

**Michigan State Police Retirement System**  
a Pension Trust Fund of the State of Michigan

**Comprehensive Annual Financial Report  
for the Fiscal Year Ended September 30, 2004**



**M S P R S**

**Prepared by:  
Financial Services  
for  
Office of Retirement Services  
P.O. Box 30171  
Lansing, Michigan 48909-7671  
517-322-5103  
1-800-381-5111**

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# INTRODUCTORY SECTION

Certificate of Achievement  
Letter of Transmittal  
Retirement Board Members  
Advisors and Consultants  
Organization Chart



# INTRODUCTORY SECTION

## Certificate of Achievement

### Certificate of Achievement for Excellence in Financial Reporting

Presented to

### Michigan State Police Retirement System

For its Comprehensive Annual  
Financial Report  
for the Fiscal Year Ended  
September 30, 2003

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



*Nancy L. Ziehl*

President

*Jeffrey R. Enow*

Executive Director

# INTRODUCTORY SECTION

## Letter of Transmittal

State Police Retirement System  
P.O. Box 30171  
Lansing, Michigan 48909-7671  
Telephone 517-322-5103  
Outside Lansing 1-800-381-5111

### STATE OF MICHIGAN

JENNIFER M. GRANHOLM, Governor

## DEPARTMENT OF MANAGEMENT AND BUDGET

December 3, 2004

The Honorable Jennifer M. Granholm  
Governor, State of Michigan,

Members of the Legislature  
State of Michigan,

Retirement Board Members  
and  
Members, Retirees and Beneficiaries

Ladies and Gentlemen:

We are pleased to present the comprehensive annual financial report of the Michigan State Police Retirement System (System) for fiscal year 2004.

Responsibility for both the accuracy of the data and the completeness and fairness of the presentation, including all disclosures, rests with the leadership team of the System. To the best of our knowledge and belief, the enclosed data is accurate in all material respects and is reported in a manner designed to present fairly the financial position and results of operations of the System.

The Michigan State Police Retirement System was established by legislation under Public Act 251 of 1935. It now operates under the provisions of Public Act 182 of 1986, as amended, and is administrated by the Office of Retirement Services (ORS). The number of active and retired members and beneficiaries of the System is presented in Note 1 of the financial statements in the Financial Section of this report. The purpose of the System is to provide benefits for all State Police. The services performed by the staff provide benefits to members.

The 2004 comprehensive annual financial report is presented in five sections. The Introductory Section contains the transmittal letter and identifies the administrative organization and professional consultants used by the System. The Financial Section contains the independent auditor's report, management's discussion and analysis, financial statements and notes of the System, and certain supplemental schedules. The Investment Section summarizes investment activities. The Actuarial Section contains the independent consulting actuary's certification, an outline of actuarial assumptions and methods, and other actuarial statistics. The Statistical Section contains statistical tables of significant data pertaining to the System.

# **INTRODUCTORY SECTION**

## **Letter of Transmittal (Continued)**

### **MAJOR GOALS ACCOMPLISHED**

The Michigan Department of Management and Budget, Office of Retirement Services continues to provide high-quality services to a large membership at an affordable cost. This level of service is achieved with the combination of management and staff that persistently questions, redefines and refines processes to stay responsive and timely. Our daily business activities are tied to achieving our mission of delivering pensions, related benefits, and services to promote the future financial security of our customers.

In this fiscal year, we embraced the realities of our Vision ORS technology solutions, sought and achieved ways to manage cost while enhancing service, and supported staff as they adapted to fast-paced changes to tools and policy. Here are some of the highlights.

#### ***Focus on Our Customer***

During the 2004 fiscal year, ORS hosted 9,600 members at our pre-retirement information meetings and personally counseled 9,500 members. This is in addition to the 237,700 members who took advantage of our phone service for retirement information and services.

System members received a much revised, customer-friendly member statement that is a significant improvement over previous year's statements. These high-quality, data-rich member statements include information about service credit, contributions, and vesting. The statements also provided basic information about eligibility and insurances, and included an opportunity to update beneficiary information.

Customers are receiving more personal service faster when they call thanks to new interconnectivity between our toll-free phone service and our Customer Relationship Management network. This tool reduces call time by automatically populating the retirement representative's computer with the personal information of the incoming caller. The results are faster service for callers and more customers are able to resolve their questions each day.

#### ***Continuously Improve Processes***

Public Act 83 of 2004 amended the State Police Retirement Act to create a Deferred Option Retirement Plan for System members with 25 years of service. This program allows state police who are eligible to retire to defer their retirement and keep working. Participants can continue employment for up to six years. ORS calculates what the participant's pension would be on the day before the DROP period starts, then credits a percentage of the monthly pension to an interest-bearing account in the participant's name. How much is determined by the length of the DROP period: 30 percent if the officer remains in the DROP program for less than one year and up to 100 percent if the officer remains in the program for six years.

#### ***Optimize Technology***

Last year, in the beginnings of our Vision ORS project, we deployed document scanning in our mailroom to get the daily documents that drive our business processed faster. This year, ORS is expanding this technology to target some of the more recently retired members and those active members who will likely retire in the next few years.

Member surveys and letters, conversations with members and member organizations, and regular discussions with our staff tell us that we are making great strides toward our vision. This success inspires us to continue to improve. The continued deployment of our Vision Project technology will provide even more opportunities to evaluate and improve ORS' service to customers.

### **CERTIFICATE OF ACHIEVEMENT**

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the System for its comprehensive annual financial report for the

## Letter of Transmittal (Continued)

fiscal year ended September 30, 2003. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both accounting principles generally accepted in the United States of America and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe our current report continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

### **FINANCIAL INFORMATION**

Please refer to Management's Discussion and Analysis in the Financial Section for condensed financial information and activities of the current and prior years.

#### *Accounting System*

Transactions of the System are reported on the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when incurred. Participants' benefits are recorded when payable by law. We believe that the accounting and administrative internal controls established by the System provide reasonable assurance that the System is carrying out its responsibilities in safeguarding its assets, in the reliability of the financial records for preparing the financial statements, and in maintaining accountability for its assets.

### **INTERNAL CONTROL**

The leadership team of the System is responsible for maintaining adequate internal accounting controls designed to provide reasonable assurance that transactions are executed in accordance with management's general or specific authorization, and are recorded as necessary to maintain accountability for assets and to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America. The internal control structure is designed to provide reasonable assurance regarding the safekeeping of assets and reliability of all financial records.

### **INVESTMENT**

The State Treasurer is the investment fiduciary and custodian of all investments of the System pursuant to State law. The primary investment objective is to maximize the rate of return on the total investment portfolio, consistent with a high degree of prudence and sufficient diversity to eliminate inordinate risks and to meet the actuarial assumption for the investment return rate. The investment activity for the year produced a total rate of return on the portfolio of 12.4%. For the last five years, the System has experienced an annualized rate of return of 3.2%. A summary of asset allocation and rates of return can be found in the Investment Section of this report.

### **FUNDING**

Funds are derived from the excess of additions to plan net assets over deductions from plan net assets. Funds are accumulated by the System in order to meet future benefit obligations to retirees and beneficiaries. The percentage computed by dividing the actuarial value of assets by the actuarial accrued liability is referred to as the "funded ratio." This ratio provides an indication of the funding status of the System and generally, the greater this percentage, the stronger the System. Effective in fiscal year 2001, the System used the actuarial valuation from the previous fiscal year for this report. This approach is consistent with Governmental Accounting Standards Board (GASB) Statement Number 25. Consistent with this approach, the most recent actuarial valuation was performed as of September 30, 2003. The actuarial value of the assets and actuarial accrued liability of the System were \$1.139 billion and \$1.186 billion, respectively, resulting in a funded ratio of 96.0% at September 30, 2003. A historical perspective of funding levels for the System is presented on the Schedule of Funding Progress in the Required Supplementary Information in the Financial Section of this report.

# ***INTRODUCTORY SECTION***

## **Letter of Transmittal (Continued)**

### **POSTEMPLOYMENT BENEFITS**

The System also administers the postemployment health benefits (health, dental, and vision) offered to retirees. The benefits are funded on a cash or "pay as you go" basis. An actuarial valuation was completed as of September 30, 2003, to determine the actuarial accrued liability if the benefits were to be pre-funded. If these benefits were pre-funded, the actuarial accrued liability for these benefits would be approximately \$540 million and the employer contribution for health care benefits would be 34.2% of payroll.

### **PROFESSIONAL SERVICES**

An annual audit of the System was conducted by Andrews Hooper & Pavlik P.L.C., independent auditors. The independent auditor's report on the System's financial statements is included in the Financial Section of this report.

Statute requires that an annual actuarial valuation be conducted. The purpose of the valuation is to evaluate the mortality, service, compensation and other financial experience of the System and to recommend employer-funding rates for the subsequent year. This annual actuarial valuation was completed by the Segal Company for the fiscal year ended September 30, 2003. Actuarial certification and supporting statistics are included in the Actuarial Section of this report.

### **ACKNOWLEDGMENTS**

The preparation of this report was accomplished with the dedication and cooperation of many people. It is intended to provide complete and reliable information as a basis for making management decisions, as a means of determining compliance with legal provisions, and as a means for determining responsible stewardship of the funds of the System.

We would, therefore, like to express our appreciation for the assistance given by staff, advisors and many people who contributed to its preparation. We believe their combined efforts have produced a report that will enable the employers and plan members to better evaluate and understand the Michigan State Police Retirement System. Their cooperation contributes significantly to the success of the System.

Sincerely,



Mitch Irwin, Director  
Department of Management and Budget



Christopher M. DeRose, Director  
Office of Retirement Services



# INTRODUCTORY SECTION

## Administrative Organization

### Retirement Board Members \*

Capt. Christopher Lewis  
Representing Director, Dept. of State  
Police  
Statutory Member

George M. Elworth  
Representing Attorney General  
Statutory Member

Sergeant Richard Hale, Chair  
Representing Sergeants and Below  
Term Expires December 31, 2003

Kenneth Harb  
General Public  
Term Expires December 31, 2003

David Fink  
Director, Office of State Employer  
Statutory Member

Scott Strong  
Representing Auditor General

Mark Haas  
Representing State Treasurer  
Statutory Member

Lieutenant Joseph Thomas  
Representing Lieutenants and Above  
Term Expires December 31, 2004

Lt. Col. James R. Snody, Jr., Vice  
Chair  
Retiree Member  
Term Expires December 31, 2005

\* Statute provides that board members may continue to serve after their term expires until they are either replaced or reappointed.

### Administrative Organization

**Department of Management and Budget  
Office of Retirement Services  
P.O. Box 30171  
Lansing, Michigan 48909-7671  
517-322-5103  
1-800-381-5111**

### Advisors and Consultants

**Actuary**  
The Segal Company  
Michael J. Karlin, F.S.A., M.A.A.A.  
New York, New York

**Auditors**  
Thomas H. McTavish, C.P.A.  
Auditor General  
State of Michigan

**Investment Manager and Custodian**  
Jay B. Rising  
State Treasurer  
State of Michigan

Andrews Hooper & Pavlik P.L.C.  
Jeffrey J. Fineis, C.P.A.  
Okemos, Michigan

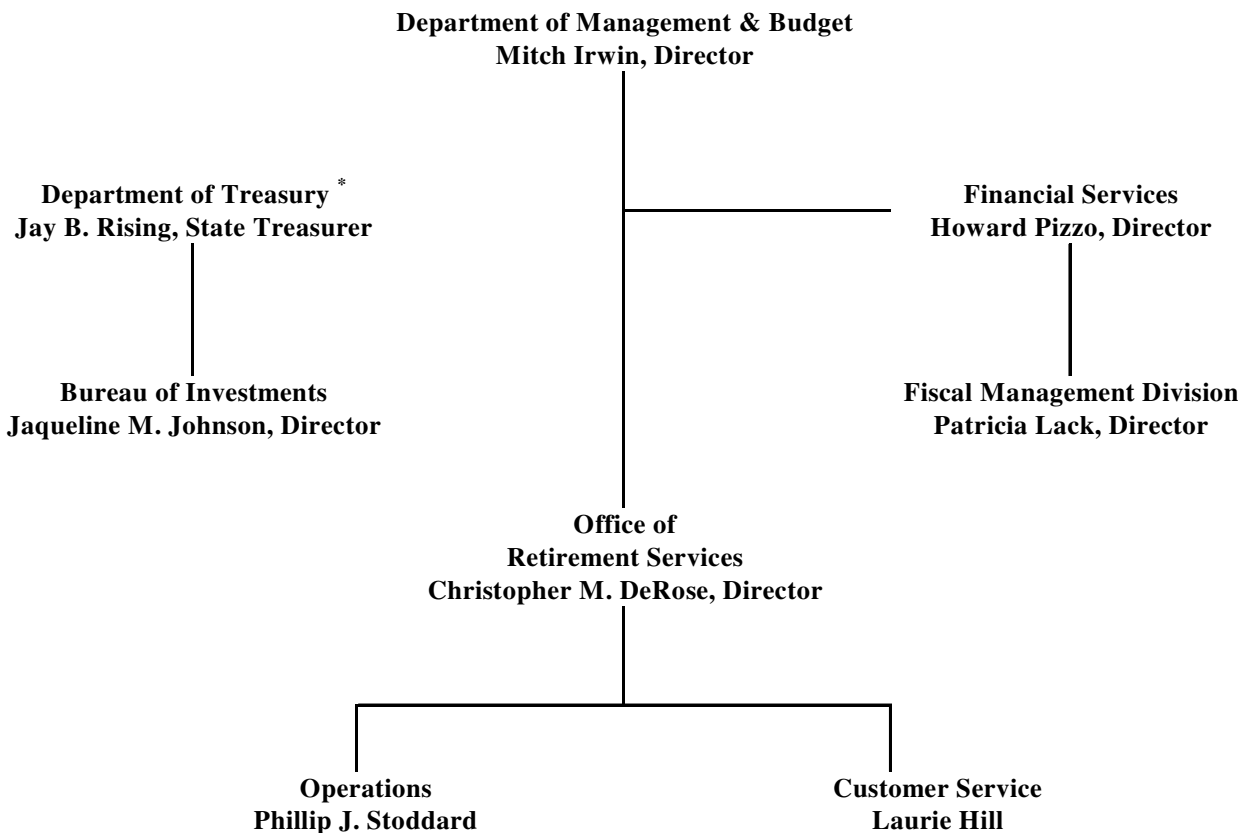
**Legal Advisor**  
Mike Cox  
Attorney General  
State of Michigan

**Investment Performance  
Measurement**  
State Street Corporation  
State Street Analytics  
Boston, MA

# INTRODUCTORY SECTION

## Administrative Organization (Continued)

### Organization Chart



\* The investments of the System are managed by the Michigan Department of Treasury. Information on the investments and the fiduciary, Michigan Department of Treasury, can be found in the Investment Section, Introduction. In addition, see the Investment Section, Schedule of Investment Fees and Schedule of Investment Commissions, for information regarding the investment fees and commissions paid as well as investment professionals utilized by the System.

# FINANCIAL SECTION

Independent Auditor's Report  
Management's Discussion and Analysis  
Basic Financial Statements  
Notes to Basic Financial Statements  
Required Supplementary Information  
Notes to Required Supplementary Information  
Supporting Schedules

# FINANCIAL SECTION

## Independent Auditor's Report



**ANDREWS HOOPER & PAVLIK P.L.C.**  
Certified Public Accountants

Mr. Mitch Irwin, Director, Department of Management and Budget  
Mr. Christopher M. DeRose, Director, Office of Retirement Services  
Mr. Thomas H. McTavish, CPA, Auditor General, Office of the Auditor General  
Michigan State Police Retirement System Board

We have audited the accompanying statements of pension plan and postemployment healthcare plan net assets of the Michigan State Police Retirement System, as of September 30, 2004 and 2003, and the related statements of changes in pension plan and postemployment healthcare plan net assets for the years then ended. These financial statements are the responsibility of the management of the Michigan State Police Retirement System. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial status of the Michigan State Police Retirement System, as of September 30, 2004 and 2003, and the changes in its financial status for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The required supplementary information and supporting schedules listed in the table of contents are presented for the purpose of additional analysis and are not a required part of the basic financial statements. The required supplementary information and supporting schedules are the responsibility of the Michigan State Police Retirement System's management. The Schedules of Funding Progress and Employer Contributions and related notes and the supporting schedules have been subjected to the auditing procedures applied in our audits of the basic financial statements, and in our opinion, are fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

The Management's Discussion and Analysis (MD&A) is not a required part of the basic financial statements but is supplemental information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this supplemental information. However, we did not audit the information and express no opinion on it. The Introductory, Investment, Actuarial, and Statistical Sections were not audited by us and, accordingly, we express no opinion on those sections.

In accordance with *Government Auditing Standards*, we have also issued a report dated December 1, 2004 on our consideration of the Michigan State Police Retirement System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

*Andrews Hooper & Pavlik P.L.C.*

Okemos, Michigan  
December 1, 2004

4295 Okemos Road, Suite 200 • Okemos, Michigan 48864 • ph 517.487.5000 fx 517.487.9535 • www.ahpplc.com

## Management's Discussion and Analysis

Our discussion and analysis of the Michigan State Police Retirement System's (System) financial performance provides an overview of the System's financial activities for the fiscal year ended September 30, 2004. Please read it in conjunction with the transmittal letter in the Introductory Section on page 5 and the basic financial statements, which follow this discussion.

