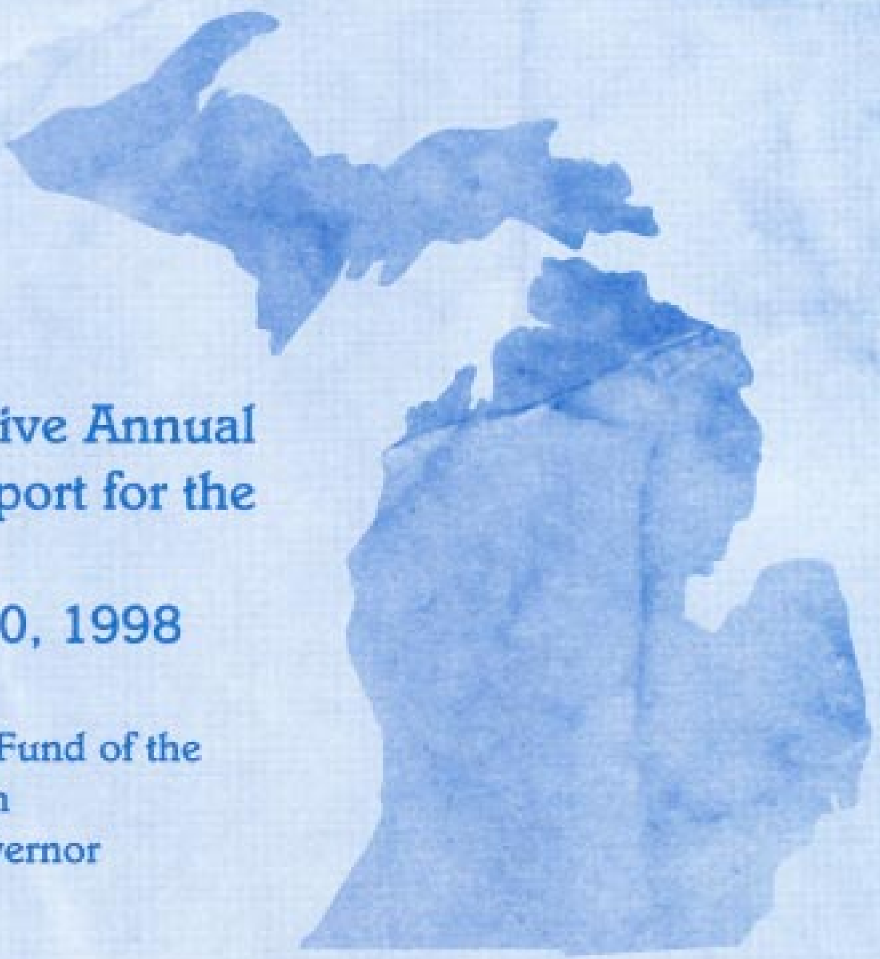
# Michigan Judges Retirement System



## Comprehensive Annual Financial Report for the Year Ended September 30, 1998

A Pension Trust Fund of the
State of Michigan
John Engler, Governor

Michigan Judges' Retirement System

# Comprehensive Annual Financial Report for the Fiscal Year Ended September 30, 1998

**MJRS**

**Prepared by:**
**Office of Retirement Services**
**Michigan Judges' Retirement System**
**7150 Harris Drive**
**P.O. Box 30171**
**Lansing, Michigan 48909-7671**
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**1-800-381-5111**

# INTRODUCTORY SECTION
## Table of Contents



The cost of printing this report was $1,353.52 ($3.38 each), which was paid for by the retirement system at no cost to the taxpayers

# INTRODUCTORY SECTION

Letter of Transmittal
Board Members
Advisors & Consultants
Organization Chart

# Letter of Transmittal

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**STATE OF MICHIGAN**

JOHN ENGLER, Governor

**DEPARTMENT OF MANAGEMENT AND BUDGET**

February 16, 1999

The Honorable John Engler
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 annual report of the Michigan Judges' Retirement System (MJRS or System) for fiscal year 1998.

Responsibility for both the accuracy of the data and the completeness and fairness of the presentation, including all disclosures, rests with the management 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 Judges' Retirement System was established by legislation under Public Act 234 of 1992 which consolidated the Judges' and former Probate Judges' retirement system. 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 judges. The services provided by the staff are performed to facilitate benefits to members.

The 1998 annual report is presented in five sections. The Introductory Section contains the transmittal letter, the identification of the administrative organization and professional consultants used by the System. The Financial Section contains the financial statements 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 Retirement System.

**MAJOR GOALS ACCOMPLISHED**

The Office of Retirement Services (ORS) accomplished several major goals and initiatives in 1998 to improve services to the Michigan Judges Retirement System.

# Letter of Transmittal (Continued)

- » The Office of Retirement Services' Customer Information Center (CIC) initiated toll-free phone service on January 30, 1998 for active and retired members who live outside the Lansing area. The CIC receives approximately 20,000 phone calls per month. In addition, the Outreach Program now makes it possible for employees of all four retirement systems to receive retirement information at four locations - Detroit, Waterford, Holland and Lansing.

- » As mandated by legislation, all Judges taking office on or after March 31, 1997, become members of a new Defined Contribution retirement plan as opposed to the Defined Benefit plan. Members hired before that date were given the option to choose whether to remain in the Defined Benefit plan or transfer to the new Defined Contribution plan. On June 30, 1998, a temporary restraining order was issued by the US Federal District Court in Detroit to halt implementation of the Defined Contribution plan for Circuit, District and Probate Judges. State Officials, Supreme Court Justices and Court of Appeals Judges who elected DC were transferred.

- » In March of 1998 the Office of Retirement Services mailed the first issue of its new Connections newsletter to all retirees, with a second issue going out in October. The objectives for this newsletter are threefold: 1) To establish a direct connection with all retirees; 2) To remind retirees ORS is available to assist them and tell them how to access that assistance, and 3) To give retirees information that will assist them in doing business with the Office of Retirement Services.

- » Reengineering has redesigned the process for disability retirement whereas a common application, procedures, policies, tracking and process flow are now used for all four retirement systems. This has laid the groundwork for reducing total processing time by 50%.

- » The Office of Retirement Services is diligently working on a year 2000 plan to assure our computer hardware and software will be ready for the new millennium and beyond so that the customers of ORS will receive benefits and information in a timely manner.

- » A pension milestone was reached in August 1998 - an annualized $2 billion in combined pension payments for State retirees, Public School retirees, State Police retirees, and retired Judges. The $1 billion mark was reached just eight years ago. This trend reinforces our ranking as the 19th largest public retirement system in the nation based on assets.

