the traditional share accounting method in which dividends are directly applied to participant accounts. The Prudential High Yield Fund is a common trust fund that also employs the traditional share accounting method. Two of the Tier II funds (T. Rowe Price Mid-Cap Value Fund and Virtus Ceredex Small-Cap Value Equity I 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 Associates Large Cap Growth Equity Fund, Artisan U.S. Mid-Cap Growth Strategy Fund, and Dodge & Cox Stock Portfolio, 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 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.

State of Michigan 401K Plan

Notes to Financial Statements (Continued)

Investment Risk:

The Plan's investments are subject to several types of risk. As of September 30, 2022, 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, 2022 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*	\$ 758,469	3.74
Common trust funds:		
State Street U.S. Aggregate Bond Index Strategy Fund	\$ 791,724	8.65
BlackRock Government Short-Term Investment Fund	\$ 206,093	0.06
Prudential High Yield Fund	\$ 31,494	5.78
Mutual Funds:		
PIMCO Total Return Instl Fund	\$ 75,907	7.86

*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, 2022 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	Duration	Rating	Rating Organization
Stable Value Fund:				
Synthetic contracts*	\$ 758,469	Long-term	A to AAA	S&P
Common trust funds:				
State Street U.S. Aggregate Bond Index Strategy Fund	\$ 791,724	Long-term	AA- to AA	S&P
BlackRock Government Short-Term Investment Fund	\$ 206,093	Short-term	A-1 to A-1+	S&P
Prudential High Yield Fund	\$ 31,494	Long-term	B- to AAA	S&P
Mutual Funds:				
PIMCO Total Return Instl Fund	\$ 75,907	Intermediate	D to AAA	S&P

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

State of Michigan 401K Plan

Notes to Financial Statements (Continued)

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, 2022 the investments shown below were subject to foreign currency risk (in thousands):

<u>Investment Type/Fund</u>	<u>Foreign Currency</u>	<u>Fair Value</u>
Separate account		
Jennison Associates Large Cap Growth Equity Fund	Euro	\$ 3,990

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, 2022, the fair value of the SGIC is shown below (in thousands):

		<u>Fair Value</u>
SGIC Components:		
Underlying investments	\$	758,997
Wrap contract		*
Total	\$	<u>758,997</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.

Fair Value of Investments

Investments are recorded at fair value in accordance with GASB Statement No. 72, *Fair Value Measurement and Application*, which establishes a hierarchy of valuation inputs based on the extent to which the inputs are observable in the marketplace. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Observable inputs reflect market data obtained from sources independent of the reporting entity. Unobservable inputs reflect the entity's own assumptions about how market participants would value an asset or liability based on the best information available. Valuation techniques used to measure fair value maximize the use of observable inputs and minimize the use of unobservable inputs. Accordingly, the change in fair value of investments is recognized as an increase or decrease to investment assets and investment income.

The Plan categorizes fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of the asset.

- a. Level 1 debt and equity securities are valued using quoted prices in active markets for the actual or identical securities. Market price data is generally obtained from relevant exchanges or dealer markets.
- b. Level 2 securities are valued using significant other observable securities.
- c. Level 3 securities are valued using significant unobservable inputs.

State of Michigan 401K Plan

Notes to Financial Statements (Continued)

The Plan has the following recurring fair value measurements as of September 30, 2022 shown below (in thousands):

	9/30/2022	Fair Value Measurements Using		
		Quoted Prices In Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Investments by fair value level				
Mutual Funds	\$ 399,127	\$ 399,127		
Common trust funds	5,582,440	3,800,878	\$ 1,781,561	
Tier III Investments*	154,267		154,267	
Stable Value Fund	758,469		758,469	
Voya Small Cap Growth Strategy Fund	91,075		91,075	
Jennison Associates Large Cap Growth Equity Fund	291,612		291,612	
Artisan U.S. Mid-Cap Growth Strategy Fund	89,205		89,205	
Dodge & Cox Stock Portfolio	447,557		447,557	
Total Investments by fair value	<u>\$ 7,813,752</u>	<u>\$ 4,200,005</u>	<u>\$ 3,613,747</u>	<u>\$ -</u>

*Tier III Investments exclude cash held in participant accounts totaling approximately \$23.23 million.

The fair value of debt and equity securities classified in Level 1 at September 30, 2022 were valued using prices quoted in active markets for those securities. The fair value of debt securities classified in Level 2 at September 30, 2022 was based on the value of their underlying investments, which include, but are not limited to, treasury bills, government and corporate bonds, mortgage backed securities, and asset backed securities.

The State Street S&P 500 Index Strategy Fund, State Street S&P Mid Cap 400 Index Strategy Fund, and State Street Target Retirement Funds - Class P, within the common trust funds, are classified as Level 1. All other common trust funds, which are similar to mutual funds though not registered like mutual funds, are Level 2 because their fair value is determined by the fund manager based on the value of each underlying investment within their respective pooled investment account. The fair value of the State Street Target Retirement Funds - Class P, within the common trust funds, was based on the units of the underlying funds that make up each Target Retirement fund, which may include, but are not limited to, the State Street S&P 500 Index Strategy Fund, State Street Russell Small/Mid Cap Index Fund, State Street MSCI ACWI ex USA IMI Index Strategy

State of Michigan 401K Plan

Notes to Financial Statements (Continued)

Fund, State Street Bloomberg Roll Select Commodity Index Fund, State Street Global Real Estate Securities Index Fund, State Street 1-10 Year U.S. TIPS Index Fund, and State Street government and corporate bond funds. The value of the Stable Value Fund was also based on the value of its underlying investments, which include a Synthetic GIC issued by Voya Retirement Insurance and Annuity Company and is classified as Level 2. The Jennison Associates Large Cap Growth Equity Fund, Dodge & Cox Stock Portfolio, Artisan U.S. Mid-Cap Growth Strategy Fund, and Voya Small Cap Growth Strategy Fund are classified as Level 2 because a portion of their value was based on assets held within State Street's Short-Term Investment Fund (STIF) for liquidity purposes. The Tier III investments are classified as Level 2 based on the value of its underlying investments, a portion of which are classified as Level 2.

The Plan does not contain any debt or equity securities classified in Level 3.

In instances where inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The Plan's assessment of the significance of particular inputs to these fair value measurements requires judgement and considers factors specific to each asset or liability.