### FINANCIAL HIGHLIGHTS

- System assets exceeded its liabilities at the close of fiscal year 2004 by \$1,042.8 million (reported as *net assets*). Net assets are held in trust to meet future benefit payments.
- System funding objective is to meet long-term benefit obligations through contributions and investment income. As of September 30, 2003, the funded ratio was approximately 96.0%.
- Revenues for the year were \$170.6 million, which is comprised of contributions of \$51.8 million and investment gains of \$118.8 million.
- Expenses increased over the prior year from \$97.6 million to \$107.1 million or 9.7%. Most of this increase represented increased retirement benefits paid.

### THE STATEMENT OF PLAN NET ASSETS AND THE STATEMENT OF CHANGES IN PLAN NET ASSETS

This Comprehensive Annual Financial Report (CAFR) consists of two financial statements; *The Statement of Pension Plan and Postemployment Healthcare Plan Net Assets* (page 18) and *The Statement of Changes in Pension Plan and Postemployment Healthcare Plan Net Assets* (page 19). These financial statements report information about the System, as a whole, and about its financial condition that should help answer the question: Is the System, as a whole, better off or worse off as a result of this year's activities? These statements include all assets and liabilities using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, all revenues and expenses are taken into account regardless of when cash is received or paid.

*The Statement of Pension Plan and Postemployment Healthcare Plan Net Assets* presents all of the System's assets and liabilities, with the difference between the two reported as net assets. Over time, increases and decreases in net assets measure whether the System's financial position is improving or deteriorating. *The Statement of Changes in Pension Plan and Postemployment Healthcare Plan Net Assets* presents how the System's net assets changed during the most recent fiscal year. These two financial statements should be reviewed along with the Schedule of Funding Progress and Schedule of Employer Contributions to determine whether the System is becoming financially stronger or weaker and to understand changes over time in the funded status of the System.

# FINANCIAL SECTION

## Management's Discussion and Analysis (Continued)

### FINANCIAL ANALYSIS

System total assets as of September 30, 2004, were \$1,108.6 million and were mostly comprised of cash, investments and contributions due from employers. Total assets increased \$103.8 million or 10.3% from fiscal year 2003 primarily due to favorable operating results and increases to invested assets (primarily collateral on loaned securities), and increased \$77.2 million or 8.3% between fiscal years 2002 and 2003 primarily due to increased investment earnings.

Total liabilities as of September 30, 2004, were \$65.8 million and were mostly comprised of warrants outstanding, accounts payable, and obligations under securities lending. Total liabilities increased \$40.2 million or 157.6% between fiscal years 2003 and 2004 primarily due to an increase in obligations under securities lending, and decreased \$15.7 million or 38.0% between fiscal years 2003 and 2002 primarily due to a decrease in obligations under securities lending.

System assets exceeded its liabilities at the close of fiscal year 2004 by \$1,042.8 million. Total net assets held in trust for pension and health benefits increased \$63.5 million or 6.5% between fiscal years 2003 and 2004. The increase is the result of favorable operating results primarily due to investment earnings and contributions for the year exceeding total deductions to System net assets. Net assets in fiscal year 2003 increased by \$92.9 million or 10.5% from the prior year due to favorable market conditions and an increase in investment earnings.

#### Net Assets (in thousands)

	<u>2004</u>	<u>Increase (Decrease)</u>		<u>2003</u>	<u>Increase (Decrease)</u>		<u>2002</u>
<b>Assets</b>							
Cash	\$ 8,386	110.3 %		\$ 3,987	145.2 %		\$ 1,626
Receivables	1,546	(68.3)		4,871	(12.4)		5,559
Investments	1,098,673	10.3		995,932	8.2		920,401
<b>Total Assets</b>	<u>1,108,605</u>	<u>10.3%</u>		<u>1,004,790</u>	<u>8.3</u>		<u>927,586</u>
<b>Liabilities</b>							
Warrants outstanding	224	(0.9)		226	1.3		223
Accounts payable and other accrued liabilities	68	(84.6)		442	(51.3)		908
Obligations under securities lending	65,551	163.3		24,894	(38.0)		40,124
<b>Total Liabilities</b>	<u>65,843</u>	<u>157.6</u>		<u>25,562</u>	<u>(38.0)</u>		<u>41,255</u>
<b>Total Net Assets</b>	<u>\$ 1,042,762</u>	<u>6.5 %</u>		<u>\$ 979,228</u>	<u>10.5 %</u>		<u>\$ 886,331</u>

# FINANCIAL SECTION

## Management's Discussion and Analysis (Continued)

### REVENUES - ADDITIONS TO PLAN NET ASSETS

The reserves needed to finance retirement and health benefits are accumulated through the collection of employer contributions and through earnings on investments. Contributions and net investment income/(losses) for fiscal year 2004 totaled \$170.6 million.

Total contributions and net investment income decreased \$19.9 million from those of fiscal year 2003, due primarily to decreased investment earnings. Total contributions and net investment income increased \$249.3 million between fiscal years 2002 and 2003 due to favorable market conditions and increased investment earnings. Total contributions decreased between fiscal years 2003 and 2004 by \$5.3 million or 9.3%. This decrease is primarily due to a decrease in the contribution rate. Total contributions increased between fiscal years 2002 and 2003 by \$7.9 million or 16.1% primarily due to an increase in the contribution rate. Investment income decreased from fiscal year 2003 by \$14.6 million. Investment income increased between fiscal years 2002 and 2003 by \$241.4 million. The Investment Section of this report reviews the results of investment activity for 2004.

#### Additions to Plan Net Assets (in thousands)

	<u>2004</u>	<u>Increase (Decrease)</u>		<u>2003</u>	<u>Increase (Decrease)</u>		<u>2002</u>
Member contributions	\$ 1,603	1.5	%	\$ 1,579	5.8	%	\$ 1,493
Employer contributions	50,219	(9.6)		55,552	16.4		47,727
Net investment income	118,817	(10.9)		133,378	223.5		(108,017)
Miscellaneous income *	-	-		-	-		-
<b>Total Additions</b>	<u>\$ 170,639</u>	<u>(10.4)</u>	%	<u>\$ 190,509</u>	<u>424.0</u>	%	<u>\$ (58,797)</u>

\* Less than one thousand.

# FINANCIAL SECTION

## Management's Discussion and Analysis (Continued)

### EXPENSES - DEDUCTIONS FROM PLAN NET ASSETS

The primary expenses of the System include the payment of pension benefits to members and beneficiaries, payment for health, dental and vision benefits, refund of contributions to former members, and the cost of administering the System. Total deductions for fiscal year 2004 were \$107.1 million, an increase of 9.7% over fiscal year 2003 expenses.

The growth of health, dental and vision care expenses continued during the year and increased by \$2.2 million or 8.0% from \$27.0 million to \$29.2 million during the fiscal year. This compares to an increase of \$1.0 million or 3.9% from \$26.0 million to \$27.0 million between fiscal years 2002 and 2003. The payment of pension benefits increased by \$7.4 million or 10.6% between fiscal years 2003 and 2004 and by \$5.7 million or 8.9% between fiscal years 2002 and 2003. The increase in pension benefit expenses resulted from an increase in retirees (48) and an increase in benefit payments to retirees, and in fiscal year 2003 the increase in pension benefit expenses resulted from an increase in retirees (187) and an increase in benefit payments to retirees. Administrative expenses decreased by \$106,855 or 25.2% between fiscal years 2003 and 2004, primarily due to a decrease in professional services during the current year for special actuarial studies. Administrative expenses increased by \$70.3 thousand or 20.1% between fiscal years 2002 and 2003, primarily due to an increase in professional services during the year for special actuarial studies.

#### Deductions to Plan Net Assets (in thousands)

	<u>2004</u>	<u>Increase (Decrease)</u>	<u>2003</u>	<u>Increase (Decrease)</u>	<u>2002</u>
Pension benefits	\$ 77,592	10.6 %	\$ 70,152	8.9 %	\$ 64,418
Health care benefits	29,195	8.0	27,036	3.9	26,030
Refunds of member contributions	1	-	-	-	-
Administrative expenses	317	(25.2)	424	20.1	353
<b>Total Deductions</b>	<u>\$ 107,105</u>	<u>9.7 %</u>	<u>\$ 97,612</u>	<u>7.5 %</u>	<u>\$ 90,801</u>



# **FINANCIAL SECTION**

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

### **RETIREMENT SYSTEM AS A WHOLE**

The System's combined net assets experienced an increase for the second consecutive year, following a decrease in fiscal year 2002. This increase is a result of a moderate national economic upturn that resulted in investment income earnings. Management believes, and actuarial studies concur, that the System is in a financial position to meet its current obligations. We believe the current financial position has improved, in part, due to a prudent investment program, cost controls, and strategic planning.

### **CONTACTING SYSTEM FINANCIAL MANAGEMENT**

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

# FINANCIAL SECTION

## Statements of Pension Plan and Postemployment Healthcare Plan Net Assets

As of Fiscal Years Ending September 30, 2004 and 2003

	September 30, 2004			September 30, 2003		
	Pension Plan	Health Plan	Total	Pension Plan	Health Plan	Total
<b>Assets:</b>						
Equity in common cash	\$ 8,385,825		\$ 8,385,825	\$ 3,978,766	\$ 8,945	\$ 3,987,711
Receivables:						
Amounts due						
from employer	1,543,082		1,543,082	2,269,679	5,102	2,274,781
Interest and dividends	2,673		2,673	2,545,881	5,723	2,551,604
Sale of investments			-	44,385	100	44,485
Total receivables	1,545,755	-	1,545,755	4,859,945	10,925	4,870,870
Investments:						
Short term investments/pools	19,503,679		19,503,679	41,143,430	92,488	41,235,918
Bonds and notes/fixed income pools	191,457,940		191,457,940	179,331,117	403,127	179,734,244
Common and preferred stock/pools	501,034,771		501,034,771	437,937,577	984,462	438,922,039
Real estate and mortgages/pools	76,438,489		76,438,489	88,901,114	199,845	89,100,959
Alternative investments/pools	132,258,513		132,258,513	127,629,100	286,904	127,916,004
International investments/pools	112,428,766		112,428,766	93,917,776	211,122	94,128,898
Cash collateral on loaned securities	65,551,067		65,551,067	24,838,060	55,835	24,893,895
Total investments	1,098,673,225	-	1,098,673,225	993,698,174	2,233,783	995,931,957
<b>Total assets</b>	<b>1,108,604,805</b>	<b>-</b>	<b>1,108,604,805</b>	<b>1,002,536,885</b>	<b>2,253,653</b>	<b>1,004,790,538</b>
<b>Liabilities:</b>						
Warrants outstanding	223,789		223,789	225,499	507	226,006
Accounts payable and other accrued liabilities	68,281		68,281	441,285	992	442,277
Obligations under securities lending	65,551,067		65,551,067	24,838,060	55,835	24,893,895
<b>Total liabilities</b>	<b>65,843,137</b>	<b>-</b>	<b>65,843,137</b>	<b>25,504,844</b>	<b>57,334</b>	<b>25,562,178</b>
<b>Net Assets (Liabilities) Held in Trust</b>						
<b>for Pension and Health Benefits*</b>	<b>\$ 1,042,761,668</b>	<b>\$ -</b>	<b>\$ 1,042,761,668</b>	<b>\$ 977,032,041</b>	<b>\$ 2,196,319</b>	<b>\$ 979,228,360</b>

\*A schedule of funding progress is presented in the Required Supplementary Information of the Financial Section.  
The accompanying notes are an integral part of these financial statements.

# FINANCIAL SECTION

## Statements of Changes in Pension Plan and Postemployment Healthcare Plan Net Assets

For Fiscal Years Ended September 30, 2004 and 2003

	September 30, 2004			September 30, 2003		
	Pension Plan	Health Plan	Total	Pension Plan	Health Plan	Total
<b>Additions:</b>						
Contributions:						
Member contributions	\$ 30,062	\$ 1,572,372	\$ 1,602,434	\$ 78,111	\$ 1,501,196	\$ 1,579,307
Employer contributions	24,792,137	25,426,780	50,218,917	25,931,762	29,620,331	55,552,093
Total contributions	24,822,199	26,999,152	51,821,351	26,009,873	31,121,527	57,131,400
Investment income (loss):						
Investment income (loss)	120,430,613		120,430,613	135,211,684		135,211,684
Investment expenses:						
Real estate operating expenses	(7,393)		(7,393)	(30,001)		(30,001)
Other investment expenses	(1,681,752)		(1,681,752)	(1,890,905)		(1,890,905)
Securities lending activities:						
Securities lending income	703,517		703,517	504,591		504,591
Securities lending expenses	(627,816)		(627,816)	(417,941)		(417,941)
Net investment income (loss)	118,817,169	-	118,817,169	133,377,428	-	133,377,428
Miscellaneous income	125		125	127		127
<b>Total additions</b>	143,639,493	26,999,152	170,638,645	159,387,428	31,121,527	190,508,955
<b>Deductions:</b>						
Benefits paid to plan members and beneficiaries:						
Retirement benefits	77,591,542		77,591,542	70,152,288		70,152,288
Health benefits		27,245,933	27,245,933		25,282,634	25,282,634
Dental/vision benefits		1,949,538	1,949,538		1,753,228	1,753,228
Refunds of member contributions	1,434		1,434			
Administrative expenses	316,890		316,890	423,745		423,745
<b>Total deductions</b>	77,909,866	29,195,471	107,105,337	70,576,033	27,035,862	97,611,895
<b>Net Increase (Decrease)</b>	65,729,627	(2,196,319)	63,533,308	88,811,395	4,085,665	92,897,060
<b>Net Assets (Liabilities) Held in Trust for Pension and Health Benefits:</b>						
<b>Beginning of Year</b>	977,032,041	2,196,319	979,228,360	888,220,646	(1,889,346)	886,331,300
<b>End of Year*</b>	\$ 1,042,761,668	\$ -	\$ 1,042,761,668	\$ 977,032,041	\$ 2,196,319	\$ 979,228,360

\* A schedule of funding progress is presented in the Required Supplementary Information of the Financial Section.

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

# FINANCIAL SECTION

## Notes to Basic Financial Statements

### NOTE 1 - PLAN DESCRIPTION

#### ORGANIZATION

The Michigan State Police Retirement System (System) is a single employer, state-wide, defined benefit public employee retirement plan governed by the State of Michigan (State), originally created under Public Act 251 of 1935, recodified and currently operating under Public Act 182 of 1986. The System was established by the State to provide retirement, survivor and disability benefits to Michigan State Police. The System is a qualified trust fund under section 401(a) of the Internal Revenue Code.

The System's financial statements are included as a pension trust fund in the combined financial statements of the State.

The System is administered by the Office of Retirement Services within the Michigan Department of Management and Budget. The Department Director appoints the Office Director who serves as Executive Secretary to the System's Board, with whom the general oversight of the System resides. The State Treasurer serves as the investment officer and custodian for the System.

#### MEMBERSHIP

At September 30, 2004, and 2003, the System's membership consisted of the following:

Retirees and beneficiaries		
currently receiving benefits:	<b>2004</b>	<b>2003 *</b>
Regular benefits	<u>2,167</u>	<u>2,135</u>
Survivor benefits	381	371
Disability benefits	<u>149</u>	<u>143</u>
<b>Total</b>	<b><u>2,697</u></b>	<b><u>2,649</u></b>
Current employees:		
Vested	901	955
Non-vested	<u>977</u>	<u>893</u>
<b>Total</b>	<b><u>1,878</u></b>	<b><u>1,848</u></b>
Inactive employees entitled		
to benefits and not yet		
receiving them	<u>16</u>	<u>15</u>
<b>Total members</b>	<b><u><u>4,591</u></u></b>	<b><u><u>4,512</u></u></b>

\* Restated based on more complete information provided by actuary.

Enrollment in the health plan is voluntary. The number of participants is as follows:

<b>Health/Dental/Vision Plan</b>	<b>2004</b>	<b>2003</b>
Eligible participants	<u>2,697</u>	<u>2,649</u>
Participants receiving benefits:		
Health	2,321	2,238
Dental	2,377	2,279
Vision	2,379	2,281

# FINANCIAL SECTION

## Notes to Basic Financial Statements (Continued)

### BENEFIT PROVISIONS

#### *Introduction*

Benefit provisions of the defined benefit pension plan are established by State statute, which may be amended. Public Act 182 of 1986, Michigan State Police Retirement Act, as amended, establishes eligibility and benefit provisions for the defined benefit pension plan. Retirement benefits are determined by final average compensation. Members are eligible to receive a monthly benefit when they meet certain age and service requirements. The System also provides duty disability, non-duty disability, and survivor benefits.

A member who leaves Michigan State Police employment may request a refund of his or her member contribution account. (The System is currently non-contributory.) A refund cancels a former member's rights to future benefits and there is no provision for repaying the refund of contributions to restore the service represented by the refund.

#### *Regular Retirement*

The retirement benefit is available if a member retires after 25 years of credited service (employment). The retirement benefit equals 60% of a member's final average compensation and is payable monthly over the lifetime of a member. Final average compensation is the average annual salary for a member's last two years of service with the Department of State Police.

#### *Deferred Retirement*

Any member with 10 or more years of credited service who terminates employment but has not reached the age of 50 is a deferred member and is entitled to receive a monthly allowance upon reaching age 50, provided the member's accumulated contributions have not been refunded. The deferred benefit is equal to two percent of the final average compensation times the years and partial years of service credit.

#### *Non-Duty Disability Benefit*

A member with 10 or more years of credited service who becomes totally and permanently disabled not due to performing duties as an employee of the Michigan State Police is eligible for a non-duty disability pension. The non-duty disability benefit is 2.4% of the final average compensation times years and partial years of credited service (but not more than 25 years).