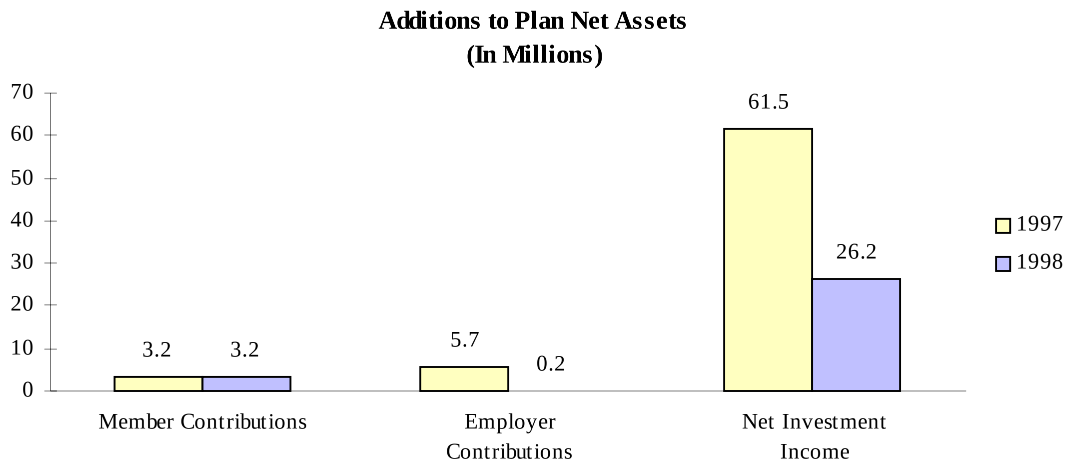
**FINANCIAL INFORMATION**

***Additions to Plan Net Assets***

The reserves needed to finance retirement and health benefits are accumulated through the collection of employer and employee contributions and through earnings on investments. Contributions and net investment income for fiscal year 1998 totaled approximately $29.7 million.

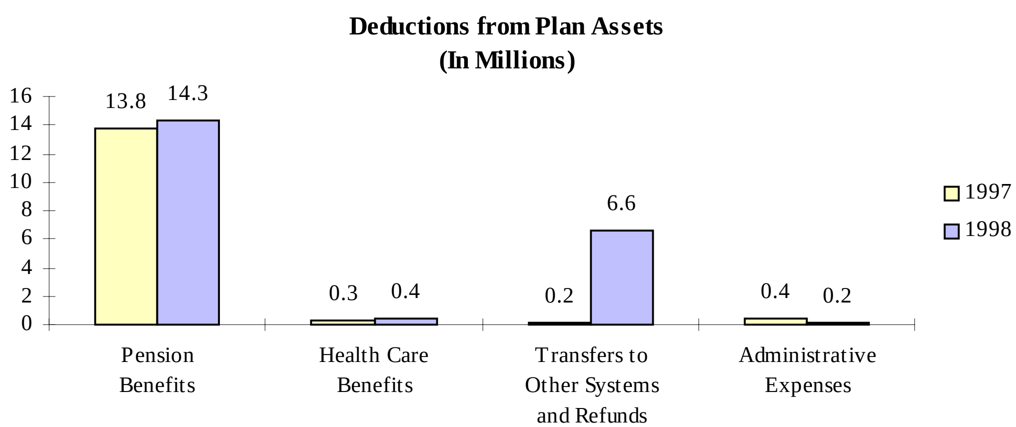
Total contributions and net investment income decreased 57.8% from those of the prior year due primarily to a decrease in employer contributions and decreased net investment earnings. Employer contributions decreased 95.7% and net investment income decreased 57.4% from the prior year. The Investment Section of this report reviews the results of investment activity for 1998.

# Letter of Transmittal (Continued)




***Deductions From Plan Assets***

The primary expenditures of the System include the payment of pension benefits to members and beneficiaries, payments for health, dental and vision benefits, refund of contributions to former members, and cost of administering the System. During fiscal year 1998, the system also transferred $6.6 million to the defined contribution plan for the judges who chose that option. The option was offered for a limited time and the decision was irrevocable. Expenditures for health care increased $37,772 from $317,751 to $355,523 during the fiscal year. Total deductions for fiscal year 1998 were $21.5 million, an increase of 45.4% over 1997 expenditures. The increase in benefit expenses resulted from a combination of increased benefits payments per retiree and increased number of retirees paid.




***Internal Control***

The management of the System is responsible for maintaining a system of adequate internal accounting control 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 generally accepted accounting principles. The internal control structure is designed to provide reasonable assurance regarding the safekeeping of assets and reliability of all financial records.

# Letter of Transmittal (Continued)

## 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 8.3%. For the last five years, the System has experienced an annualized dollar weighted rate of return of 13.0%. 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. As of September 30, 1998, the actuarial value of the assets and actuarial accrued liability of the System were $289 million and $237 million resulting in a funded ratio of 122%. As of September 30, 1997, the amounts were $271 million and $231 million respectively. 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.

## PROFESSIONAL SERVICES

An audit of the System (for fiscal year ended September 30, 1998) was conducted by Andrews, Hooper & Pavlik P.L.C., independent auditors. The auditors' 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 years ended September 30, 1998, and 1997. 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 employer and plan members to better evaluate and understand the Michigan Judges' Retirement System. Their cooperation contributes significantly to the success of MJRS.

Sincerely,

Janet E. Phipps

Janet E. Phipps, Director
Department of Management and Budget

Christopher M. DeRose

Christopher M. DeRose, Director
Office of Retirement Services

# Administrative Organization

## Retirement Board Members

Dr. James S. Neubecker, C.P.A, Chair
Deputy Auditor General
Statutory Member

Roy Pentilla
Representing State Treasurer
Statutory Member

Eric E. Doster
Trustee (General Public)
Term Expires March 31, 1999

George M. Elworth
Representing Attorney General
Statutory Member

Lyle Van Houten
Trustee (General Public)
Terms Expires March 31, 1999

## Administrative Organization

**Department of Management and Budget**
**Office of Retirement Services**
**Third Floor, Wing A, General Office Building**
**7150 Harris Drive**
**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

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

**Investment Manager and Custodian**
Douglas B. Roberts
State Treasurer
State of Michigan

**Legal Advisor**
Frank J. Kelley
Attorney General
State of Michigan

**Investment Performance Measurement**
Capital Resource Advisors
Chicago, Illinois

# Administrative Organization

## Organization Chart

**Department of Management & Budget**
**Janet E. Phipps, Director**

- **Office of Retirement Services**
  **Christopher M. DeRose, Director**
  - **Finance & Administration** — **Deborah A. Gearhart**
  - **Operations** — **Phillip J. Stoddard**
  - **Information Technology & Reengineering** — **Ginger Bomar**
  - **Customer Service** — **Laurie Hill**

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# FINANCIAL SECTION

# Independent Auditors' Report

ANDREWS HOOPER & PAVLIK P.L.C.

*4295 Okemos Road, Suite 200 • Okemos, Michigan 48864*

Ms. Janet Phipps, Director
Department of Management and Budget
Mr. Thomas H. McTavish, CPA
Auditor General
Michigan Judges
Retirement System Board:

We have audited the accompanying statement of pension plan and postemployment healthcare plan net assets of the Michigan Judges Retirement System, as of September 30, 1998 and the related statement of changes in pension plan and postemployment healthcare plan net assets for the year then ended. These financial statements are the responsibility of the management of the Michigan Judges Retirement System. Our responsibility is to express an opinion on these financial statements based on our audit. The accompanying statement of pension plan and postemployment healthcare plan net assets of the Michigan Judges Retirement System, as of September 30, 1997, and the related statement of changes in pension plan and postemployment healthcare plan net assets for the year then ended were not audited by us and, accordingly, we do not express an opinion on them.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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 audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Michigan Judges Retirement System, as of September 30, 1998, and the changes in plan net assets for the year then ended in conformity with generally accepted accounting principles.

Our audit was conducted for the purpose of forming an opinion on the 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 System's management. The Schedules of Funding Progress and Employer Contributions and related notes on pages 25 to 27 and the supporting schedules on pages 29 and 30 have been subjected to the auditing procedures applied in our audit 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 Year 2000 information on page 28 is not a required part of the basic financial statements but is supplementary 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 the supplementary information. However, we did not audit the information and do not express an opinion on it. In addition, we do not provide assurance that Michigan Judges Retirement System is or will become year 2000 compliant, that Michigan Judges Retirement System year 2000 remediation efforts will be successful in whole or in part, or that parties with which Michigan Judges Retirement System does business are or will become year 2000 compliant.

In accordance with *Government Auditing Standards*, we have also issued a report dated February 4, 1999 on our consideration of the Michigan Judges Retirement System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts.

Andrews Hooper & Pavlik P.L.C.

February 4, 1999

*Okemos 517 487-5000 • Fax 517 487-9535 / Saginaw 517 497-5300 • Fax 517 497-5353*

# Statements of Pension Plan and Postemployment Healthcare Plan Net Assets

**As of fiscal year end September 30, 1998, and 1997**

| | As of September 30, 1998 | | | Unaudited As of September 30, 1997 | | |
|---|---|---|---|---|---|---|
| | Pension Plan | Health Plan | Total | Pension Plan | Health Plan | Total |
| Assets: | | | | | | |
| Cash | $ 3,338 | $ 1 | $ 3,339 | $ 2,503,428 | $ 343 | $ 2,503,771 |
| Receivables: | | | | | | |
| Amounts due from employer | 264,169 | 93 | 264,262 | 201,620 | 28 | 201,648 |
| Interest and dividends | 1,389,967 | | 1,389,967 | 1,543,545 | | 1,543,545 |
| Sale of investments | 233,382 | | 233,382 | 342,275 | | 342,275 |
| Total receivables | 1,887,518 | 93 | 1,887,611 | 2,087,440 | 28 | 2,087,468 |
| Investments: | | | | | | |
| Short-term investments | 11,561,197 | | 11,561,197 | 24,567,420 | | 24,567,420 |
| Bonds, notes mortgages and preferred stock | 82,097,068 | | 82,097,068 | 81,270,561 | | 81,270,561 |
| Common stock | 165,156,856 | | 165,156,856 | 153,112,064 | | 153,112,064 |
| Real estate | 26,305,950 | | 26,305,950 | 19,708,357 | | 19,708,357 |
| Alternative investments | 28,689,415 | | 28,689,415 | 20,249,939 | | 20,249,939 |
| International investments | 13,446,821 | | 13,446,821 | 16,773,619 | | 16,773,619 |
| Collateral on | | | - | | | |
| loaned securities | 13,623,046 | | 13,623,046 | 11,552,820 | | 11,552,820 |
| Total investments | 340,880,353 | - | 340,880,353 | 327,234,780 | - | 327,234,780 |
| Total assets | 342,771,209 | 94 | 342,771,303 | 331,825,648 | 371 | 331,826,019 |
| Liabilities: | | | | | | |
| Warrants outstanding | (74,780) | (26) | (74,806) | (108,303) | (15) | (108,318) |
| Accounts payable and other accrued liabilities | (1,070,102) | (115,541) | (1,185,643) | (447,283) | (44,143) | (491,426) |
| Deferred Revenue | (2,263) | (1) | (2,264) | | | |
| Obligations under securities lending | (13,623,046) | | (13,623,046) | (11,552,820) | | (11,552,820) |
| Total liabilities | (14,770,191) | (115,568) | (14,885,759) | (12,108,406) | (44,158) | (12,152,564) |
| Net Assets Held in Trust for Pension and Healthcare Benefits* | $328,001,018 | $ (115,474) | $327,885,544 | $319,717,242 | $ (43,787) | $319,673,455 |