#### *Duty Disability Benefit*

A member who becomes totally and permanently disabled from performing duties as a Michigan State Police Officer is eligible for a duty disability pension. The amount, payable monthly, is equal to 60% of the final average compensation.

#### *Survivor Benefit*

Upon the death of a member who completed at least 10 years of service, the surviving spouse receives a benefit based on 2.4% of the final average compensation for each year and partial years of credited service. If there is no spouse, surviving children are entitled to equally share the benefit until age 18. If death occurs in the line of duty, the surviving spouse receives a benefit of 60% of the final average compensation. Children receive \$100 each month until age 18. A \$1,500 funeral expense is also authorized by State statute.

#### *Post Retirement Adjustments*

Effective October 1, 1996, the monthly pension was increased 10% if certain requirements were met. This was a one time increase.

Each October 1, the benefits of all pension recipients increase 2% (not to exceed \$500). This non-compounding increase is paid to persons who have been retired 12 months.

# FINANCIAL SECTION

## Notes to Basic Financial Statements (Continued)

### *Contributions*

Member Contributions — Members currently participate on a noncontributory basis. Under certain circumstances, members may contribute to the System for the purchase of creditable service, such as military, maternity or paternity leave, Peace Corps or VISTA service. If a member terminates employment before a retirement benefit is payable, the member's contribution and interest on deposit are refunded. If the member dies before being vested, the member's contribution and interest are refunded to the designated beneficiaries.

Employer Contributions — The statute requires that the employer contribute to finance the benefits of plan members. These employer contributions are determined annually by the System's actuary and are based upon level-percent-of-payroll funding principles so that the contribution rates do not have to increase over time. A chart showing the employer contribution rates is included on the Schedule of Revenues by Source in the Statistical Section.

### *Other Post Employment Benefits*

Under the Michigan State Police Retirement Act, all retirees have the option of continuing health, dental, and vision coverage. Retirees with this coverage contribute 5%, 10% and 10% of the monthly premium amount for the health, dental, and vision coverage, respectively. The State funds 95% of the health and 90% of the dental and vision insurance. The employer payroll contribution rate to provide these benefits was 18.0% and 21.2% for 2004 and 2003, respectively.

Retirees are provided with life insurance coverage equal to 25% of the active life insurance coverage, \$1,000 for spouse and \$1,000 for each dependent under age 23. Premiums are fully paid by the State.

### *Deferred Retirement Option Plan*

Public Act 83 of 2004 amended the State Police Retirement Act to create a Deferred Retirement Option Plan (DROP) for members with 25 years of service. This benefit program allows state police who are eligible to retire to defer their retirement and keep working for up to six years. The participant's pension amount is calculated on the day before the DROP period starts, and a percentage of the equivalent monthly pension is credited to an interest-bearing account in the participant's name. The DROP balance will be available at the time their DROP participation ends.

### *Banked Leave Time*

Public Act 50 of 2004 amended the State Police Retirement Act to include Banked Leave Time (BLT) for members. BLT is an extension of the State's current annual leave program, which banks a predetermined number of hours per pay period. However, the BLT program will not have an effect on a member's Final Average Compensation calculation.

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

### *Basis of Accounting and Presentation*

Financial statements are prepared using the accrual basis of accounting. Contributions from the State are recognized as revenue when due and payable. Benefits and refunds are recognized when due and payable in accordance with the terms of the System.

### *Reserves*

Public Act 182 of 1986, as amended, created the Reserve for Employee Contributions, Reserve for Retired Benefit Payments, Reserve for Employer Contributions, Reserve for Undistributed Investment Income, and Reserve for Health Related Benefits. The financial transactions of the System are recorded in these accounts as required by Public Act 182 of 1986, as amended.

# FINANCIAL SECTION

## Notes to Basic Financial Statements (Continued)

Reserve for Employee Contributions — Members do not contribute to this fund except to purchase eligible service credit. This fund represents active member contributions and interest less amounts transferred to the Pension Reserve for regular and disability retirement, amounts refunded to terminated members, and unclaimed amounts transferred to the income account. At September 30, 2004, and 2003, the balance in this account was \$216.7 thousand and \$239.8 thousand, respectively.

Reserve for Employer Contributions — All employer contributions are credited to this reserve. Interest from the Reserve for Undistributed Investment Income is credited annually. Amounts are transferred annually from this reserve to the Reserve for Retired Benefit Payments to fund that reserve. At September 30, 2004, and 2003, the balance in this account was \$87.7 million and \$164.9 million, respectively.

Reserve for Retired Benefit Payments — This represents the reserves for payment of future retirement benefits to persons already on the retirement rolls. At retirement, a member's accumulated contributions plus interest are transferred into this reserve from the Reserve for Employee Contributions. Monthly benefits, which are paid to the retirees, reduce this reserve. At the end of each fiscal year, an amount is transferred from the Reserve for Employer Contributions to bring the reserve into balance with the actuarial present value of retirement allowances. At September 30, 2004, and 2003, the balance in this account was \$843.9 million and \$746.5 million, respectively.

Reserve for Undistributed Investment Income — The reserve is credited with all investment earnings and changes in fair value of assets. Interest is transferred annually to the other reserves. Administrative expenses are paid from this reserve account. The legislature appropriates the funds necessary to defray and cover the administration of the plan. At September 30, 2004, and 2003, the balance of this reserve was \$111.0 million and \$65.4 million, respectively.

Reserve for Health Related Benefits — This reserve is credited with employer contributions for retirees' health benefits. From this reserve, the System pays 95% of the premiums for hospitalization and medical coverage insurance and 90% of the monthly premium for dental and vision coverage insurance. At September 30, 2004, and 2003, the balance in this account was \$0.0 million and \$2.2 million, respectively.

Section 204 of Public Act 431 of 1984, as amended, provides management the ability to administer selected risk management related programs for insurance or related services. In fiscal year 2004 the Reserve for Health Related Benefits expenses exceeded revenues by \$6.8 million prior to a return of \$4.6 million to the System. The \$4.6 million in excess premiums collected by the State Sponsored Group Insurance Fund, which bears the risk of such losses, were returned to make the Reserve whole. This is reflected in the Statement of Changes in Pension Plan Net Assets as an employer contribution to the Health Plan.

### ***Reporting Entity***

The System is a pension trust fund of the State. As such, the System is considered part of the State and is included in the State's Comprehensive Annual Financial Report as a pension trust fund. The System and its Board are not financially accountable for any other entities or other organizations. Accordingly, the System is the only entity included in this financial report.

### ***Benefit Protection***

Public Act 100 of 2002 was passed by the Michigan Legislature to protect pension benefits of public employees from alienation (being transferred). Alienation is attachment, garnishment, levy, execution, bankruptcy or other legal process except for divorce orders or eligible domestic relation orders. The statutes governing the System contained an "anti-alienation" clause to provide for this protection; however, many smaller public pension systems did not have the benefit of this protection. Therefore, Public Act 100 of 2002 was passed to establish legal protection of pension assets that encompasses all public employees.

# FINANCIAL SECTION

## Notes to Basic Financial Statements (Continued)

### *Internal Fund Pools*

On July 1, 2004, the System's assets were invested in internal fund pools. The pools own the assets and may hold an interest in the short-term investment pool. These investments in the short-term pool provide necessary liquidity and/or protection of principal during market reversals. The 2004 classification of investments on the Statement of Net Assets will not be entirely comparable with the prior year's classification because of the holding of short-term investment interests within the other investment pools.

### *Fair Value of Investments*

For fiscal year 2004 plan investments are reported at fair value. For fiscal year 2003 investments are reported at fair value except for short term investments, which are carried at cost and approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Corporate bonds not traded on a national or international exchange are based on equivalent values of comparable securities with similar yield and risk. Real estate debt is valued on the basis of future principal and interest payments, and is discounted at prevailing interest rates for similar instruments. The fair value of real estate investments is based on independent appraisals. Other investments not having an established market are recorded at estimated fair value.

### *Investment Income*

Dividend and interest income is recognized on the accrual basis. Fair value changes are recorded as investment income or loss. Purchases and sales of investments are recorded as of the trade date (the date upon which the transaction is initiated), except for purchase and sale of mortgages, real estate, and alternative investments, which are recorded as of the settlement date (the date upon which the transaction is ultimately completed). The effect of recording such transaction as of the settlement date does not materially affect the financial statements.

### *Costs of Administering the System*

Each year a restricted general fund appropriation is requested to fund the on-going business operations of the System. These administrative costs are ultimately funded by the System through the regular transfer of funds from the System to the general fund appropriation based on either a direct cost or allocation basis depending on the nature of the expense.

### *Property and Equipment*

Office space is leased from the State on a year to year basis. Office equipment is capitalized if the value exceeds \$5,000. These assets are recorded at cost and are reported net of depreciation in the Statement of Pension Plan and Postemployment Healthcare Plan Net Assets. Such assets are depreciated on a straight-line basis over 10 years. The System does not have equipment that falls within these parameters.

### *Related Party Transactions*

Leases and Services — The System leases operating space and purchases certain administrative, data processing, legal and investment services from the State. The space and services are not otherwise available by competitive bid. The following summarizes costs incurred by the System for such services.

	<u>2004</u>	<u>2003</u>
Building Rentals	\$ 5,763	\$ 6,546
Technological Support	67,475	73,575
Attorney General	19,482	14,903
Investment Services	198,726	215,131
Personnel Services	68,758	70,394



# FINANCIAL SECTION

## Notes to Basic Financial Statements (Continued)

Commitment and Contingency – The State has signed a contract with a vendor for technological support through 2004. As of September 30, 2004, the System's portion of this commitment remaining is approximately \$95,000.

Cash— On September 30, 2004, and 2003, the System had \$8.4 million and \$4.0 million, respectively in a common cash investment pool maintained for various State operating funds. The participating funds in the common cash pool earn interest at various rates depending upon prevailing short-term interest rates. Earnings from these activities amounted to \$32,864 and \$143,360 for the years ended September 30, 2004, and 2003, respectively.

### *Reclassification of Prior Year Amounts*

Certain prior year amounts have been reclassified to conform with the current year presentation.

## NOTE 3 - CONTRIBUTIONS

Members currently participate in the System on a noncontributory basis. Under certain circumstances, members may contribute to the System for the purchase of creditable service, such as military service or maternity leave. The State is required by Public Act 182 of 1986, as amended, to contribute amounts necessary to finance the benefits of its employees. Contribution provisions are specified by State statute and may be amended only by action of the State Legislature.

Periodic employer contributions to the System are determined on an actuarial basis using the entry age normal actuarial cost method. Under this method, the actuarial present value of the projected benefits of each individual included in the actuarial valuation is allocated on a level basis over the service of the individual between entry age and assumed exit age. The portion of this cost allocated to the current valuation year is called the normal cost. The remainder is called the actuarial accrued liability. Normal cost is funded on a current basis. The unfunded (overfunded) actuarial accrued liability is amortized over a 33-year period for the 2003 fiscal year and a 32-year period for the 2004 fiscal year.

Actual employer contributions for retirement benefits were \$24.8 million and \$25.9 million for fiscal years 2004 and 2003, respectively, representing 22.9% of annual covered payroll for the year ended September 30, 2003. The fiscal year 2004 annual covered payroll is not yet available. Required employer contributions for pensions included:

1. \$24.5 million and \$27.0 million for fiscal years 2004 and 2003, respectively, for the normal cost of pensions representing 23.8% of annual covered payroll for fiscal year 2003.
2. \$2.5 million and (\$0.3) million for fiscal years 2004 and 2003, respectively, for amortization of overfunded actuarial accrued liability representing (0.3%) of annual covered payroll for fiscal year 2003.

## NOTE 4 - INVESTMENTS

### *Risks and Uncertainties*

The System's investments are exposed to various risks, such as interest rate, market, credit, and other. Due to these various risks, it is at least reasonably possible that changes in market values will occur in the near term and that such changes could materially affect the System and the amount reported in the statement of net assets as available for benefits.

### *Investment Authority*

Under Public Act 380 of 1965, as amended, the authority for the purchase and the sale of investments resides with the State Treasurer. Investments are made subject to the Michigan Public Pension Investment Act, Public Act 314 of 1965, as amended. The Michigan Public Pension Investment Act authorizes, with certain restrictions, the investment of pension fund assets in stocks, corporate and government bonds and notes, mortgages, real estate, and certain short-term and alternative investments. Investments must be made for the exclusive purposes of providing benefits to active members, retired members and beneficiaries, and for defraying the expenses of investing the assets.

# FINANCIAL SECTION

## Notes to Basic Financial Statements (Continued)

Under Public Act 314 of 1965, as amended, the State Treasurer may invest up to 5% of the System's assets in small businesses having more than one-half of assets or employees in Michigan as described in section 20(a) of the act and up to 20% of the System's assets in investments not otherwise qualified under the act as described in section 20(d). Alternative investments include limited partnerships and distributions from these partnerships in the form of bonds, preferred stock, common stock and direct investments.

### *Derivatives*

The State Treasurer employs the use of derivatives in the investment of the pension trust fund.

Derivatives are used in managing pension trust fund pooled investments, but uses do not include speculation or leverage of investments. Less than 11.0% of the total pension trust fund's portfolio has been invested from time to time in futures contracts, collateralized mortgages and swap agreements. State investment statutes limit total derivative exposure to 15.0% of a fund's total invested asset value, and restrict uses to replication of returns and hedging of assets. Swap agreements represent the largest category of derivatives used, and they represented 10.0% of market value of total pooled assets on September 30, 2004 and 9.0% of market value of total invested assets on September 30, 2003. Futures contracts represent the second largest category of derivatives used, and they represented .3% of market value of total pooled assets on September 30, 2004, and less than .1 % of market value of total invested assets on September 30, 2003.

To enhance management flexibility, the State Treasurer has purchased futures contracts tied to S&P indices. The futures contracts are combined with short-term investments to replicate the return of the S&P indices. The value of these synthetic equity structures is a combination of the value of the futures contract and the value of the dedicated short-term investments.

To diversify the pension trust fund's portfolio, the State Treasurer has entered into swap agreements with investment grade counterparties, which are tied to stock market indices in the United States and twenty-two foreign countries. The notional amounts of the swap agreements at September 30, 2004, and 2003, were \$93.0 million and \$95.7 million, respectively. Approximately one half of the notional amount tied to foreign stock market indices is hedged against foreign currency fluctuations. The swap agreements provide that the System will pay quarterly, over the term of the swap agreements, interest indexed to the three month London Inter Bank Offer Rate (LIBOR), adjusted for an interest rate spread, on the notional amount stated in the agreements. At the maturity of the swap agreements, the investment pools will either receive the increase in the value of the equity indices from the level at the inception of the agreements, or pay the decrease in the value of the indices. Swap agreement maturity dates range from October 2004 to September 2007. U.S. domestic LIBOR based floating rate notes were purchased in the open market to correspond with the notional amount of the swap agreements. The State Treasurer maintains custody and control of these notes.

The value of these synthetic equity structures is a combination of the value of the swap agreements and the value of the notes. The book value represents the cost of the notes. The current value represents the current value of the notes and the change in value of the underlying indices from the inception of the swap agreements. The current value is used as a representation of the fair value based on the intention to hold all swap agreements until maturity. Since the inception of the international equity investment program, over \$14.4 million of gains on equity exposure and excess interest received have been realized on matured swap agreements.

The unrealized gain of \$10.3 million at September 30, 2004, primarily reflects the increases in international stock indices and changes in currency exchange rates. The combined swap structure realizes gains and losses on a rolling three year basis.

The respective September 30, 2004, and 2003 swap values are as follows:

	<u>Notional Value</u>	<u>Current Value</u>
9/30/2004 (dollars in millions)	\$ 93.0	\$ 103.2
9/30/2003 (dollars in millions)	95.7	88.1

# FINANCIAL SECTION

## Notes to Basic Financial Statements (Continued)

The amounts shown on the prior page reflect both the total International Equity Pool swap exposure, and the smaller swap exposure to the S&P 600 Small Cap Index Pool.

### *Investments Exceeding 5% of Plan Net Assets*

The System did not hold an individual investment (other than U. S. Government securities) that exceeded 5% of net assets available for benefits at September 30, 2003.

On July 1, 2004, the System's investments were invested in internal pools, which own the investments. Through its investment in the pools, the System did not hold an individual investment (other than U. S. Government securities) that exceeded 5% of net assets available for benefits at September 30, 2004.

### *Securities Lending*

State statutes allow the System to participate in securities lending transactions, and the System has, via a Securities Lending Authorization Agreement, authorized the agent bank to lend its securities to broker-dealers and banks pursuant to a form of loan agreement.

During the fiscal year, the agent bank lent, at the direction of the System, the System's securities and received cash (United States and foreign currency), securities issued or guaranteed by the United States government, sovereign debt rated A or better, convertible bonds and irrevocable bank letters of credit as collateral. The agent bank did not have the ability to pledge or sell collateral securities delivered absent a borrower default. Borrowers were required to deliver collateral for each loan equal to (i) at least 102% of the market value of the loaned securities in the case of loaned securities denominated in the United States dollars or whose primary trading market was located in the United States or sovereign debt issued by foreign governments or (ii) 105% of the market value of the loaned securities in the case of loaned securities not denominated in the United States dollars or whose primary trading market was not located in the United States.

The System did not impose any restrictions during the fiscal year on the amount of the loans that the agent bank made on its behalf. There were no failures by any borrowers to return loaned securities or pay distributions thereon during the fiscal year. Moreover, there were no losses during the fiscal year resulting from a default of the borrowers or the agent bank.