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

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

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

**For the fiscal years ended September 30, 1998, and 1997**

| | For Year Ended September 30, 1998 | | | Unaudited For Year Ended September 30, 1997 | | |
|---|---|---|---|---|---|---|
| | Pension Contributions | Health Benefits | Total | Pension Contributions | Health Benefits | Total |
| **Additions:** | | | | | | |
| Member contributions: | | | | | | |
| Military | $ 43,591 | | $ 43,591 | | | |
| Other | 2,887,279 | $ 283,836 | 3,171,115 | $ 2,928,906 | $ 279,729 | $ 3,208,635 |
| Employer contributions | | | | | | |
| Court fees | | | - | 4,080,730 | | 4,080,730 |
| General fund financing | 246,659 | | 246,659 | 1,592,853 | | 1,592,853 |
| Investment income: | | | | | | |
| Investment income | 26,448,496 | | 26,448,496 | 61,569,938 | | 61,569,938 |
| Securities lending income | 593,022 | | 593,022 | 422,324 | | 422,324 |
| Less investment expenses: | | | | | | |
| Real estate operating expenses | (21,260) | | (21,260) | (10,508) | | (10,508) |
| Securities lending expenses | (574,406) | | (574,406) | (408,348) | | (408,348) |
| Other investment expenses | (230,595) | | (230,595) | (79,223) | | (79,223) |
| Miscellaneous | 34,948 | | 34,948 | 282 | | 282 |
| **Total additions** | 29,427,734 | 283,836 | 29,711,570 | 70,096,954 | 279,729 | 70,376,683 |
| **Deductions:** | | | | | | |
| Benefits and refunds paid to plan members and beneficiaries | | | | | | |
| Retirement benefits | 14,304,553 | | 14,304,553 | 13,839,289 | | 13,839,289 |
| Health benefits | | 355,523 | 355,523 | | 317,751 | 317,751 |
| Refunds of contributions | | | - | 236,326 | | 236,326 |
| Transfers to other systems | 6,641,662 | | 6,641,662 | | | - |
| Administrative expenses | 197,743 | | 197,743 | 395,428 | | 395,428 |
| **Total deductions** | 21,143,958 | 355,523 | 21,499,481 | 14,471,043 | 317,751 | 14,788,794 |
| **Net increase (decrease)** | 8,283,776 | (71,687) | 8,212,089 | 55,625,911 | (38,022) | 55,587,889 |
| **Net Assets Held in Trust for Pension and Healthcare Benefits:** | | | | | | |
| **Beginning of year** | 319,717,242 | (43,787) | 319,673,455 | 264,091,331 | (5,765) | 264,085,566 |
| **End of year *** | $ 328,001,018 | $(115,474) | $ 327,885,544 | $ 319,717,242 | $ (43,787) | $ 319,673,455 |

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

## Notes to General Purpose Financial Statements

## NOTE 1 - PLAN DESCRIPTION

### ORGANIZATION

The Michigan Judges' Retirement System (MJRS) is a multiple employer, state-wide, defined benefit public employee retirement plan governed by the State of Michigan (State). The Michigan Judges' Retirement System, created under Public Act 234 of 1992, consolidated the former Judges' and Probate Judges' Retirement Systems (MPJRS) into one retirement system. MJRS was established by the State to provide retirement, survivor and disability benefits to judges in the judicial branch of state government. There are 316 participating employers. MJRS also includes the Governor of the State of Michigan, Lieutenant Governor, Secretary of State, Attorney General, Legislative Auditor General and the Constitutional Court Administrator.

MJRS' financial statements are included as a pension trust fund in the combined financial statements of the State of Michigan.

MJRS operates within the Michigan Department of Management and Budget, Office of Retirement Services. The Department Director appoints the Office Director who serves as Executive Secretary to the MJRS' 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, 1998, and 1997, the System's membership consisted of the following:

| Retirees and beneficiaries currently receiving benefits: | 1998 | 1997 |
|---|---|---|
| Regular benefits | 349 | 355 |
| Survivor benefits | 152 | 145 |
| Disability benefits | 13 | 12 |
| **Total** | 514 | 512 |
| Current employees: | | |
| Vested | 380 | 367 |
| Non-vested | 220 | 242 |
| **Total** | 600 | 609 |
| Inactive employees entitled to benefits and not yet receiving them | 24 | 25 |
| **Total All Members** | 1,138 | 1,146 |

Plan 1 or 2 members (Supreme Court Justice, Court of Appeals or elected officials) may enroll in the State Health Plan when they retire and their premium rate is subsidized. All other judges may enroll in the State Health Plan if they wish to, but they must pay the entire premium cost. There are a total of 514 retirees who may participate in the health benefits. The number of participants is as follows:

| Participants receiving benefits: | 1998 |
|---|---|
| Health | 80 |
| Dental | 130 |
| Vision | 96 |

## Notes to General Purpose Financial Statements

### BENEFIT PROVISIONS

Benefit provisions of the defined benefit pension plan are established by state statute, which may be amended. Public Act 234 of 1992, Michigan Judges' Retirement Act, as amended, establishes eligibility and benefit provisions for the defined benefit pension plan. Retirement benefits are determined by final compensation and years of service. Members are eligible to receive a monthly benefit when they meet certain age and service requirements. MJRS also provides disability and survivor benefits.

A member who leaves judicial service may request a refund of his or her member contribution account. A refund cancels a former member's rights to future benefits. Returning members who previously received a refund of their contributions may reinstate their service credit through repayment of the refund upon satisfaction of certain requirements. For salary, contribution and calculation of retirement benefit, the membership of the System is categorized into seven plans. The categories are based on the position to which the member was elected or appointed.

Public Act 523 of 1996, which was effective March 31, 1997, closed the plan to new entrants. Judges or state officials newly appointed or elected on or after March 31, 1997, become members of the defined contribution plan.

#### *Regular Retirement*

The retirement benefit or allowance is calculated in accordance with the formula of the plan which applies to the member. In all seven plans, the formula is based on a member's years of credited service (employment) and final compensation. The normal retirement benefit is payable monthly over the lifetime of a member.

A member may retire and receive a monthly benefit after attaining:

1. age 60 with 8 or more years of credited service; or
2. age 55 with 18 or more years of credited service (the last 6 years continuous); or
3. 25 or more years of service, the last 6 years continuous; no age requirement; or
4. age 60 with service of two full terms in the office of Governor, Lieutenant Governor, Secretary of State, or Attorney General, or one full term in the office of Legislative Auditor General.

#### *Early Retirement*

If a member leaves judicial service but has not met the age requirement for regular retirement benefits, the member may retire with a reduced retirement allowance. To be eligible for early retirement, the member must be age 55 or over, but less than 60, with 12 or more, but less than 18, years of service

#### *Deferred Retirement*

A member with 8 or more years of credited service who terminates judicial service before meeting the age requirements to receive a retirement allowance and who does not withdraw his or her contributions, is entitled to receive a monthly allowance upon reaching age 60 or age 55 with 18 years of service the last 6 of which were continuous service.

#### *Disability Benefit*

A member with 8 or more years of credited service who is totally disabled from physically or mentally performing his or her duties, is eligible for a disability pension. The disability benefit is computed in the same manner as an age and service allowance based upon service and final salary at the time of disability.

## Notes to General Purpose Financial Statements

***Pension Payment Options***

A pension is payable monthly for the lifetime of a MJRS retiree and equals 3% of final salary times years of service for up to 12 years of service; or 50% of salary with 12 years, increased 2.5% for each additional year up to a maximum of 60% of salary. A former MPJRS retiree receives 3% of salary times years of service, to a maximum of the greater of 40% of salary or $15,000 but not to exceed 66 2/3% of final salary when added to a county pension; or 3.5% of salary times years of service with a maximum of two thirds of final salary, if elected.

Option A — Under this option, after the retiree's death, the beneficiary will receive 100% of the pension for the remainder of the beneficiary's lifetime. If this option is elected, the normal retirement benefit is reduced by a factor based upon the ages of the retiree and of the beneficiary.

Option B — Under this option, after the retiree's death, the beneficiary will receive 50% of the pension for the remainder of the beneficiary's lifetime. If this option is elected, the normal retirement benefit is reduced by a factor based upon the ages of the retiree and of the beneficiary. The reduction factor is smaller than the factor used in Option A above.

***Survivor Benefit***

A survivor benefit may be paid if (i) a member who has 8 or more years of credited service dies while in office, (ii) a vested former member dies before retirement, or (iii) a retiree dies following retirement.

***Contributions***

Member Contributions — Members currently participate in MJRS on a contributory basis. For contribution purposes, the membership of the System is categorized in seven plans, which are based on the position to which the member was elected or appointed. Under certain circumstances, members may contribute to the System for the purchase of creditable service, such as military service or other public service. If a member terminates MJRS covered employment before a retirement benefit is payable, the member's contribution and interest on deposit may be refunded. If the member dies before being vested, the member's contribution and interest are refunded to the designated beneficiaries.

Publicly Financed Contributions — There are two public sources which fund retirement benefits: Court fees and State appropriations. The State contributes annually the greater of 3.5% of the aggregate annual compensation of State paid base salaries, or the difference between the total actuarial requirement of current service and unfunded accrued liabilities minus the revenues from court filing fees and member contributions. Since the system was fully funded, the appropriation was not requested for fiscal year 1998. If the court fees deposited in the reserve for employer contributions equals the amount needed in addition to other publicly financed contributions to sustain the required level of publicly financed contributions, Section 304(4) requires court fees be deposited in the court fee fund. In accordance with Section 304(4) of the Judges' Retirement Act, the court fees are being deposited in the court fee fund in the state treasury. A chart showing the publicly financed contribution rates is included in the Schedule of Revenue by Source in the Statistical Section.

***Other Post Employment Benefits***

Under the Michigan Judges' Retirement Act, plan 1 or 2, members may enroll in the State Health Plan when they retire. Five percent of the health insurance premium is deducted from the monthly pension check until age 65, at which time Medicare provides primary health insurance coverage. All other members may enroll in the State Health Plan during an open enrollment period. The total premium is deducted from the monthly pension check.

All retirees may enroll in the State Dental and/or Vision Plan during an open enrollment period. The cost of the premiums are deducted from the monthly pension check.

Retirees of plan 1 and 2 are provided with life insurance coverage equal to 25% of the active life insurance coverage and $1,000 for each dependent. Premiums are fully paid by the State for plan 1 and 2 members. All others must pay the full premium.

## Notes to General Purpose Financial Statements

***Transfer to Defined Contribution Plan***

During fiscal year 1998, the JRS Retirement Act provided members an opportunity to transfer to the defined contribution plan. The decision is irrevocable and the transfer was completed by September 30, 1998. A total of 13 vested individuals with funds totaling $6,641,662 was transferred. No judges that were not vested were transferred. This was a one-time opportunity. With the passage of the legislation permitting the transfer, the System also became a closed system. All new judges and officials are members of the defined contribution plan.

## NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

***Basis of Accounting and Presentation***

MJRS' financial statements are prepared using the accrual basis of accounting. Court filing fees are recognized as revenue in the period received. Contributions from the State are recognized as revenue in the period in which employees provide service and expenses are recorded when incurred regardless of when payment is made. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

***Reserves***

Public Act 234 of 1992, as amended, created several reserve accounts. The reserves are described below.

<u>Reserve for Member Contributions</u> — This fund represents active member contributions, payments for the purchase of service credit, repayment of previously refunded contributions and interest less amounts transferred to the Reserve for Retirement Benefits for regular and disability retirement, amounts refunded to terminated members, and transferring inactive accounts. At September 30, 1998, and 1997, the balance in this account was $61 million and $40 million respectively.

<u>Reserve for Employer Contributions</u> — Court fees, late fees, interest payments, employer contributions, and state appropriations. Amounts are transferred annually from this reserve to the Reserve for Retirement Benefits to fund that reserve. In addition, the reserve transfers court fees to the Supreme Court in accordance with statutory requirements. At September 30, 1998, and 1997, the balance in this account was $90 million and $103 million respectively.

<u>Reserve for Retirement Benefits</u> — This reserve represents the reserves for payment of future retirement benefits to current retirees. At retirement, a member’s accumulated contributions plus interest are transferred into this reserve from the Reserve for Member Contributions and the Reserve for Employer Contributions. Monthly benefits, which are paid to the member, reduce the reserve. At the end of each fiscal year, an amount is transferred from the Reserve for Employer Contributions to bring the balance into balance with the actuarial present value of retirement allowances. At September 30, 1998, and 1997, the balance in this account was $110 million and $115 million respectively.

<u>Reserve for Investment Income</u> — This reserve is credited with all investment earnings, changes in fair values, gifts to the Retirement System, and forfeited contributions. All administrative expenses are paid from this reserve and interest is transferred annually to the other reserves. At September 30, 1998, and 1997, the balance in this account was $67 million and $62 million respectively.

<u>Reserve for Health Benefits</u> — This reserve is credited with member contributions for health benefits. Health benefits are paid from this reserve. At September 30, 1998, and 1997, the balance in this account was negative $115 thousand and negative $44 thousand respectively.

## Notes to General Purpose Financial Statements

***Fair Value of Investments***

Plan investments are presented at fair value, except for short-term investments. Short-term investments are carried at cost, which 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.

***Reporting Entity***

MJRS is a pension trust fund of the State of Michigan. As such, MJRS is considered part of the State and is included in the State's comprehensive annual financial report as a pension trust fund. MJRS and the MJRS' board are not financially accountable for any other entities. Accordingly, MJRS is the only entity included in this financial report.

***Investment Income***

Dividend income is recognized based on the ex-dividend date and interest income is recognized on the accrual basis as earned. 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 transactions as of the settlement date does not materially affect the financial statements.