During the fiscal year, the System and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other qualified tax-exempt plan lenders, in a collective investment pool. As of September 30, 2004, such investment pool had an average duration of 42 days and an average expected maturity of 546 days. Because the loans were terminable at will their duration did not generally match the duration of the investments made with cash collateral. On September 30, 2004 the System had no credit risk exposure to borrowers. The cash and non-cash collateral held for securities on loan for the System as of September 30, 2004, were \$65,551,067 and \$678,939, respectively. The carrying amount, which is the fair market value, of securities on loan for the System as of September 30, 2004 was \$64,766,388.

Gross income from security lending for the fiscal year was \$703,517. Expenses associated with this income were the borrower's rebate of \$602,404 and fees paid to the agent of \$25,412.

### *Categories of Investment Risk*

Investments are categorized to give an indication of the level of risk that is assumed. Category 1 includes investments insured, registered or held by the System or its agent in the System's name. Category 2 includes uninsured and unregistered investments for which the securities are held by the counter party's trust department or agent in the System's name. Category 3 includes uninsured and unregistered investments held by the counterparty or by its trust department or agent, but not in the System's name.

At September 30, 2004, the System does not own any investments that are considered securities for purposes of assessing credit risk. All System investments are held in State of Michigan – Department of Treasury investment administered pools.

# FINANCIAL SECTION

## Notes to Basic Financial Statements (Continued)

In July 2004 the System's investments were contributed to an investment pool structure. In the following table, 2004 amounts represent a pro rata share based on the System's ownership of the investment pools. For fiscal year 2004 reporting purposes the investment pools are presented on a comparative basis in the Non-Categorized section of the schedule of investment risk.

<u>Category 1</u>	<u>2004</u>	<u>2003</u>
Prime Commercial Paper		\$ 41,235,918
Government Securities		92,922,250
Corporate Bonds & Notes		72,823,698
Common and Preferred Stock		427,514,005
Alternative Investments <sup>2</sup>		1,047,846
International Investments <sup>3</sup>		87,160,663
<b>Total Category 1</b>	<u>-</u>	<u>722,704,380</u>
 <u>Category 3</u>		
Government Securities	<u>-</u>	<u>1,173,916</u>
 <u>Non-Categorized</u>		
Real Estate and Mortgages <sup>1</sup>		89,100,959
Alternative Investments <sup>2</sup>		126,860,971
International Investments <sup>3</sup>		6,221,704
Cash Collateral on loaned securities	\$ 65,551,067	24,893,895
Securities on Loan:		
Government Securities		10,612,962
Corporate Bonds & Notes		2,201,418
Alternative Investments <sup>2</sup>		7,187
International Investments <sup>3</sup>		746,531
Common Stock		11,408,034
Fixed Income:		
Government Bond Pool	95,458,458	
Corporate Bond Pool	95,999,482	
Equity Pools	501,034,771	
Real Estate Pools	76,438,489	
Alternative Investment Pool	132,258,513	
International Investment Pool	112,428,766	
Short Term Investments Pool	19,503,679	
<b>Total Non-Categorized</b>	<u>1,098,673,225</u>	<u>272,053,661</u>
 <b>Grand Total</b>	 <u>\$ 1,098,673,225</u>	 <u>\$ 995,931,957</u>

<sup>1</sup> Non-Categorized Real Estate consists of investments in real estate through various legal entities.

<sup>2</sup> In Category 1, the Alternative Investments are small-cap equities. Non-Categorized Alternative Investments consist of limited partnerships and securities on loan.

<sup>3</sup> In Category 1 the International Investments consist of International Swap Derivatives and ADRs (American Depository Receipts). The Non-Categorized International Investments consist of Primary Market and Extended Market Index Funds and securities on loan.

## NOTE 5 - COMMITMENTS AND CONTINGENCIES

Under the Administrative Procedures Act, members may appeal a decision by the Board. Once the administrative procedure has been exhausted, the decision may be appealed in Michigan's court system. Various cases that have exhausted the administrative procedures have been appealed in the court system. These cases are in the normal course of business and the System does not anticipate any material loss as a result of the contingent liabilities.

## Required Supplementary Information

### Schedule of Funding Progress

Expressing the net assets available for benefits as a percentage of the actuarial accrued liability provides one indication of the System's funding status. Analysis of this percentage over time indicates whether the System is becoming financially stronger or weaker. Generally, the greater this percentage, the stronger the System. Trends in unfunded actuarial accrued liability and annual covered payroll are both affected by inflation. Expressing the unfunded or overfunded actuarial accrued liability as a percentage of annual covered payroll approximately adjusts for the effects of inflation and aids analysis of progress made in accumulating sufficient assets to pay benefits when due. Generally, the smaller this percentage, the stronger the System.

#### Retirement Benefits (in millions)

Valuation Date Sept 30	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Entry Age (b)	Unfunded (Overfunded) Accrued Liability (UAAL) (b-a)	Funded Ratio AAL (a/b)	Covered Payroll (c)	UAAL as a % of Covered Payroll ((b-a)/c)
1994	\$ 566.5	\$ 709.3	\$ 142.8	79.9 %	\$ 88.6	161.1 %
1994 <sup>(2)</sup>	566.5	711.8	145.3	79.6	88.6	164.0
1995	622.6	798.8	176.2	77.9	104.5	168.6
1996	697.9	823.5	125.5	84.8	106.8	117.5
1997	787.2	880.3	93.1	89.4	110.1	84.6
1997 <sup>(1)</sup>	928.7	880.3	(48.4)	105.5	110.1	(44.0)
1997 <sup>(3)</sup>	928.7	876.8	(52.0)	105.9	110.1	(47.2)
1998	974.4	943.7	(30.6)	103.2	108.2	(28.3)
1998 <sup>(2)</sup>	974.4	962.5	(11.9)	101.2	108.2	(11.0)
1999	1,036.8	1,006.5	(30.3)	103.0	116.9	(25.9)
2000	1,113.1	1,040.7	(72.4)	107.0	116.6	(62.1)
2001	1,148.6	1,073.6	(75.0)	107.0	118.8	(63.1)
2002	1,141.3	1,135.7	(5.6)	100.5	124.4	(4.6)
2003	1,139.1	1,186.4	47.3	96.0	113.2	41.8

(1) Change in asset valuation method.

(2) Assumption change.

(3) Change in inflation.

# FINANCIAL SECTION

## Required Supplementary Information (Continued)

### Schedule of Employer Contributions

<u>Fiscal Year Ended Sept. 30</u>	<u>Required Contribution (ARC)</u>	<u>Actual Contribution</u>	<u>Percentage Contributed</u>
1995	\$ 27,916,677	\$ 25,047,023	89.7 %
1996	35,149,438	35,994,833	102.4
1997	30,821,696	35,142,572	114.0
1998	20,257,237	20,003,807	98.7
1999	22,733,833	21,609,520	95.1
2000	24,266,567	22,107,292	91.1
2001	21,989,439	24,064,039	109.4
2002	22,041,827	22,456,469	101.9
2003	26,683,625	25,931,762	97.2
2004	26,997,861	24,792,137	91.8

# FINANCIAL SECTION

## Notes to Required Supplementary Information

### NOTE A - DESCRIPTION

Ten year historical trend information designed to provide information about the System's progress made in accumulating sufficient assets to pay benefits when due is presented in the preceding schedules. Other ten year historical trend information related to the System is presented in the Statistical and Actuarial Sections of the report. This information is presented to enable the reader to assess the progress made by the System in accumulating sufficient assets to pay pension benefits as they become due.

The comparability of trend information is affected by changes in actuarial assumptions, benefit provisions, actuarial funding methods, accounting policies, and other changes. Those changes usually affect trends in contribution requirements and in ratios that use the pension benefit obligation as a factor.

The Schedule of Funding Progress and Schedule of Employer Contributions are reported as historical trend information. The Schedule of Funding Progress is presented to measure the progress being made to accumulate sufficient assets to pay benefits when due. The Schedule of Employer Contributions is presented to show the responsibility of the Employer in meeting the actuarial requirements to maintain the System on a sound financial basis.

### NOTE B - SUMMARY OF ACTUARIAL ASSUMPTIONS

The information presented in the required supplementary schedules was determined as part of the actuarial valuations at the dates indicated. Additional information as of the latest actuarial valuation follows:

Valuation Date	9/30/2003
Actuarial Cost Method	Entry Age, Normal
Amortization Method	Level Percent of Payroll, Closed
Remaining Amortization Period	33 years
Asset Valuation Method	5-Year Smoothed Market
Actuarial Assumptions:	
Inflation Rate	4%
Investment Rate of Return	8%
Projected Salary Increases	4.7% - 84.0%
Cost-of-Living Adjustments	2% Annual Non-Compounded with Maximum Annual Increase of \$500 for those eligible

# FINANCIAL SECTION

## Supporting Schedules

### Comparative Summary Schedule of Pension Plan Administrative Expenses For the Years Ended September 30, 2004 and 2003

	<u>2004</u>	<u>2003</u>
<b>Personnel Services:</b>		
Staff Salaries	\$ 48,443	\$ 52,056
Retirement and Social Security	11,368	10,907
Other Fringe Benefits	8,947	7,431
<b>Total</b>	<u>68,758</u>	<u>70,394</u>
<b>Professional Services:</b>		
Accounting *	8,181	
Actuarial	63,000	122,775
Attorney General	19,482	14,903
Audit	31,296	34,793
Consulting	6,774	21,913
Medical	14,713	16,348
<b>Total</b>	<u>143,446</u>	<u>210,732</u>
<b>Building Equipment</b>		
Building Rentals	5,763	6,546
Equipment Purchase, Maintenance, and Rentals	312	1,870
<b>Total</b>	<u>6,075</u>	<u>8,416</u>
<b>Miscellaneous:</b>		
Travel and Board Meetings	144	791
Office Supplies	710	607
Postage, Telephone and Other	25,937	53,438
Printing	4,345	5,792
Technological Support	67,475	73,575
<b>Total</b>	<u>98,611</u>	<u>134,203</u>
<b>Total Administrative Expenses</b>	<u>\$ 316,890</u>	<u>\$ 423,745</u>

\* In 2003 accounting services were included as a component of Postage, Telephone and Other within the Miscellaneous section of this schedule.



## Supporting Schedules (Continued)

### Schedule of Investment Expenses

	2004	2003
Real Estate Operating Expenses	\$ 7,393	\$ 30,001
Securities Lending Expenses	627,816	417,941
Other Investment Expenses*	1,681,752	1,890,905
<b>Total Investment Expenses</b>	<b>\$ 2,316,961</b>	<b>\$ 2,338,847</b>

\* Refer to Investment Section for fees paid to investment professionals.

### Schedule of Payments to Consultants

	2004	2003
Independent Auditors	\$ 31,296	\$ 34,793
Consulting	6,774	21,913
Medical	14,713	16,348
Attorney General	19,482	14,903
Accounting	8,181	
Actuary	63,000	122,775
<b>Total Payment to Consultants</b>	<b>\$ 143,446</b>	<b>\$ 210,732</b>

# FINANCIAL SECTION

## Supporting Schedules (Continued)

### Detail of Changes in Plan Net Assets (Pension and Postemployment Healthcare Benefits) For the Year Ended September 30, 2004

	<u>Employee Contributions</u>	<u>Employer Contributions</u>	<u>Retired Benefit Payments*</u>	<u>Undistributed Investment Income</u>	<u>Health Related Benefits</u>	<u>Total</u>
<b>Additions:</b>						
Contributions:						
Member contributions	\$ 30,062				\$ 1,572,372	\$ 1,602,434
Employer contributions		\$ 24,792,137			25,426,780	50,218,917
Total Contributions	<u>30,062</u>	<u>24,792,137</u>	<u>-</u>	<u>-</u>	<u>26,999,152</u>	<u>51,821,351</u>
Investment income (loss):						
Investment income (loss)				\$ 120,430,613		120,430,613
Investment expenses:						
Real estate operating expenses				(7,393)		(7,393)
Other investment expenses				(1,681,752)		(1,681,752)
Securities lending activities:						
Securities lending income				703,517		703,517
Securities lending expenses				(627,816)		(627,816)
Net investment income (loss)	<u>-</u>	<u>-</u>	<u>-</u>	<u>118,817,169</u>	<u>-</u>	<u>118,817,169</u>
Miscellaneous income				125		125
<b>Total additions</b>	<u>30,062</u>	<u>24,792,137</u>	<u>-</u>	<u>118,817,294</u>	<u>26,999,152</u>	<u>170,638,645</u>
<b>Deductions:</b>						
Benefits paid to plan members and beneficiaries:						
Retirement benefits			\$ 77,591,542			77,591,542
Health benefits					27,245,933	27,245,933
Dental/vision benefits					1,949,538	1,949,538
Refunds of member contributions	1,434					1,434
Administrative expenses				316,890		316,890
<b>Total deductions</b>	<u>1,434</u>	<u>-</u>	<u>77,591,542</u>	<u>316,890</u>	<u>29,195,471</u>	<u>107,105,337</u>
<b>Net Increase (Decrease)</b>	<u>28,628</u>	<u>24,792,137</u>	<u>(77,591,542)</u>	<u>118,500,404</u>	<u>(2,196,319)</u>	<u>63,533,308</u>
<b>Other Changes in Net Assets:</b>						
Interest allocation	9,547	13,191,074	59,721,139	(72,921,760)		-
Transfers upon retirement	(61,272)	(115,215,012)	115,276,284			-
Total other changes in net assets	<u>(51,725)</u>	<u>(102,023,938)</u>	<u>174,997,423</u>	<u>(72,921,760)</u>	<u>-</u>	<u>-</u>
<b>Net Increase (Decrease) After Other Changes</b>	<u>(23,097)</u>	<u>(77,231,801)</u>	<u>97,405,881</u>	<u>45,578,644</u>	<u>(2,196,319)</u>	<u>63,533,308</u>
<b>Net Assets (Liabilities) Held in Trust for Pension and Health Benefits:</b>						
<b>Beginning of Year</b>	<u>239,801</u>	<u>164,888,428</u>	<u>746,514,236</u>	<u>65,389,576</u>	<u>2,196,319</u>	<u>979,228,360</u>
<b>End of Year</b>	<u>\$ 216,704</u>	<u>\$ 87,656,627</u>	<u>\$ 843,920,117</u>	<u>\$ 110,968,220</u>	<u>\$ -</u>	<u>\$ 1,042,761,668</u>

\*Casualty Reserve is included.

# FINANCIAL SECTION

## Supporting Schedules (Continued)

### Detail of Changes in Plan Net Assets (Pension and Postemployment Healthcare Benefits) For the Year Ended September 30, 2003

	Employee Contributions	Employer Contributions	Retired Benefit Payments*	Undistributed Investment Income	Health Related Benefits	Total
<b>Additions:</b>						
Contributions:						
Member contributions	\$ 78,111				\$ 1,501,196	\$ 1,579,307
Employer contributions		\$ 25,931,762			29,620,331	55,552,093
Total Contributions	78,111	25,931,762	-	-	31,121,527	57,131,400
Investment income (loss):						
Investment income (loss)				\$ 135,211,684		135,211,684
Investment expenses:						
Real estate operating expenses				(30,001)		(30,001)
Other investment expenses				(1,890,905)		(1,890,905)
Securities lending activities:						
Securities lending income				504,591		504,591
Securities lending expenses				(417,941)		(417,941)
Net investment income (loss)	-	-	-	133,377,428	-	133,377,428
Miscellaneous income						
				127		127
<b>Total additions</b>	78,111	25,931,762	-	133,377,555	31,121,527	190,508,955
<b>Deductions:</b>						
Benefits paid to plan members and beneficiaries:						
Retirement benefits			\$ 70,152,288			70,152,288
Health benefits					25,282,634	25,282,634
Dental/vision benefits					1,753,228	1,753,228
Refunds of member contributions						
Administrative expenses				423,745		423,745
<b>Total deductions</b>	-	-	70,152,288	423,745	27,035,862	97,611,895
<b>Net Increase (Decrease)</b>	78,111	25,931,762	(70,152,288)	132,953,810	4,085,665	92,897,060
<b>Other Changes in Net Assets:</b>						
Interest allocation	6,371	14,210,004	56,564,066	(70,780,441)		-
Transfers upon retirement	(173,237)	(52,878,392)	53,051,629			-
Total other changes in net assets	(166,866)	(38,668,388)	109,615,695	(70,780,441)	-	-
<b>Net Increase (Decrease) After Other Changes</b>	(88,755)	(12,736,626)	39,463,407	62,173,369	4,085,665	92,897,060
<b>Net Assets (Liabilities) Held in Trust for Pension and Health Benefits:</b>						
<b>Beginning of Year</b>	328,556	177,625,054	707,050,829	3,216,207	(1,889,346)	886,331,300
<b>End of Year</b>	\$ 239,801	\$ 164,888,428	\$ 746,514,236	\$ 65,389,576	\$ 2,196,319	\$ 979,228,360

\*Casualty Reserve is included.

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# **INVESTMENT SECTION**

Prepared by Michigan Department of Treasury, Bureau of Investments

Jacqueline M. Johnson, CFA, Director

Report on Investment Activity  
    Asset Allocation  
        Investment Results  
List of Largest Stock Holdings  
List of Largest Bond Holdings  
    Schedule of Investment Fees  
Schedule of Investment Commissions  
    Investment Summary

# INVESTMENT SECTION

## Report on Investment Activity

### INTRODUCTION

The State Treasurer reports quarterly the investment activity to the Investment Advisory Committee, which reviews the investments, goals, and objectives of the System and may submit recommendations regarding them to the State Treasurer. The Investment Advisory Committee may also, by a majority vote, direct the State Treasurer to dispose of any holdings that, in the Committee's judgment, are not suitable for the funds involved, and may, by unanimous vote, direct the State Treasurer to make specific investments.