***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 Plan Net Assets. Such assets are depreciated on a straight line basis over 10 years. MJRS does not have equipment that falls within these parameters.

***Related Party Transactions***

Leases and services — The Retirement 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 MJRS for such services.

| | **1998** | **1997** |
|---|---|---|
| Building rentals | $ 1,071 | $ 6,371 |
| Data processing services | 12,296 | 132,824 |
| Legal | 2,318 | 19,046 |
| Investment | 55,725 | 70,283 |

Common Cash — The cash account includes $ 3,339 and $2,503,771, on September 30, 1998, and 1997, respectively, which represents funds deposited 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 $ 72,837 and $114,447 for the years ended September 30, 1998, and 1997, respectively.

***Reclassification of Prior Year Amounts***

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

## Notes to General Purpose Financial Statements

### NOTE 3 - CONTRIBUTIONS

Members' contributions range from 3.5% to 7% of their salary depending on the plan (described in statute). Contributions are tax deferred under Section 414(h)(2) of the Internal Revenue Code, except for probate judges whose contributions are tax deferred only if the local unit of government has adopted a resolution to do so. Contribuition provisions are specified by state statute and may be amended only by action of the state legislature.

The State contributes annually the greater of 3.5% of the aggregate annual compensation of State paid base salaries, or the difference between the total actuarial requirem ent of current service and unfunded accrued liabilities minus the revenues from court filing fees and member contributions. Since the system was fully funded, the appropriation was not requested for fiscal year 1998. If the court fees deposited in the reseve for employer contributions equals the amount needed in addition to other publicly financed contributions to sustain the required level of publicly financed contributions, Section 304(4) requires court fees be deposited in the court fee fund. In accordance with Section 304(4) of the Judges' Retirement Act, the court fees are being deposited in the court fee fund in the state treasury. The state treasurer transmits the money in the court fee fund, not exceeding $2.2 million in any fiscal year, to the court equity fund for operational expenses of trial courts.

Employer contributions are determined annually by the System's actuary and are based upon level-percent-of-payroll funding principles. Under this method, amortization payments are calculated so that they are a constant percentage of the projected payroll of active plan members over a given period of time.

Employer contributions were $247 thousand and $5.7 million for fiscal year 1998 and 1997, respectively.

### NOTE 4 - INVESTMENTS

***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 stock, 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 of defraying the expenses of investing the assets.

Under Public Act 314 of 1965, as amended, the State Treasurer may invest up to 5% of the System's assets in alternative investments and up to 15% of the System's assets may be invested in investments not otherwise qualified under the act. Alternative investments include limited partnerships and distribution from these partnerships in the form of bonds, common stock and preferred stock.

***Derivatives***

The State Treasurer does not employ the use of derivatives in the investment of the Common Cash or the investment of trust funds other than the pension trust funds.

Derivatives are used for a small amount of the pension trust fund portfolios. However, derivatives are not used for speculation and they are not used to leverage the investment portfolios. Less than 6% of the total pension trust fund's portfolio has been invested from time to time in future contracts, collateralized mortgages and swap agreements. Swap agreements represent the largest category of derivatives used and represented 4.1% of the total portfolio at market values.

To further diversify the pension fund's portfolio into international equities, the State Treasurer has entered into swap agreements with investment grade counterparties which are tied to stock market indices in eighteen foreign countries. The notional amounts of the swap agreements at September 30, 1998, and 1997, were $13.7 million and $13.9 million, respectively. One half of the notional amount is hedged against foreign currency fluctuations. The swap agreements provide that the retirement 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 pension fund will either receive the increase in the value of the international equity indices from the level of the indices at the inception of the agreements, or pay the decrease in the value of the indices. Swap agreement maturities range from October 1998 to December 2001.

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 upon the intention to hold all swap agreements until maturity. Since the inception of the international equity investment program, over $3.9 million of gains on international equity exposure and excess interest received have been realized. The unrealized loss of $.5 million at September 30, 1998, reflects the decrease in international indices and higher notional cost levels following realization of gains in the months prior to September.

The respective September 30, 1998, and 1997 values are as follows:

| | Notional Value | Book Value | Current Value |
|---|---|---|---|
| 9/30/98 (dollars in millions) | $ 13.72 | $13.99 | $13.45 |
| 9/30/97 (dollars in millions) | 13.92 | 13.79 | 16.77 |

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

MJRS did not hold an individual investment (other than U.S. Government securities) that exceeded 5% of net assets available for benefits at September 30, 1998, or 1997.

***Securities Lending***

State statutes do not prohibit the retirement system from participating in securities lending transactions, and the retirement 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 retirement system, the retirement 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 issued by a person other than the borrower or an affiliate of the borrower 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) in the case of loaned securities denominated in United States dollars or whose primary trading market as located in the United States or sovereign debt issued by foreign governments, 102% of the market value of the loaned securities; and (ii) in the case of loaned securities not denominated in United States dollars or whose primary trading market was not located in the United States, 105% of the market value of the loaned securities.

The retirement 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 retirement 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, 1998, such investment pool had an average duration of 64 days and an average weighted maturity of 504 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,

## Notes to General Purpose Financial Statements

1998, the retirement system had no credit risk exposure to borrowers. The collateral held and the market value of securities on loan for the retirement system as of September 30, 1998, were $14,093,011 and $13,552,626 respectively.

Gross income from security lending for the fiscal year was $593,022. Expenses associated with this income amounted to $568,079 for the borrower's rebate and $6,327 for fees paid to the agent.

### *Categories of Investment Risk*

Investments made by the fund, including repurchase agreements and information concerning reverse repurchase agreements, are summarized below. The investments that are represented by specific identifiable investment securities are classified as to credit risk in three categories.

Category 1 includes investments that are insured, registered, or held by MJRS or its agent in MJRS' name. Category 2 includes uninsured and unregistered investments that are held by the counterparty's trust department or agent in MJRS' name. Category 3 includes uninsured and unregistered investments that are held by the counterparty, its trust department, or agent, but not in MJRS' name.

At September 30, 1998, all investments of the pension trust fund were classified as Category 1, except for certain investments that were not categorized.

The following table summarizes the investments:

| **Category 1** | **1998** | **1997** |
|---|---|---|
| Prime Commercial Paper | $ 7,311,413 | $ 19,090,856 |
| Short Term Note | 4,249,784 | 5,476,564 |
| Government Securities | 36,979,638 | 43,036,675 |
| Corporate Bonds & Notes | 33,258,294 | 30,260,206 |
| Convertible Bonds | 0 | 160,383 |
| Preferred Stock | 8,762 | 3,761 |
| Equities | 160,098,246 | 147,915,148 |
| Real Estate | 2,437,295 | 2,205,485 |
| Alternative Investments | 1,065,975 | 980,882 |
| Derivatives (International) | 13,446,821 | 16,773,619 |
| **Total Category 1** | $ 258,856,228 | $ 265,903,579 |
| **Non-Categorized** | | |
| Private Placements | $ 3,542,905 | $ 1,248,946 |
| Mortgages | 272,031 | 527,692 |
| Real Estate | 23,868,655 | 17,502,872 |
| Alternative Investments | 27,623,440 | 19,269,057 |
| Cash Collateral | 13,623,046 | 11,552,820 |
| Securities on Loan: | | |
| Government Securities | 7,358,715 | 5,991,661 |
| Corporate Bonds & Notes | 676,723 | 41,237 |
| Equities | 5,058,610 | 5,196,916 |
| **Total Non-Categorized** | $ 82,024,125 | $ 61,331,201 |
| **Grand Total** | $ 340,880,353 | $ 327,234,780 |

## NOTE 5 - COMMITMENT AND CONTINGENCIES

***Michigan Judges Association et al v. State Treasurer et al***

Plaintiffs in the case obtained a restraining order to stop the implementation of an irrevocable date of Midnight June 30, 1998, concerning plaintiffs' election of pension plans (a switch from current DB plan-Tier 1 to the states' DC plan-Tier 2).

Under current law, the effective date for participation in the defined contribution plan for members of the Judges Retirement System was July 1, 1998. Because eligibility and compensation issues for Circuit, District and Probate Court judges were still unanswered by the Internal Revenue Service on that date, full participation by those judges in the defined contribution plan was not allowed pending Internal Revenue Service determination. This action at the State Level was confirmed by an injunctive order entered by the Federal District Court for the Eastern District of Michigan in a lawsuit brought by various judges and judges' associations. The outcome and potential range of loss cannot be determined.

***Fox et al v. Judges Retirement System***

The System is named as defendant in a case that alleges the statute discriminates against certain members as a result of differences in contribution rates and benefit allowances.

***Other***

Under the Administrative Procedures Act, members may appeal a decision made 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 adminitrative procedures have been appealed in the court system. The 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 MJRS' 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**

| Valuation Date Sept. 30 | Actuarial Value of Assets (a) | Actuarial Accrued Liability (AAL) ** (b) | Unfunded (Overfunded) Actuarial Accrued Liability (b-a) | Funded Ratio (a/b) | Covered Payroll (c) | UAAL as a % of Covered Payroll ((b-a)/c) |
|---|---|---|---|---|---|---|
| 1990 | $ 150,024,407 | $ 163,107,674 | $ 13,083,267 | 92.0 % | $ 43,081,777 | 30.4 % |
| 1991 | 162,053,379 | 171,279,850 | 9,226,471 | 94.6 | 43,905,860 | 21.0 |
| 1992 | 171,969,030 | 179,495,676 | 7,526,646 | 95.8 | 43,840,733 | 17.2 |
| 1993 | 187,736,576 | 192,962,549 | 5,225,973 | 97.3 | 44,472,833 | 11.8 |
| 1993+ | 189,133,980 | 192,426,903 | 3,292,923 | 98.3 | 44,472,833 | 7.4 |
| 1994 | 202,370,785 | 196,990,884 | (5,379,901) | 102.7 | 46,276,785 | (11.6) |
| 1995 | 222,229,865 | 204,326,966 | (17,902,899) | 108.8 | 48,195,528 | (37.1) |
| 1996 | 243,248,207 | 211,500,798 | (31,747,409) | 115.0 | 49,350,572 | (64.3) |
| 1997 | 271,457,805 | 230,511,070 | (40,946,735) | 117.8 | 49,000,856 | (83.6) |
| 1998 | 288,671,130 | 236,520,337 | (52,150,793) | 122.0 | 48,865,572 | (106.7) |

+ Revised actuarial assumptions and asset valuation method.
** Under entry age actuarial cost method.

# Required Supplementary Information (Continued)

## Schedule of Employer Contributions

| Fiscal Year Ending Sept. 30 | Annual Required Contribution (ARC) | Actual Employer Contributions | Percentage Contributed |
|---|---|---|---|
| 1989 | $7,111,349 | $7,270,173 | 102.2% |
| 1990 | 7,276,275 | 7,562,504 | 103.9 |
| 1991 | 7,566,113 | 7,923,138 | 104.7 |
| 1992 | 7,137,221 | 7,996,188 | 112.0 |
| 1993* | 7,112,624 | | |
| 1993 | 6,661,731 | 7,687,638 | 115.4 |
| 1994 | 6,638,110 | 6,576,996 | 99.1 |
| 1995 | 6,559,552 | 6,228,812 | 95.0 |
| 1996 | 5,992,698 | 6,191,607 | 103.3 |
| 1997 | 5,527,350 | 5,673,583 | 102.6 |
| 1998 | 5,040,121 | 246,659 | 4.9 |

* Revised actuarial assumptions.

## Notes to Required Supplemental Information

### NOTE A - DESCRIPTION

Ten year historical trend information designed to provide information about MJRS' 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 pension plan 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 MJRS 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 | 09/30/98 |
| Actuarial Cost Method | Entry Age, Normal |
| Amortization Method | Level Percent, Closed |
| Remaining Amortization Period | 38 years |
| Asset Valuation Method | 5-Year Smoothed Market |
| Actuarial Assumptions: | |
| Inflation Rate | 5% |
| Investment Rate of Return | 8% |
| Projected Salary Increases | 5.5% |
| Cost-of-Living Adjustments | None |

# Required Supplementary Information (Continued)

## YEAR 2000

In October 1998, the Governmental Accounting Standards Board (GASB) issued Technical Bulletin 98-1, entitled *Disclosures about Year 2000 Issues.* The provisions of the GASB technical bulletin, as amended by Technical Bulletin 99-1, require the System to make disclosures about its readiness in addressing year 2000 issues for its computer systems and other electronic equipment.