The Investment Advisory Committee was created by Act 380 of the Public Acts of 1965. The three public members of the five-member committee are appointed by the Governor with the advice and consent of the Senate for three-year terms. The Director of the Department of Labor and Economic Growth and the Director of the Department of Management and Budget are ex-officio members. In fiscal 2004, the members of the Committee were as follows: James B. Henry, PhD (public member), Robert E. Swaney, CFA (public member), David G. Sowerby, CFA (public member), David Hollister (ex-officio member), and Mitch Irwin (ex-officio member). The public members serve without pay, but are paid actual and necessary travel and other expenses.

### INVESTMENT POLICY & GOALS

Investment policy states that the fiduciary will operate within standard investment practices of the prudent person. The fiduciary is authorized to invest in government obligations, corporate obligations, various short-term obligations, corporate (domestic and international) stocks, venture capital interests, mutual funds, real estate interests, and other investments subject to specific parameters. Above all, pension fund assets are to be invested for the exclusive benefit of the members of the System.

The System's Proxy Voting Policy sets forth directives on the following issues: Boards of Directors, corporate governance, social issues, corporate restructurings and defenses. All proxies are reviewed and voted in accordance with the System's policy.

The primary function of the System is to provide retirement, survivor and disability benefits to its members. The State Treasurer is the sole investment fiduciary and custodian of the System's investments pursuant to State law. The primary investment objective is to maximize the rate of return on the total investment portfolio, consistent with a high degree of prudence and sufficient diversity to eliminate inordinate risks and to meet the actuarial assumption for the investment rate of return, at a reasonable cost achieved by cultivating a motivated team of dedicated professionals. The goals of the System are:

1. Assure the availability of sufficient assets to pay benefits.
2. Maintain sufficient diversification to avoid large losses and preserve capital.
3. Meet or exceed the actuarial assumption over the long term.
4. Achieve the optimal rate of return possible within prudent levels of risk and liquidity.
5. Perform in the top half of the public plan universe over the long term.
6. Exceed individual asset class benchmarks over the long term.
7. Operate in a cost-effective manner relative to peers.

The strategy for achieving these goals is carried out by investing the assets of the System according to a five-year asset allocation model. The System currently has seven different asset classes, which provide for a well-diversified portfolio.

# INVESTMENT SECTION

## Report on Investment Activity (Continued)

### Asset Allocation (Excludes Collateral on Loaned Securities)

<u>Investment Category</u>	<u>As of 9/30/04 Actual %</u>	<u>Five-Year Target %</u>
Domestic Equity - Active	32.4%	33.0%
Large Cap Value Pool	16.7%	
Large Cap Growth Pool	15.3%	
Small Cap Pool	0.4%	
Domestic Equity - Passive	16.1%	16.0%
S&P 500 Index Pool	13.9%	
S&P MidCap Index Pool	1.9%	
S&P Small Cap Index Pool	0.3%	
International Equity Pool	10.9%	11.0%
Alternative Investments Pool	12.8%	14.0%
Real Estate Pool	7.4%	10.0%
Fixed Income	18.5%	15.0%
Government Bond Pool	9.2%	
Corporate Bond Pool	9.3%	
Short Term Investment Pool	1.9%	1.0%
<b>Total</b>	<b><u>100.0%</u></b>	<b><u>100.0%</u></b>

### INVESTMENT AUTHORITY

Pursuant to State Law (Section 91 of Act No. 380 of the Public Acts of 1965, as amended), the State Treasurer, State of Michigan, is the investment fiduciary for the following four State sponsored retirement systems: Michigan Public School Employees' Retirement System, Michigan State Employees' Retirement System, Michigan State Police Retirement System, and Michigan Judges' Retirement System.

Act No. 314 of the Public Acts of 1965, as amended, authorizes the investment of assets of public employee retirement systems or plans created and established by the State or any political subdivision.

### INVESTMENT RESULTS

#### *Total Portfolio Results*

For the fiscal year ended September 30, 2004, the total System's rate of return was 12.4% as compiled by State Street Analytics. Annualized rates of return for the three-year period ending September 30, 2004, were 5.0%; for the five-year period were 3.2 %; and for the ten-year period were 9.3%.

Returns were calculated using a time-weighted rate of return in accordance with standards of the CFA Institute, unless a modification is described in the discussion of the reported return.

These results were driven by double-digit returns from the Domestic and International Equity pools and from the Alternative Investments pool as markets continued their rebound early in the fiscal year. Later in the year, equity markets flattened out when they encountered slower economic growth, higher energy prices and continuing geopolitical worries. For those same reasons, bond markets were very volatile during fiscal 2004. Real estate and alternative investments experienced favorable environments in which they realized gains.

# INVESTMENT SECTION

## Report on Investment Activity (Continued)

The U.S. economy grew at a rate of 4.5% in fiscal year 2004 as measured by real gross domestic product. The first half was stronger while the second half of the year was buffeted by escalating oil prices, slower retail sales, slow job growth and a series of hurricanes that hit the Southeast. Corporate earnings remained robust, helped by several years of cost-cutting and clean balance sheets. Inflation, as measured by the consumer price index, increased only 2.5% as higher commodity prices were, for the most part, absorbed by producers.

The Federal Reserve began its “measured pace” of monetary tightening by raising the Fed Funds rate by 0.25% at each of its Federal Open Market Committee meetings in June, August and September of 2004. This resulted in a Fed Funds rate of 1.75% by the end of fiscal 2004, up from its 50-year low of 1.00% last spring.

For the fiscal year, the Dow Jones Industrial Average provided a total return of 11.0%, while the broader S&P 500 returned 13.9%. The Lehman Brothers U.S. Aggregate Bond Index appreciated 3.7%.

The System remains well diversified, both across and within asset classes, and positioned to benefit from moderate economic growth.

On July 1, 2004, the System’s assets were invested in internal fund pools. The pools own the assets and may hold an interest in the short-term investment pool. These investments in the short-term pool provide necessary liquidity and/or protection of principal during market reversals. Because prior year results only include returns on assets and not the pools, results are not entirely comparable.

### *Large Cap Value Pool*

The primary objective of the pool of large company value stocks is to generate a rate of return from investment in common stocks and equity equivalents that exceeds that of the S & P Barra Value Index. A second objective is to generate a rate of return that exceeds the annualized median return of the State Street public plan universe of large-cap value equity managers.

The pool invests primarily in equities and equity-related securities of U.S. companies with market capitalization generally greater than \$5 billion that are significantly under-priced as measured by price-to-earnings and/or price-to-book value ratios and below fair value as determined by quantitative and qualitative models. The focus is on companies with a strong presence in depressed categories, experienced management and conservative accounting practices. At times a portion of the pool may be invested in fixed-income short-term securities with maturities of less than one year.

The pool invests in equities and equity related securities that are listed on U.S. national securities exchanges, including American Depositary Receipts (ADRs). It may also invest in stocks that are traded over-the-counter. The pool diversifies its investments by allocating its equities with weightings that approximate the weightings of the S & P Barra Value Index. The following summarizes the weightings of the pool at September 30, 2004:

Finance	39.8 %
Energy	13.3
Consumer Non-Durable	11.2
Short Term Investments	8.1
Manufacturing	5.0
Consumer Durable	5.0
Basic Industries	4.7
Utilities	4.6
Technology	3.8
Capital Goods	3.0
Other	1.5
<b>Total</b>	<b><u>100.0</u> %</b>



# INVESTMENT SECTION

## Report on Investment Activity (Continued)

Three Small Cap Value managers were selected at the end of the fiscal year to manage money for the System beginning October 1, 2004. They will be funded from short-term investments out of the Large Cap Value pool. Their primary investment objective will be to generate a rate of return from investment in common stocks and equivalents that exceeds the Russell 2000 Value Index.

The System's Large Cap Value pool achieved a total rate of return of 19.3% for fiscal 2004. This compared with 20.5% for the S&P 500 Barra Value Index.

At the close of fiscal year 2004, the Large Cap Value pool represented 16.7% of total investments. This compares to 14.8% for fiscal year 2003. The following summarizes the System's 2.2% ownership share of the Large Cap Value pool at September 30, 2004:

### Large Cap Value Pool (in thousands)

Short Term Pooled investments	\$	12,459
Equities		159,526
Settlement Principal Payable		(38)
Settlement Proceeds Receivable		74
Accrued dividends		149
<b>Total</b>	<b>\$</b>	<b><u>172,170</u></b>

### Large Cap Growth Pool

The primary investment objective is to generate a rate of return from investment in common stocks and equity equivalents that exceeds that of the S & P Barra Growth Index. A second objective is to generate a rate of return that exceeds the annualized median return of the State Street public plan universe of large-cap growth equity managers.

The pool invests primarily in equities and equity-related securities of U.S. companies with market capitalization generally greater than \$5 billion whose earnings growth rates are expected to exceed the growth rate of the S & P 500 Index by at least 50% and are priced at or below fair value as determined by quantitative and qualitative models. The focus is on companies with a strong presence in categories anticipated to be fast growing, with high rates of unit sales growth and seasoned management. At times a portion of the pool may be invested in fixed-income short-term securities with maturities of less than one year.

The pool invests in equities and equity related securities that are listed on U.S. national securities exchanges, including American Depository Receipts (ADRs). It may also invest in stocks that are traded over-the-counter. The pool diversifies its investments by allocating its equities with weightings that approximate the weightings of the S & P Barra Growth Index. The following summarizes the weightings of various sectors in the pool at September 30, 2004:

Consumer Non-Durable	42.6 %
Technology	29.8
Manufacturing	11.1
Basic Industries	5.1
Short Term Investments	3.5
Capital Goods	2.5
Energy	2.0
Finance	2.0
Other	1.4
<b>Total</b>	<b><u>100.0 %</u></b>

# INVESTMENT SECTION

## Report on Investment Activity (Continued)

The Large Cap Growth pool's total rate of return was 6.7% for the fiscal year versus 7.5% for the S&P 500 Barra Growth Index.

At the close of fiscal year 2004, the Large Cap Growth pool represented 15.3% of total investments. This compares to 14.8% for fiscal year 2003. The following summarizes the System's ownership 2.2% share of the Large Cap Growth pool at September 30, 2004:

<b>Large Cap Growth Pool</b>	
<b>(in thousands)</b>	
Short Term Pooled investments	\$ 5,371
Equities	152,771
Settlement Principal Payable	(287)
Settlement Proceeds Receivable	896
Accrued dividends	168
<b>Total</b>	<b><u>\$ 158,919</u></b>

### *Small Cap Pools*

The Primary investment objection is to generate a rate of return from investment in common stocks and equivalents that exceeds the Russell 2000 Growth Index.

The System invests in the Delaware and Putnam pools. These are investment positions with the small company growth managers at Delaware Investment Advisors (Delaware) and Putnam Investments (Putnam.)

The System's Small Cap pool invested with Delaware achieved a total rate of return of 14.0% for fiscal 2004, while Putnam's total rate of return was 9.5% resulting in a combined return of 12.5%. This compared favorably with the Russell 2000 Growth Index total return of 11.9%.

At the close of fiscal year 2004, the two Small Cap pools represented 0.4% of total investments. This compares to 0.4% for fiscal year 2003. The following summarizes the System's ownership share and composition of the two Small Cap pools at September 30, 2004:

<b>Small Cap Pools</b>		
<b>(in thousands)</b>		
	<b>Delaware</b>	<b>Putnam</b>
Total Equities	\$ 3,080	\$ 1,431
Ownership percentage	2.3%	2.3%

### *S&P 500 Index Pool*

The objective of the enhanced S&P 500 Index pool is to closely match the return performance of its benchmark, the S&P 500 Index, and to use low risk strategies to offset transaction costs and add to performance when possible. The pool generally holds all 500 stocks that make up the Standard & Poor's 500 Index in proportion to their weighting in the index.

# INVESTMENT SECTION

## Report on Investment Activity (Continued)

The following summarizes the sector weightings of the pool at September 30, 2004:

Financials	20.8 %
Information Technology	15.7
Health Care	13.1
Industrials	11.6
Consumer Discretionary	11.0
Consumer Staples	10.7
Energy	7.4
Telecomm. Services	3.7
Materials	3.1
Utilities	2.9
<b>Total</b>	<b><u><u>100.0 %</u></u></b>

The S&P 500 Index pool return for the fiscal year was 13.9% versus the benchmark's 13.9%.

At the close of fiscal year 2004, the S&P 500 Index pool represented 13.9% of total investments. This compares to 13.1% for fiscal year 2003. The following summarizes the System's 2.2% ownership share of the S&P 500 Index pool at September 30, 2004:

### S&P 500 Index Pool (in thousands)

Short Term Pooled investments	\$ 3,096
Equities	139,759
Hedge Contracts	(1)
Settlement Principal Payable	(3)
Accrued dividends	163
<b>Total</b>	<b><u><u>\$ 143,014</u></u></b>

### *S&P MidCap Pool*

The objective of the S&P MidCap Index pool is to closely match the return performance of its benchmark, the S&P MidCap, and use low risk strategies to offset transaction costs and add to performance when possible. The pool invests in equities of mid-size firms.

The S&P MidCap Index pool return for the fiscal year was 17.6% versus its benchmark's 17.6%.

At the close of fiscal year 2004, the S&P MidCap Index pool represented 1.9% of total investments. This compares to 1.7% for fiscal year 2003. The following summarizes the System's 2.3% ownership share of the S&P Midcap Index pool at September 30, 2004:

### S&P MidCap Pool (in thousands)

Short Term Pooled investments	\$ 404
Equities	19,511
Hedge Contracts	2
Settlement Principal Payable	(170)
Settlement Proceeds Receivable	18
Accrued dividends	13
<b>Total</b>	<b><u><u>\$ 19,778</u></u></b>

# INVESTMENT SECTION

## Report on Investment Activity (Continued)

### *S&P Small Cap Index Pool*

The objective of the S&P Small Cap Index pool is to match the return of its benchmark, the S&P 600 Small Cap Index. The S&P Small Cap Index pool return for the fiscal year was 24.6% versus the benchmark's 24.6%.

The pool achieves exposure to Small Cap equity returns primarily by investing in a combination of fixed income notes and equity swap agreements tied to the S&P 600 index. The total notional amount of the S&P 600 swap agreements is invested in dedicated fixed income notes. Interest from the dedicated notes is exchanged for S&P 600 stock returns. Use of swap agreements for a core position began in 2002, and an S&P 600 Exchange Traded Fund was added to this pool in 2004 to enhance management flexibility.

At the close of fiscal year 2004, the S&P Small Cap Index pool represented 0.3% of total investments. This compares to 0.2% for fiscal year 2003. The following summarizes the System's 2.2% ownership share of the S&P Small Cap Index pool at September 30, 2004:

#### **S&P Small Cap Index Pool (in thousands)**

Short Term Pooled investments	\$	15
Equities		344
Debt Securities		2,229
Hedge Contracts		51
Accrued dividends		4
<b>Total</b>	<b>\$</b>	<b>2,643</b>

### *International Equities Pool - Passive*

The objective of the International Equities Pool - Passive is to match the return performance of the S&P Citigroup Broad Market Index (BMI) Europe and Pacific Composite (EPAC) adjusted for net dividends. Fifty percent of the benchmark is hedged to the U.S. Dollar and the other half is impacted by foreign currency exchange rate changes. The total passive international return of 19.3% in the fiscal year approximately matched the Citigroup BMI-EPAC return of 19.5%.

Core passive exposure to international equity returns is achieved primarily by investing in a combination of fixed income notes and equity swap agreements on foreign stock indices in developed markets. Interest on the dedicated notes is exchanged for international stock returns, and the total notional amount of the swap agreements is invested in the approximate proportions of the S&P Citigroup Broad Market Index (BMI) Europe and Pacific Composite (EPAC) country weightings in related indices. Use of swap agreements for a core position began in 1993, an American Depository Receipts (ADR) and index-related security portfolio was added in June of 1999 to increase management flexibility, and a country fund portfolio was added in September of 2002 to improve exposure to the smallest companies in the BMI index. During fiscal year 2004, \$0.8 million was withdrawn, bringing passive international investments to 10.8% of total investment assets.

The combination of fixed income LIBOR notes and equity swap agreements was valued at \$100.8 million on September 30, 2004. That valuation included a net unrealized gain of \$10.2 million on equity index exposures and an unrealized loss of \$13 thousand on LIBOR note investments held. The combined swap agreement and LIBOR portfolio structure continues to perform like a stock index fund that realizes all gains and losses on a rolling three year basis. During fiscal year 2004, \$2.7 million of losses on equity exposures were realized, \$1.9 million of interest in excess of obligations on completed swaps was recognized, and \$2 thousand of gains on LIBOR notes were realized. At the end of the fiscal year, total realized gains and net interest received in excess of counterparty obligations on completed agreements were \$14 million since the program began.

# INVESTMENT SECTION

## Report on Investment Activity (Continued)

At the close of fiscal year 2004, the International Equities Pool – Passive represented 10.9% of total investments. This compares to 9.7% for fiscal year 2003. The following summarizes the System's 2.3% ownership share of the International Equities Pool - Passive at September 30, 2004:

### International Equities Pool - Passive (in thousands)

Short Term Pooled investments	\$	1,191
Equities		10,148
Debt Securities		90,596
Hedge Contracts		10,237
Accrued dividends and interest		257
<b>Total</b>	<b>\$</b>	<b>112,429</b>

### Alternative Investments Pool

The Alternative Investments pool objective is to meet or exceed the S&P 500 plus 300 basis points for all private equity pools over long time periods.

Alternative Investments are investments in the private equity market, primarily through limited partnerships. Of the investments, approximately 61.8% were in partnerships investing in buyouts, 16.2% in venture capital, 10.4% in special situations, and 4.3% in mezzanine. The remaining 7.3% were investments in fund of funds, hedge funds, and short term. The asset allocation range for alternative investments is 12.0% to 16.0%, while the long-term target asset allocation target is 14.0%.

The Alternative Investments pool had a return of 22.7% for the fiscal year ended September 30, 2004 as compiled by State Street Analytics versus the S&P 500 Index plus 300 basis points of 16.9%.

Credit Suisse Asset Management (CSAM) manages the stock distributions of the Alternative Investments. The CSAM return for the fiscal year ending September 30, 2004 was 6.0%.

At the close of fiscal year 2004, the Alternative Investments pool represented 12.7% of total investments and Credit Suisse Asset Management represented 0.1% of total investments. This compares to 13.0% for Alternative and 0.1% for CSAM for fiscal year 2003. The following summarizes the System's ownership share and composition of the Alternative Investments pool and the Credit Suisse Asset Management pool at September 30, 2004:

### Alternative Investments Pool (in thousands)

	Alternative	CSAM
Short Term Pooled investments	\$ 1,626	\$ 19
Equities	129,778	836
<b>Total</b>	<b>\$ 131,404</b>	<b>\$ 855</b>
Ownership percentage	2.1%	1.9%

# INVESTMENT SECTION

## Report on Investment Activity (Continued)

### *Real Estate Pool*

The Real Estate pool seeks favorable risk-adjusted returns through rental income and appreciation of real estate investments. Real estate investments are typically held through various legal investment entities, such as limited partnerships or limited liability companies, established for the specific purpose of owning, leasing, managing, financing, or developing real estate and real estate related investments. Independent third parties regularly value the real estate investments to establish current market values.

The Real Estate pool may invest in each of the following four quadrants of the real estate capital markets:

- Private equity markets - An ownership interest in stabilized real estate assets, which may also include development and redevelopment of real estate.
- Public equity markets - Securities of publicly traded equity real estate companies whose primary purpose is to own, lease, manage, and develop real estate.
- Private debt markets - Mortgage loans secured by real estate.
- Public debt markets - Publicly traded commercial mortgage-backed securities market.

The Real Estate pool diversifies its holdings by:

- Geographic region - The pool is broadly diversified geographically across the country. Emphasis is placed upon U.S. real estate investments, but may also include foreign real estate investments. Foreign investments are currently less than one percent of the total equity value of the pool, and are not expected to exceed ten percent of the total equity value of the pool.
- Property (size and value) - The pool diversifies its holdings so that it is not concentrated in a few large real estate assets.
- Property type - The pool is diversified by type of property and by class of property.

Major property types as of September 30, 2004:

Multi-family apartments	41.3 %
Commercial office buildings	21.5
Retail shopping centers	14.5
Industrial warehouse buildings	8.5
For sale housing, senior living facilities, land, hotels and self-storage facilities	14.2
<b>Total</b>	<b><u>100.0</u> %</b>

The net total return for the fiscal year ending September 30, 2004, was 8.0%, as compiled by State Street Analytics. This compares to the benchmark return of 11.7%. The benchmark is the National Council of Real Estate Investment Fiduciaries Property Index (NPI) less 75 basis points. The adjustment to the NPI is made to approximate industry comparable returns due to the fact that the Real Estate pool's returns are calculated net of all overhead and management fees, while the NPI calculates returns on a gross property level basis before overhead and standard investment management fees.

At the close of fiscal year 2004, the Real Estate pool had a total net equity value of \$76.4 million that represented 7.4% of total investments. This compares to 9.1% for fiscal year 2003.

# INVESTMENT SECTION

## Report on Investment Activity (Continued)

The following summarizes the System's 2.3% ownership share of the Real Estate pool at September 30, 2004:

<b>Real Estate Pool</b>	
<b>(in thousands)</b>	
Short Term Pooled investments	\$ 853
Equities	75,526
Debt Securities	59
Accrued Interest	- *
<b>Total</b>	<b>\$ 76,438</b>

\* Less than one thousand.

### ***Government Bond Pool***

The objectives are to maximize the rate of return consistent with sound portfolio management principles and to outperform the benchmark, Lehman Brothers Government Index.

The pool invests in a diversified portfolio of government bonds including, but not limited to, treasuries, agencies, and government sponsored enterprises. To achieve above average returns, the pool emphasizes those sectors exhibiting the best risk reward relationship relative to historical norms and the outlook for interest rates.

For the fiscal year ending September 30, 2004, the Government Bond pool returned 3.1% compared to the Lehman Brothers Government Index of 2.5%.

During the year rates were somewhat volatile reaching a low point in mid-March, increasing more than one hundred basis points by mid-June and finally declining again through September. In addition to the general volatility of rates, the yield curve flattened with short and intermediate rates rising while longer term rates remained constant or exhibited a modest decline, all of which tended to favor longer term portfolios.

At the close of fiscal year 2004, the Government Bond pool represented 9.2% of total investments. This compares to 10.7% for fiscal year 2003. The following summarizes the System's 2.4% ownership share of the Government Bond pool at September 30, 2004:

<b>Government Bond Pool</b>	
<b>(in thousands)</b>	
Short Term Pooled investments	\$ 13,003
Debt Securities	82,148
Settlement Principal Payable	(282)
Accrued dividends	589
<b>Total</b>	<b>\$ 95,458</b>

### ***Corporate Bond Pool***

The objectives are to maximize the rate of return consistent with sound portfolio management principles and to outperform the Lehman Brothers Credit Index.

The pool invests in a diversified portfolio of investment grade corporate issues. Such issues are rated in the top four categories by nationally recognized rating agencies. Non-rated bonds are acceptable if they are determined to be comparable quality. To achieve above average returns the pool emphasizes those sectors exhibiting the best risk reward relationship relative to historical norms and the outlook for interest rates.

For the fiscal year ending September 30, 2004 the Corporate Bond pool returned 4.1% compared to the Lehman Brothers Credit Index of 4.4%.

# INVESTMENT SECTION

## Report on Investment Activity (Continued)

During the year rates were somewhat volatile reaching a low point in mid-March, increasing more than one hundred basis points by mid-June and finally declining again through September. In addition to the general volatility of rates, the yield curve flattened with short and intermediate rates rising while longer term rates remained constant or exhibited a modest decline, all of which tended to favor longer term portfolios.

At the close of fiscal year 2004, the Corporate Bond pool represented 9.3% of total investments. This compares to 7.7% for fiscal year 2003. The following summarizes the System's 2.3% ownership share of the Corporate Bond pool at September 30, 2004:

<b>Corporate Bond Pool</b>	
<b>(in thousands)</b>	
Short Term Pooled investments	\$ 3,515
Debt Securities	95,179
Settlement Principal Payable	(3,826)
Aintransit Interest Receivable	27
Accrued dividends	1,104
<b>Total</b>	<b>\$ 95,999</b>

### ***Short Term Investments Pool***

The objective of the Short Term Investment pool is to closely match the return performance of its benchmark, the 91 day Treasury bill. The Short Term Investment pool return for the fiscal year was 1.1% versus the benchmark's 1.1%.

Potential areas of investment are:

- Obligations of the United States or its agencies.
- Banker's acceptances, commercial accounts, certificates of deposit or depository receipts.
- Repurchase agreements for the purchase of securities issued by the US government or its agencies.
- Commercial paper rated at the time of purchase within the two highest classifications established by not less than two national rating services as determined by the State Treasurer.

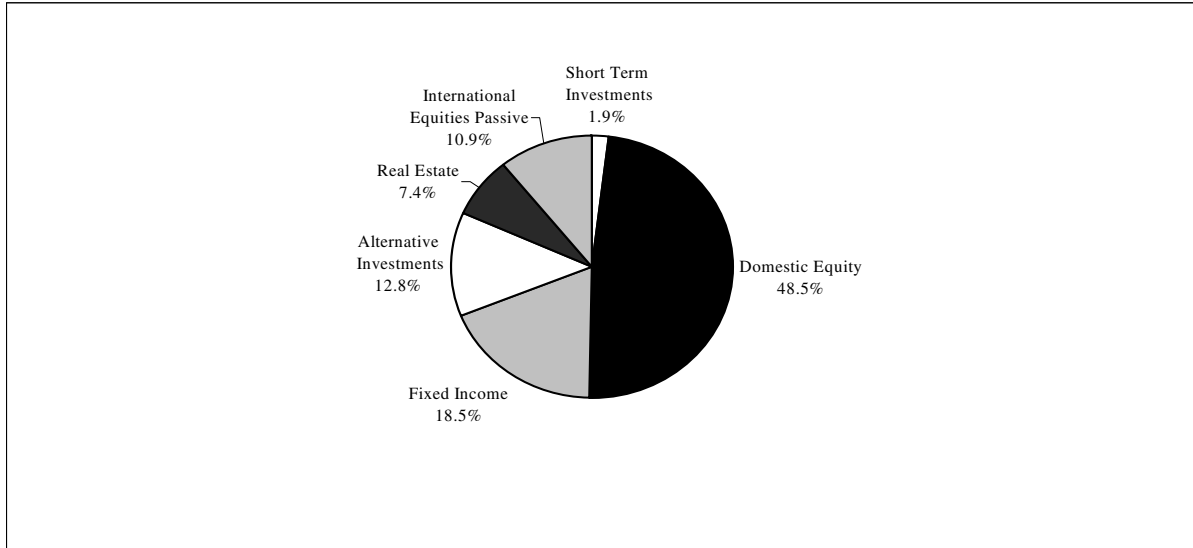
As of September 30, 2004, the Short Term Investment pool was 100% invested in commercial paper because of its advantages in yield and flexibility in maturities.

At the close of fiscal year 2004, the Short Term Investment pool represented 1.9% of total investments. This compares to 4.6% for fiscal year 2003. The System's 0.6% ownership share of the Short Term Investment Pool at September 30, 2004, was \$19,503,679 composed of debt securities.



# INVESTMENT SECTION

## Asset Allocation – Security Type



## Investment Results for the Period Ending September 30, 2004

Investment Category	Current Year	Annualized Rate of Return <sup>1</sup>		
		3 Years	5 Years	10 Years
Total Portfolio	12.4 %	5.0 %	3.2 %	9.3 %
Total Domestic Equity	13.4	5.0	0.1	11.3
S&P 1500 Index	14.6	5.1	(0.1)	N/A
Large Cap Value Pool	19.3			
Large Cap Growth Pool	6.7			
Small Cap Pools	12.5			
S&P 500 Index Pool	13.9			
S&P MidCap Index Pool	17.6			
S&P Small Cap Index Pool	24.6			
International Equity Pool - Passive	19.3	6.9	(0.3)	6.0
S&P Citigroup BMI - EPAC - 50/50	19.5	7.0	(0.4)	5.0
Alternative Investments Pool	22.7	1.1	4.2	12.1
S&P 500 Index plus 300 Basis Points	16.9	7.1	1.7	14.1
Credit Suisse Asset Management (Stock Distributions)	6.0			
Real Estate Pool	8.0	7.6	8.7	9.9
NCREIF Property Index minus 75 Basis Points	11.7	7.9	8.8	9.8
Total Fixed Income	3.6	5.4	7.0	7.6
Lehman Brothers Government/Credit	3.3	6.3	7.7	7.8
Government Bond Pool	3.1			
Corporate Bond Pool	4.1			
Short Term Investment Pool	1.1	1.6	3.2	4.6
91 Day Treasury Bill	1.1	1.5	3.1	4.3

<sup>1</sup> Calculations used a time-weighted rate of return based on the market rate of return in accordance with AIRM's Performance Presentation Standards.

# INVESTMENT SECTION

## Largest Assets Held

### Largest Stock Holdings (By Market Value)\* September 30, 2004

<u>Rank</u>	<u>Shares</u>	<u>Stocks</u>	<u>Market Value</u>
1	502,226	General Electric Corporation	\$ 16,799,587
2	591,203	Microsoft Corporation	16,291,493
3	331,672	Exxon Mobil Corporation	15,871,755
4	350,856	Citigroup Incorporated	15,332,388
5	478,129	Pfizer Incorporated	14,588,262
6	184,419	Wal-Mart Stores Incorporated	9,769,603
7	224,823	Bank of America Corporation	9,646,636
8	154,248	Wells Fargo & Company	9,112,670
9	124,129	American International Group	8,355,552
10	136,474	BP PLC	7,804,282

### Largest Bond Holdings (By Market Value)\* September 30, 2004

<u>Rank</u>	<u>Par Amount</u>	<u>Description</u>	<u>Market Value</u>
1	\$ 5,415,448	U.S. Treasury Strip 0% Coupon Due 11-15-2011	\$ 5,123,014
2	4,771,320	FHLB 2.71% FRN Due 1-12-2007	4,771,330
3	4,546,714	US Bank NA 2.0275% FRN Due 4-5-2007	4,546,558
4	3,506,736	Wells Fargo & Company 1.72% FRN Due 8-4-2006	3,506,164
5	3,448,350	Wells Fargo & Company 2.03% FRN Due 9-28-2007	3,448,350
6	3,430,105	Canadian Imperial Bank 2.0775% FRN Due 1-5-2007	3,429,987
7	3,393,615	Bayerische Landesbank NY 1.91313 FRN Due 3-17-2006	3,392,910
8	2,941,133	Citigroup Global Markets 1.75% FRN Due 1-30-2007	2,940,741
9	2,828,013	Key Bank NA 1.73% FRN Due 7-31-2006	2,827,613
10	2,828,013	JPMorgan Chase & Co 1.76188% FRN Due 7-28-2006	2,827,609

\* A complete list of stock and bond holdings is available from the Michigan Department of Treasury.

\* The System's investments are commingled in various pooled accounts. Shares, par and market value represent the System's pro-rata ownership through its ownership of the pools.

# INVESTMENT SECTION

## Schedule of Investment Fees

The State Treasurer is the investment fiduciary and custodian of the System's funds pursuant to State law. Outside advisors are utilized to augment the State Treasurer's internal staff in the real estate and alternative investment markets. Only 12.6% of the total investment portfolio is managed by fully discretionary outside advisors. Outside advisors' fees are netted against the partnership or trust fund income. The Michigan Department of Treasury's cost of operations applicable to the System for the fiscal year amounted to \$198,700 or less than three basis points (.024%) of the market value of the portfolio.

State law created an Investment Advisory Committee (Committee) comprised of the directors of the Department of Labor and Economic Growth and Department of Management and Budget, or their duly authorized representatives, and three public members appointed by the Governor with the advice and consent of the Senate. The public members serve without pay, but are paid actual and necessary travel and other expenses. The Committee meets quarterly to review investments, goals and objectives and may submit recommendations to the State Treasurer. The Committee may also, by a majority vote, direct the State Treasurer to dispose of any holding, which in the Committee's judgment is not suitable for the fund involved, and may by unanimous vote direct the State Treasurer to make specific investments.

### Schedule of Investment Fees

#### *Investment Managers' Fees:*

	<b>Assets under Management ( in thousands)</b>	<b>Fees ( in thousands)</b>	<b>Basis Points<sup>*</sup></b>
State Treasurer	\$ 824,098.1	\$ 198.7	2.4
Outside Advisors -			
Small Cap Growth - Delaware	3,079.8	16.7	54.2
Small Cap Growth - Putnam	1,431.0	13.1	91.6
International	7,847.3	2.0	2.5
Alternative	130,612.9	1,437.6	110.7
Real Estate	66,053.1		
<b>Total</b>	<b>\$ 1,033,122.2</b>		

#### *Other Investment Services Fees:*

Custody & Research Fees	\$ 1,013,617.8	\$ 45.5
Security Lending Fees	64,766.4	25.4

\* Outside Advisors Fees are netted against income for Small Cap Growth and International. For Alternative partnership agreements that define the management fees, which range from 150 to 250 basis points of the committed capital, in most cases the fees are netted against income. For Real Estate the asset management fee normally ranges from 25 to 90 basis points and is netted against current year's income.

# INVESTMENT SECTION

## Schedule of Investment Commissions

	<b>Fiscal Year Ended September 30, 2004</b>		
	<b>Commissions Paid <sup>(1)</sup></b>	<b>Number of Shares Traded</b>	<b>Average Commission Rate Per Share</b>
<b>Investment Brokerage Firms:</b>			
Alex Brown and Sons	\$ 307	7,681	\$ 0.04
Banc America Securities	1,667	33,335	0.05
Bear Stearns & Co Inc	6,351	135,514	0.05
Bridge Trading	11,466	232,519	0.05
B-Trade Services LLC	35	1,743	0.02
Cantor Fitzgerald & Co.	1,186	38,317	0.03
Cap Institutional Services Inc	10	197	0.05
Charles Schwab Co Inc	1,775	35,494	0.05
CIBC World Markets Corp	31	774	0.04
Citigroupglobal Markets Inc	16,774	424,016	0.04
Credit Suisse First Boston Corporation	6,576	131,513	0.05
Davidson D.A. & Company Inc	45	1,485	0.03
Deutsche Bank Securities Inc	4,741	107,514	0.04
First Albany Corp.	69	1,388	0.05
Goldman Sachs & Co	10,954	242,048	0.05
Griswold Company	3,080	139,985	0.02
Howard Weil	579	11,579	0.05
Investment Technology Group Inc.	24	1,210	0.02
ISI Group Inc	2,893	57,854	0.05
J P Morgan Securities Inc	5,853	117,385	0.05
Jefferies Company Inc	152	3,032	0.05
Knight Securities	51	1,276	0.04
Lehman Brothers Inc	10,092	233,701	0.04
Liquidnet Inc	99	4,944	0.02
OTA Research	2,182	43,632	0.05
Merrill Lynch, Pierce, Fenner & Smith, Inc	6,751	147,708	0.05
Morgan Stanley Co Inc	5,213	104,263	0.05
Piper Jaffray & Co.	23	458	0.05
Prudential Equity Group	5,297	105,931	0.05
Raymond James & Associates Inc	70	1,392	0.05
S.G. Cowen & Co., LLC	1,433	28,652	0.05
Salomon Smith Barney	29	869	0.03
Sanders Morris Mundy	140	2,792	0.05
Sanford C Bernstein Co., LLC	3,251	65,028	0.05
State Street Brokerage Services	18	391	0.05
Thinkequity Partners LLC	79	1,573	0.05
Thomas Weisel Partners	481	10,642	0.05
UBS Securities LLC	5,669	120,524	0.05
Wachovia Capital Markets, LLC	78	1,565	0.05
Weeden & Co.	545	11,431	0.05
Wells Fargo Securities LLC	78	1,773	0.04
<b>Total</b>	<b>\$ 116,147</b>	<b>2,613,128</b>	<b>\$ 0.04 <sup>(2)</sup></b>

<sup>(1)</sup> Commission are included in purchase and sale prices of investments. The commission and shares represent the System's pro-rata share of commission and share transactions based on ownership in the investment pools.

<sup>(2)</sup> The average commission rate per share for all brokerage firms.

# INVESTMENT SECTION

## Investment Summary Fiscal Year Ended September 30, 2004

	<u>Market Value (a)</u>	<u>Percent of Total Market Value</u>	<u>Investment &amp; Interest Income (b, c)</u>	<u>Percent of Investment &amp; Interest Income</u>
Fixed Income:				
Government Bond Pool	\$ 95,458,458	9.2%	\$ 2,919,045	2.4%
Corporate Bond Pool	95,999,482	9.3%	3,628,675	3.0%
Total Fixed Income	<u>191,457,940</u>	<u>18.5%</u>	<u>6,547,720</u>	<u>5.4%</u>
Equity Pools	501,034,771	48.5%	60,323,855	50.1%
Real Estate Pool	76,438,489	7.4%	6,477,066	5.4%
Alternative Investment Pool	132,258,513	12.8%	28,120,518	23.3%
International Equities Pool	112,428,766	10.9%	18,363,457	15.3%
Short Term Investments Pool	<u>19,503,679</u>	<u>1.9%</u>	<u>597,997</u>	<u>0.5%</u>
<b>Total</b>	<u><u>\$ 1,033,122,158</u></u>	<u><u>100.0%</u></u>	<u><u>\$ 120,430,613</u></u>	<u><u>100.0%</u></u>

- (a) Market value excludes \$8,385,825 and \$65,551,067 in equity in common cash and cash collateral for security lending for fiscal year 2004.
- (b) Total Investment & Interest Income excludes net security lending income of \$75,701.
- (c) Effective July 1, 2004, the System's investments were contributed to the various investment pools listed above. The income on investments for the first nine months of the fiscal year is reported as income for the pool to which the security was contributed.

# INVESTMENT SECTION

## Investment Summary (Continued)

Fiscal Year Ended September 30, 2003

	Market Value (a)	Percent of Total Market Value	Investment & Interest Income (c)	Percent of Investment & Interest
Fixed Income:				
Government Bonds	\$ 104,709,133	10.7%	\$ 3,182,977	2.4%
Corporate Bonds	75,025,111	7.7%	6,626,940	4.9%
Total Fixed Income	179,734,244	18.4%	9,809,917	7.3%
Common and Preferred Stock	438,922,039	45.1%	94,996,948	70.3%
Real Estate and Mortgages	89,100,959	9.1%	5,825,294	4.3%
Alternative Investments	127,916,004	13.1%	7,339,236	5.4%
International Equities	94,128,898	9.7%	16,631,030	12.3%
Short Term Investments (b)	45,223,629	4.6%	609,259	0.4%
<b>Total</b>	<b>\$ 975,025,773</b>	<b>100.0%</b>	<b>\$ 135,211,684</b>	<b>100.0%</b>

(a) Short Term Investments are at cost, which approximates market value.

(b) Excludes the amounts payable and receivable for sales and purchases of securities with a settlement date after September for each fiscal year. Amount also excludes \$24,893,895 in cash collateral for security lending for fiscal year 2003.

(c) Total Investment & Interest Income excludes net security lending income of \$86,650 for fiscal year 2003.

# ACTUARIAL SECTION

Actuary's Certification  
Summary of Actuarial Assumptions and Methods  
Schedule of Active Member Valuation Data  
Retirant and Beneficiary Data  
Prioritized Solvency Test  
Analysis of Financial Experience  
Summary of Plan Provisions

# ACTUARIAL SECTION

## Actuary's Certification



THE SEGAL COMPANY  
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November 10, 2004

Mr. Mitch Irwin  
Director  
Department of Management and Budget  
and  
Retirement Board  
Michigan State Police Retirement System  
P.O. Box 30176  
Lansing, Michigan 48909

Ladies and Gentlemen:

The Michigan State Police Retirement System (MSPRS) is funded on an actuarial reserve basis. The basic financial objective of MSPRS is to establish and receive contributions that remain approximately level as a percentage of active member payroll over a long period of years.

Actuarial valuations are prepared annually to determine MSPRS's actuarial liabilities and the employer contributions required to fund the System in accordance with the actuarial reserve funding provisions of the governing State Statute. The most recent actuarial valuation as of September 30, 2003 included a total of 4,512 members of MSPRS. The actuarial value of MSPRS's assets amounted to approximately \$1,139.1 million on September 30, 2003.

The actuarial assumptions used in the 2003 valuation are the same as those used in the previous annual actuarial valuation. These assumptions produce valuation results which we consider to be reasonably indicative of the plan's underlying cost. Also, in our opinion, the actuarial assumptions and methods used for funding purposes meet the parameters for the disclosures presented in the financial section by GASB Statement No. 25.

Our actuarial valuation of MSPRS as of September 30, 2003 was performed by qualified actuaries in accordance with accepted actuarial procedures. In our opinion, the calculated contribution rate meets the fundamental objectives of State law. Based on the 2003 valuation results, it is also our opinion that the Michigan State Police Retirement System continues in sound condition, in accordance with actuarial principles of level cost financing.

Most of the information used in the supporting schedules in the Actuarial and Statistical Sections, as well as the Schedules of Funding Progress and the employer contributions shown in the Schedules of Employer Contributions in the Financial Section of this report were provided by our firm.

Sincerely,

Michael Karlin, F.S.A., M.A.A.A.  
Senior Vice President & Actuary

Benefits, Compensation and HR Consulting ATLANTA BOSTON CHICAGO CLEVELAND DENVER HARTFORD HOUSTON LOS ANGELES MINNEAPOLIS  
NEW ORLEANS NEW YORK PHILADELPHIA PHOENIX SAN FRANCISCO SEATTLE TORONTO WASHINGTON, DC



Multinational Group of Actuaries and Consultants AMSTERDAM BARCELONA GENEVA HAMBURG LONDON MELBOURNE MEXICO CITY OSLO PARIS



## Summary of Actuarial Assumptions and Methods

1. The investment return rate used in making the valuations was 8% per year, compounded annually. This rate of return is not the assumed real rate of return. Considering other financial assumptions, this 8% investment return rate translates to an assumed real rate of return of 4%. Adopted 1994.
2. The mortality table used in evaluating allowances to be paid was the 1994 Group Annuity Mortality Table, set forward one year for both men and women. Adopted 1998.
3. Sample probabilities of retirement with an age and service allowance are shown in Schedule 1 on the next page. Adopted 1998.
4. Sample probabilities of withdrawal from service and disability, together with individual pay increase assumptions, are shown in Schedule 2 on the next page. Adopted 1998.
5. Total active member payroll is assumed to increase 4% per year. This represents the portion of the individual pay increase assumptions attributable to inflation. In effect, this assumes no change in the number of active members. Adopted 1998.
6. An individual entry age actuarial cost method of valuation was used in determining age and service allowance actuarial liabilities and normal cost. Unfunded actuarial accrued liabilities, including actuarial gains and losses, are financed over a period of 50 years and over a declining 40 year period for years beginning October 1, 1986. Adopted 1986.
7. The Department of Management and Budget approved the use of market value of assets as of September 30, 1997, for actuarial valuation purposes. For investment gains or losses that occur after that date, a 5-year smoothing technique will be used. Specifically, the excess (shortfall) of actual investment income (including interest, dividends, realized and unrealized gains or losses) over the imputed income at the valuation interest rate is considered the gain (loss), which is spread over 5 years. Adopted 1997.
8. The data about persons now covered and about present assets was furnished by the System's administrative staff. Although examined for general reasonableness, the data were not audited by the actuary.
9. The actuarial valuation computations were made by or under the supervision of a Member of the American Academy of Actuaries (MAAA). The assumptions used in the actuarial valuations were adopted by the System's Board after consulting with the actuary.

# ACTUARIAL SECTION

## Summary of Actuarial Assumptions and Methods (Continued)

### SCHEDULE 1

#### Percent of Eligible Active Members Retiring Within Next Year

<u>Retirement Ages</u>	<u>Percent of Eligible Active Members Retiring Within Next Year</u>
44-49 (first year eligible to retire)	50 %
44-49 (after first year eligible to retire)	25
50-57	25
58	35
59	50
60	65
61	80
62-63	100
64 and over	100

### SCHEDULE 2

#### Separation From Active Employment Before Age & Service Retirement & Individual Pay Increase Assumptions

<u>Sample Ages</u>	<u>Years of Service</u>	<u>Percent of Active Members Withdrawing Within Next Year (Men and Women)</u>	<u>Percent of Active Members Becoming Disabled Within Next Year</u>	<u>Percent Increase In Pay During Next Year*</u>
All	0	6.50 %		
	1	4.00		
20	2 & Over	2.00	0.30 %	11.30 %
25	"	2.00	0.31	10.70
30	"	1.50	0.31	7.85
35	"	0.60	0.32	6.10
40	"	0.35	0.36	5.24
45	"	0.35	0.43	4.89
50	"	0.35	0.53	4.86
55	"		0.63	4.68
60	"		0.75	4.68

\*These rates apply after 2 years of service. During the first 3 years, the assumed increases are 84%, 19% and 14% respectively.

# ACTUARIAL SECTION

## Actuarial Valuation Data

### Schedule of Active Member Valuation Data

<u>Valuation Date Sept. 30</u>	<u>Number</u>	<u>Reported Annual Payroll</u>	<u>Average Annual Pay</u>	<u>% Increase</u>	<u>Average Age</u>	<u>Average Service</u>
1994	1,992	\$ 88,623,068	\$ 44,490	(3.4) %	38.8	13.7
1995	2,181	104,500,048	47,914	7.7	37.9	13.0
1996	2,135	106,826,272	50,036	4.4	38.2	13.1
1997	2,090	110,085,960	52,673	5.3	38.2	12.9
1998	2,220	108,183,040	48,731	(7.5)	37.5	11.6
1999	2,216	116,910,216	52,757	8.3	37.0	11.5
2000	2,210	116,558,417	52,741	(0.0)	37.2	11.6
2001	2137	118,788,227	55,586	5.4	37.9	12.2
2002	2048	124,366,038	60,726	9.3	38.5	12.8
2003	1848	113,201,430	61,256	0.9	38.3	12.5

### Retirant and Beneficiary Data Rolls End of Year

<u>Year Ended Sept. 30</u>	<u>Number</u>			<u>Average Monthly Benefit</u>			<u>Average Age</u>		
	<u>Pensioners</u>	<u>Widows</u>	<u>Children</u>	<u>Pensioners</u>	<u>Widows</u>	<u>Children</u>	<u>Pensioners</u>	<u>Widows</u>	<u>Children</u>
1994	1,483	273	3	\$ 1,721	\$ 938	\$ 100	60.5	69.5	16.4
1995	1,548	279	4	1,770	962	100	60.8	69.6	14.8
1996	1612	397	6	1,845	1,001	100	61.6	69.3	10.3
1997	1,703	310	5	1,963	1,192	419	62.5	70.4	10.7
1998	1,820	314	5	2,062	1,225	499	62.8	71.0	10.1
1999	1,893	334	4	2,141	1,263	499	63.1	71.5	10.8
2000	1,968	345	6	2,227	1,308	366	61.9	71.9	10.4
2001	2,023	353	6	2,298	1,357	366	62.5	73.3	11.4
2002	2,095	361	6	2,378	1,415	366	62.6	72.7	16.3
2003	2,280	364	5	2,506	1,464	419	62.2	73.1	16.3

# ACTUARIAL SECTION

## Prioritized Solvency Test

The System's funding objective is to meet long term benefit promises through contributions that remain approximately level from year to year as a percent of member payroll. If the contributions to the System are level in concept and soundly executed, the System will pay all promised benefits when due, the ultimate test of financial soundness. Testing for level contribution rates is the long-term solvency test.

A prioritized solvency test is another means of checking a system's progress under its funding program. In a short condition test, the plan's present assets (cash and investments) are compared with: (1) active member contributions on deposit; (2) the liabilities for future benefits to present retired lives; and (3) the liabilities for service already rendered by active and inactive members. In a system that has been following the discipline of level percent of payroll financing, the liabilities for active member contributions on deposit (liability 1) and the liabilities for future benefits to present retired lives (liability 2) will be fully covered by present assets (except in rare circumstances). In addition, the liabilities for service already rendered by active members (liability 3) is normally partially covered by the remainder of present assets. Generally, if the System has been using level-cost financing, the funded portion of liability 3 will increase over time. Liability 3 being fully funded is not necessarily a by-product of level percent of payroll funding methods.

The schedule below illustrates the history of the liabilities of the System and is indicative of the System's policy of following the discipline of level percent of payroll financing.

Valuation Date	Actuarial Present Value of Actuarial Accrued Liability (in Thousands)			Valuation Assets	Portion of Present Value Covered by Assets			
	(1)	(2)	(3)		(1)	(2)	(3)	(4) <sup>3</sup>
	Active Member Contributions	Retirants and Beneficiaries	Active and Inactive Members (Employer Financed Portion)					
1994	\$ 1,770	\$ 370,681	\$ 336,847	\$ 566,541	100 %	100 %	57.6 %	79.9 %
1994 <sup>1</sup>	1,770	394,292	315,779	566,541	100	100	54.0	79.6
1995	1,497	422,960	374,363	622,626	100	100	52.9	77.9
1996	1,183	459,985	362,293	697,923	100	100	65.3	84.8
1997	847	516,379	363,100	787,240	100	100	74.4	89.4
1997 <sup>2</sup>	847	516,379	363,100	928,714	100	100	113.3	105.5
1997 <sup>4</sup>	847	516,379	395,533	928,714	100	100	104.0	101.7
1998	614	593,169	349,941	974,365	100	100	108.8	103.2
1998 <sup>1</sup>	614	604,724	357,130	974,365	100	100	103.3	101.2
1999	464	643,284	362,780	1,036,840	100	100	108.4	103.0
2000	383	685,272	355,059	1,113,065	100	100	120.3	107.0
2001	368	717,244	356,021	1,148,609	100	100	121.1	107.0
2002	329	759,929	375,400	1,141,348	100	100	101.5	100.5
2003	240	861,504	324,666	1,139,138	100	100	85.4	96.0

<sup>1</sup> Revised asset valuation assumptions.

<sup>2</sup> Revised asset valuation method.

<sup>3</sup> Percents funded on a total valuation asset and total actuarial accrued liability basis.

<sup>4</sup> Revised inflation assumption.

## Analysis of Financial Experience

### Gains/(Losses) in Accrued Liabilities During Year Ended September 30, 2003 Resulting from Differences Between Assumed Experience & Actual Experience

<u>Type of Activity</u>	<u>Gain/(Loss)</u>
1. <b>Retirements (including Disability Retirement).</b> If members retire at older ages or with lower final average pay than assumed, there is a gain. If younger ages or higher average pays, a loss.	\$ (12,749,109)
2. <b>Withdrawal From Employment</b> (including death-in-service). If more liabilities are released by withdrawals and deaths than assumed, there is a gain. If smaller releases, a loss.	2,305,586
3. <b>Pay Increases.</b> If there are smaller pay increases than assumed, there is a gain. If greater increases, a loss.	11,035,141
4. <b>Investment Income.</b> If there is greater investment income than assumed, there is a gain. If less income, a loss.	(47,609,629)
5. <b>Death After Retirement.</b> If retirants live longer than assumed, there is a loss. If not as long, a gain.	(4,937,911)
6. <b>New entrants.</b> New entrants into the System will generally result in an actuarial loss. This does not apply to plans closed to new entrants.	-
7. <b>Other.</b> Miscellaneous gains and losses resulting from data adjustments, timing of financial transactions, etc.	709,477
8. <b>Composite Gain (or Loss) During Year</b>	<u>\$ (51,246,445)</u>

# ACTUARIAL SECTION

## Summary of Plan Provisions

Our actuarial valuation of the System as of September 30, 2003, is based on the present provisions of Public Act 182 of 1986, as amended.

### ***Regular Retirement***

Eligibility — 25 years of credited service with no age requirement; or age 50 with 10 years credited service.

Annual Amount — If member has 25 or more years of credited service, 60% of final average compensation; if member has less than 25 years of credited service, total credited service times 2% of final average compensation.

Type of Final Average Compensation — Average of 2 final years.

### ***Early Retirement***

None.

### ***Deferred Retirement (vested benefit)***

Eligibility — 10 years of credited service. Benefit commences at age 50.

Annual Amount — Computed as Regular Retirement benefit based on credited service and final average compensation at termination.

### ***Duty-Disability Retirement***

Eligibility — No age or service requirement.

Annual Amount — 60% of final average compensation. Disability benefit plus workers' compensation benefit, if any, shall not exceed 100% of final average compensation.

### ***Non-Duty Disability Retirement***

Eligibility — 10 years of credited service.

Annual Amount — 2.4% of final average compensation times years of credited service, to a maximum of 60% of final average compensation.

### ***Duty Death Before Retirement***

Eligibility — No age or service requirement.

Annual Amount — 60% of final average compensation is payable to surviving spouse; additional \$1,200 per year for each child under 18 is also payable. If no surviving spouse, children under 18 share in 60% benefit until attainment of age 18. If no spouse or children, dependent parents are eligible for 60% benefit (plus \$1,200 per dependent sibling under 18). Retirement benefit plus workers' compensation, if any, shall not exceed 100% of final average compensation.

Lump Sum Payment — A \$1,500 funeral benefit is also payable.

## Summary of Plan Provisions (Continued)

### *Non-Duty Death Before Retirement*

Eligibility — 10 years of credited service.

Annual Amount — 2.4% of final average compensation times years of credited service, to a maximum of 60% of final average compensation, payable to surviving spouse. If no surviving spouse, children under 18 share in benefit until attainment of age 18.

### *Death After Retirement*

The retired member's benefit continues to the surviving spouse. If no surviving spouse, children under 18 share in the continued benefit until attainment of age 18.

### *Post-Retirement Cost-of-Living Adjustments*

All members retiring (or leaving employment with vested benefits), and their survivors, are eligible for automatic 2% annual (non-compounded) benefit increases, with a maximum annual increase of \$500.

### *Post-Retirement Health Insurance Coverage*

Persons in receipt of retirement allowances, and their dependents, are eligible for 95% State-paid health insurance coverage and 90% State-paid dental and vision insurance.

### *Member Contributions*

None.

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# STATISTICAL SECTION

Schedule of Revenues by Source  
Schedule of Expenses by Type  
Schedule of Benefit Expenses by Type  
Schedule of Retired Members by Type of Benefit  
Schedule of Average Benefit Payments  
Ten Year History of Membership

# STATISTICAL SECTION

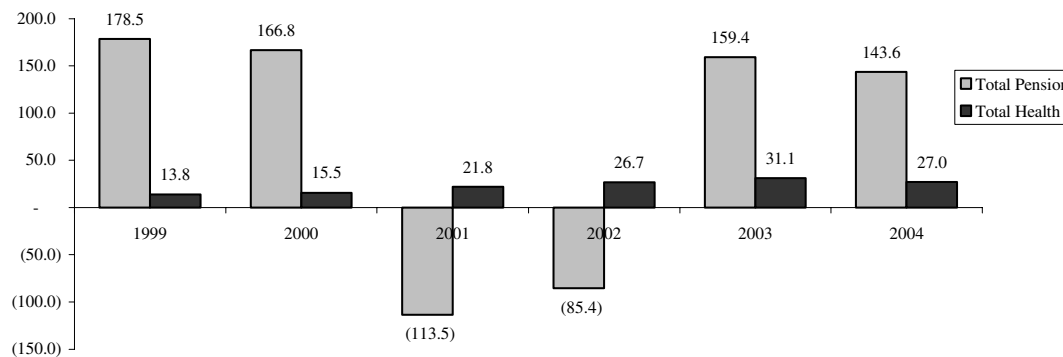
## Schedule of Pension Plan Revenues by Source

Fiscal Year Ended Sept. 30	Member Contributions	Employer Contributions		Net Investment & Other Income	Total
		Dollars	% of Annual Covered Payroll		
1999	\$ 7,679	\$ 21,609,520	18.5 %	\$ 156,896,728	\$ 178,513,927
2000	16,793	22,107,292	19.0	144,657,843	166,781,928
2001	197,234	24,064,039	20.3	(137,798,523)	(113,537,250)
2002	113,114	22,456,469	18.1	(108,017,248)	(85,447,665)
2003	78,111	25,931,762	22.9	133,377,555	159,387,428
2004	30,062	24,792,137	N/A	118,817,294	143,639,493

## Schedule of Health Plan Revenues by Source

Fiscal Year Ended Sept. 30	Member Contributions	Employer Contributions		Net Investment & Other Income	Total
		Dollars	% of Annual Covered Payroll		
1999	\$ 992,839	\$ 12,838,366	11.0 %		\$ 13,831,205
2000	1,098,440	14,421,517	12.4		15,519,957
2001	1,265,408	20,581,979	17.3		21,847,387
2002	1,380,199	25,270,639	20.3		26,650,838
2003	1,501,196	29,620,331	26.2		31,121,527
2004	1,572,372	25,426,780	N/A		26,999,152

**Total Revenue**  
Year Ended September 30  
(in millions)



# STATISTICAL SECTION

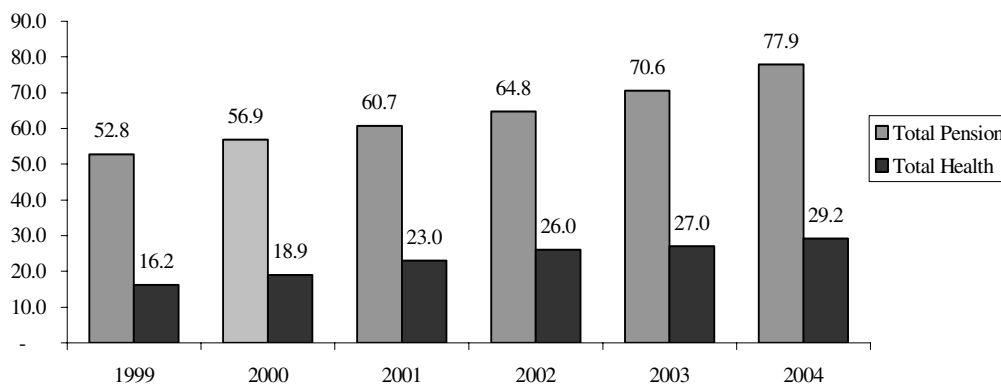
## Schedule of Pension Plan Expenses by Type

<u>Fiscal Year Ended Sept. 30</u>	<u>Benefit Payments</u>	<u>Refunds and Transfers</u>	<u>Administrative and Other Expenses</u>	<u>Total</u>
1999	\$ 52,486,589	\$ 4,694	\$ 322,997	\$ 52,814,280
2000	56,693,183		158,935	56,852,118
2001	60,407,395	6	298,711	60,706,112
2002	64,418,130		353,403	64,771,533
2003	70,152,288		423,745	70,576,033
2004	77,591,542	1,434	316,890	77,909,866

## Schedule of Health Plan Expenses by Type

<u>Fiscal Year Ended Sept. 30</u>	<u>Benefit Payments</u>	<u>Refunds and Transfers</u>	<u>Administrative and Other Expenses</u>	<u>Total</u>
1999	\$ 16,206,544			\$ 16,206,544
2000	18,938,222			18,938,222
2001	23,024,104			23,024,104
2002	26,029,522			26,029,522
2003	27,035,862			27,035,862
2004	29,195,471			29,195,471

**Total Expenses**  
Year Ended September 30  
(in millions)

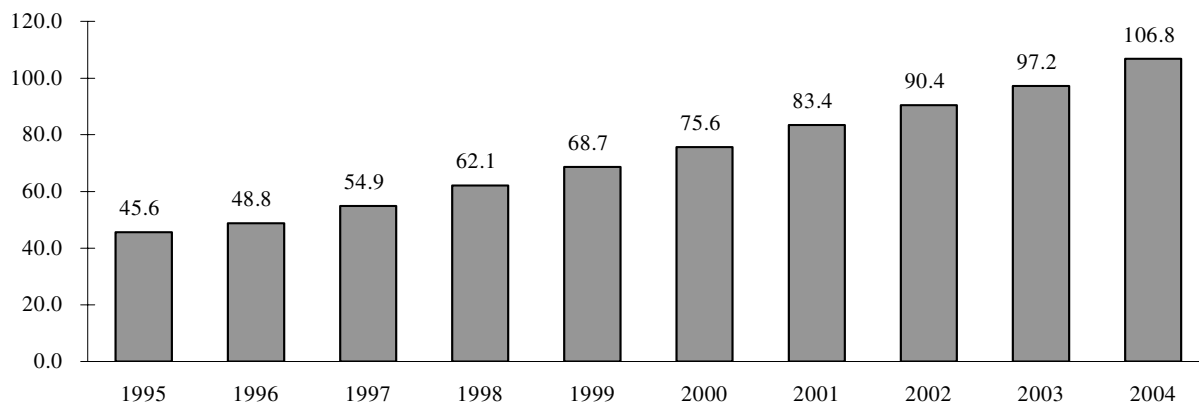


# STATISTICAL SECTION

## Schedule of Benefit Expenses by Type

<b>Fiscal Year Ended Sept. 30</b>	<b>Regular Benefits</b>	<b>Disability Benefits</b>	<b>Funeral Benefits</b>	<b>Health Benefits</b>	<b>Total</b>
1995	\$ 33,141,186	\$ 2,366,398		\$ 10,131,706	\$ 45,639,290
1996	35,794,961	2,482,429	\$ 1,500	10,516,619	48,795,509
1997	40,536,134	2,782,100		11,594,161	54,912,395
1998	45,216,692	3,010,640		13,856,103	62,083,435
1999	49,330,784	3,155,805		16,206,544	68,693,133
2000	53,466,267	3,223,915	3,000	18,938,222	75,631,405
2001	57,019,158	3,388,237		23,024,104	83,431,499
2002	60,747,711	3,670,419		26,029,522	90,447,652
2003	66,277,685	3,873,103	1,500	27,035,862	97,188,150
2004	73,358,911	4,232,631		29,195,471	106,787,013

**Total Benefit Expenses**  
**For Year Ended September 30**  
**(in millions)**



# STATISTICAL SECTION

## Schedule of Retired Members by Type of Benefit

September 30, 2003

<u>Amount Monthly Benefit</u>	<u>Number of Retirees</u>	<u>Type of Retirement *</u>						<u>Option **</u>
		<u>1</u>	<u>2</u>	<u>3</u>	<u>4</u>	<u>5</u>	<u>6</u>	<u>Life</u>
\$ 001 - 400	40	28	1	3	2	4	2	40
401 - 800	135	110	6	3	6	0	10	135
801 - 1,200	339	161	126	24	3	16	9	339
1,201 - 1,600	307	190	67	27	10	6	7	307
1,601 - 2,000	193	143	22	14	6	3	5	193
2,001 - 2,400	160	113	19	15	7	2	4	160
2,401 - 2,800	374	322	22	22	4	1	3	374
2,801 - 3,200	503	482	8	7	2	2	2	503
3,201 - 3,600	342	334	4	2	0	0	2	342
3,601 - 4,000	173	169	0	4	0	0	0	173
Over 4,000	<u>83</u>	<u>83</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>83</u>
Totals	<u>2,649</u>	<u>2,135</u>	<u>275</u>	<u>121</u>	<u>40</u>	<u>34</u>	<u>44</u>	<u>2,649</u>

\* Type of Retirement

- 1 - Normal retirement for age & service
- 2 - Survivor payment - normal retirement
- 3 - Duty disability retirement
- 4 - Non-duty disability retirement
- 5 - Survivor payment - duty death in service
- 6 - Survivor payment - non-duty death in service

\*\*Selected Option

Life - 100% Joint and Survivors

Source: The Segal Company

# STATISTICAL SECTION

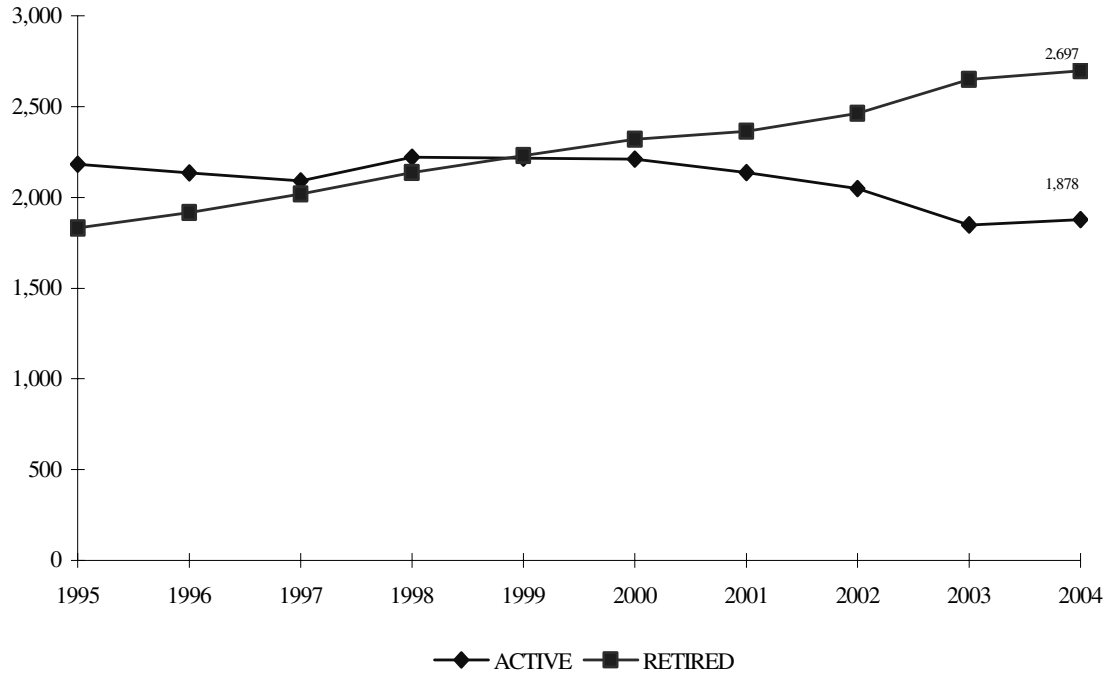
## Schedule of Average Benefit Payments

Retirement Effective Dates	Years Credited Service							Total
	0-5	5-10	10-15	15-20	20-25	25-30	30+	
Period 10/1/98 to 9/30/99:								
Average Monthly Benefit	\$ 731	\$ 1,188	\$ 819	\$ 1,114	\$ 1,351	\$ 2,084	\$ 2,392	\$ 1,936
Average Final Average Salary	2,116	21,238	23,006	22,791	26,112	36,912	44,432	34,509
Number of Active Retirants	98	22	75	70	98	1,548	227	2,138
Period 10/1/99 to 9/30/00:								
Average Monthly Benefit	\$ 746	\$ 1,196	\$ 856	\$ 1,120	\$ 1,401	\$ 2,173	\$ 2,489	\$ 2,006
Average Final Average Salary	1,852	22,257	24,530	22,790	27,318	38,441	45,879	35,702
Number of Active Retirants	112	23	85	70	102	1,601	238	2,231
Period 10/1/00 to 9/30/01:								
Average Monthly Benefit	\$ 938	\$ 1,408	\$ 854	\$ 1,124	\$ 1,421	\$ 2,267	\$ 2,569	\$ 2,086
Average Final Average Salary	8,313	25,199	24,827	23,537	27,727	39,975	47,088	37,065
Number of Active Retirants	141	25	86	67	103	1,651	246	2,319
Period 10/1/01 to 9/30/02:								
Average Monthly Benefit	\$ 1,074	\$ 1,464	\$ 891	\$ 1,164	\$ 1,451	\$ 2,344	\$ 2,618	\$ 2,154
Average Final Average Salary	11,602	26,268	25,563	24,298	27,958	41,278	47,650	38,158
Number of Active Retirants	161	29	85	63	107	1,684	253	2,382
Period 10/1/02 to 9/30/03:								
Average Monthly Benefit	\$ 1,689	\$ 1,579	\$ 915	\$ 1,299	\$ 1,572	\$ 2,546	\$ 2,848	\$ 2,359
Average Final Average Salary	14,507	31,832	25,938	27,928	29,701	44,536	50,383	39,364
Number of Active Retirants	240	32	94	69	105	1,838	271	2,649

Source: The Segal Company

# STATISTICAL SECTION

## Ten Year History of Membership Fiscal Year Ended September 30



Source: The Segal Company

## ACKNOWLEDGMENTS

The *Michigan State Police Retirement System Comprehensive Annual Financial Report* is prepared by Financial Services, Fiscal Management Division. Staff of the division for the fiscal year 2003-2004 report included:

### Management:

Patricia Lack, CPA, Director  
Ronald Foss, Accounting Manager  
Cindy Moerdyk, Accounting Manager

### Accountants:

Jennifer Ashton  
Randy Bitner  
Gina Feguer  
Nonnie Struble  
Paula Webb

### Technical and Support Staff:

Robert Johnson  
Patricia Jorae  
Kelly Manning  
Jamin Schroeder

Special thanks are also extended to the Office of Retirement Services personnel, accounting and support personnel throughout Financial Services, Investments Division of Treasury, Office of the Auditor General, Andrews Hooper & Pavlik P.L.C., The Segal Company, and the staff at the Office of Financial Management. Preparation of this report would not have been possible without the efforts of these individuals.

The report may be viewed on-line at: [www.michigan.gov/ors](http://www.michigan.gov/ors)