The year 2000 issue is the result of shortcomings in the manner in which "year" information is stored and interpreted by many electronic data processing systems and other electronic equipment. Operations may be adversely affected if critical systems and equipment are not made year 2000 compliant. The year 2000 issue will impact not only internal operations, but also interactions with external parties such as other governmental entities and critical vendors. To address the year 2000 issues, the State established the Year 2000 Project Office within the Department of Management and Budget (DMB). The Year 2000 Project Office's mission is to lead, support, and facilitate achievement of year 2000 compliance throughout the state's executive branch to ensure uninterrupted service to Michigan's citizens. The Year 2000 Project Office is monitoring year 2000 compliance efforts at the various agencies and is providing assistance and assigning resources to accelerate compliance for all mission cirtical systems and equipment. Additional disclosure regarding the status of statewide systems year 2000 compliance efforts upon which MJRS is dependent can be found in the State of Michigan's Comprehensive Annual Financial Report.

MJRS' in conjunction with the Year 2000 Project Office, DMB is subjecting those systems and equipment to the following stages of work to address year 2000 issues:

Awareness stage — Establishing a budget and project plan for dealing with the year 2000 issue.
Assessment stage — Identifying the systems and components for year 2000 compliance.
Remediation stage — Making changes to systems and equipment.
Validation/testing stage — Validating and testing the changes that were made during the remediation stage.

MJRS has identified the computer systems and electronic equipment that are critical to its operations, and the following is a summary of progress towards achieving year 2000 compliance:

Internal Systems:
Common Pension Payroll -- MJRS has completed the assessment, remediation, validation and testing stages of these systems. In addition, in 1999 there will be additional testing of these systems and on other non-critical systems.

As of year-end, MJRS has a commitment to spend approximately $45 thousand to make critical computer systems and equipment year 2000 compliant.

External Factors:
There can be no assurance that organizations and governmental agencies with which MJRS interacts, including banks, vendors, customers, state and federal governments will be year 2000 compliant. With regard to these external organizations, MJRS is currently in the process of obtaining assurances that their systems will be ready for the year 2000. If issues are identified, action plans will be instituted as necessary. However, even if the systems of both are compliant in a timely manner, problems could arise with communications between systems if compliance is achieved through inconsistent approaches or methodologies.

Because of the unprecedented nature of the year 2000 issue, its effects and the success of related remediation efforts will not be fully determinable until the year 2000 and thereafter. Management cannot assure that MJRS is or will be year 2000 ready, or that MJRS' remediation efforts have been successful in whole or in part. However, management believes that it has instituted a plan to minimize the impact that the year 2000 issue may have on ciritical operations.

# Supporting Schedules

## Comparative Summary Schedule of Pension Plan Administrative Expenses For the Years Ended September 30, 1998 and 1997

| | 1998 | 1997 |
|---|---|---|
| Personnel Services: | | |
| Staff salaries | $ 71,945 | $ 108,212 |
| Retirement and social security | 16,570 | 25,278 |
| Other fringe benefits | 2,106 | 14,151 |
| Total | 90,621 | 147,641 |
| Professional Services: | | |
| Actuarial | 32,560 | 18,505 |
| Accounting, records mgt., and mail | 3,898 | 2,772 |
| Data processing | 12,296 | 132,824 |
| Attorney general | 2,318 | 19,046 |
| Audit | 46,800 | 50,700 |
| Medical | - | 125 |
| Total | 97,872 | 223,972 |
| Building and Equipment: | | |
| Building rentals | 1,071 | 6,371 |
| Equipment purchase, maintenance and rentals | 307 | 772 |
| Total | 1,378 | 7,143 |
| Miscellaneous: | | |
| Office administrative support | 688 | 688 |
| Department administrative support | 202 | 2,367 |
| Travel and meetings | 343 | 249 |
| Postage, telephone, and other | 6,271 | 13,126 |
| Customer Information Center | 368 | 242 |
| Total | 7,872 | 16,672 |
| Total Administrative Expenses | $ 197,743 | $ 395,428 |

# Supporting Schedules (Continued)

## Schedule of Investment Expenses

| | 1998 | 1997 |
|---|---|---|
| Real Estate | $ 21,260 | $ 10,508 |
| Securities Lending Expense | 574,406 | 408,348 |
| Other Investment Expense | 230,595 | 79,223 |
| **Total Investment Expenses** | $ 826,261 | $ 498,079 |

## Schedule of Payments to Consultants

| | 1998 | 1997 |
|---|---|---|
| Auditor General | $ 46,800 | $ 50,700 |
| Attorney General | 3,523 | 19,046 |
| Actuary | 32,560 | 18,505 |
| **Total Payments** | $ 82,883 | $ 88,376 |

# Supporting Schedules (continued)

## Detail of Changes in Plan Net Assets (Pension and Postemployment Healthcare Benefits)

| | For Year Ended September 30, 1998 | | | | | |
|---|---|---|---|---|---|---|
| | Member Contributions | Employer Contributions | Retirement Benefits | Health Benefits | Investment Income | Total |
| **Additions:** | | | | | | |
| Member contributions: | | | | | | |
| Military | $ 43,591 | | | | | $ 43,591 |
| Other | 2,887,279 | | | $ 283,836 | | 3,171,115 |
| Employer contributions | | | | | | |
| Court fees | | | | | | |
| General fund financing | | $ 246,659 | | | | 246,659 |
| Investment income: | | | | | | |
| Investment income | | | | | $ 26,448,496 | 26,448,496 |
| Securities lending income | | | | | 593,022 | 593,022 |
| Less investment expenses: | | | | | | |
| Real estate operating expenses | | | | | (21,260) | (21,260) |
| Securities lending expenses | | | | | (574,406) | (574,406) |
| Other investment expenses | | | | | (230,595) | (230,595) |
| Miscellaneous | | 34,948 | | | | 34,948 |
| **Total additions** | 2,930,870 | 281,607 | | 283,836 | 26,215,257 | $ 29,711,570 |
| **Deductions:** | | | | | | |
| Benefits and refunds paid to plan members and beneficiaries | | | | | | |
| Retirement benefits | | | $ 14,304,553 | | | 14,304,553 |
| Health benefits | | | | 355,523 | | 355,523 |
| Transfers to other systems | 1,013,715 | 5,627,947 | | | | 6,641,662 |
| Administrative expenses | | | | | 197,743 | 197,743 |
| **Total deductions** | 1,013,715 | 5,627,947 | 14,304,553 | 355,523 | 197,743 | 21,499,481 |
| **Net increase (decrease)** | 1,917,155 | (5,346,340) | (14,304,553) | (71,687) | 26,017,514 | 8,212,089 |
| **Other changes in net assets:** | | | | | | |
| Interest allocation | 2,995,286 | 8,264,521 | 9,220,295 | | (20,480,102) | - |
| Transfers upon retirements | (1,171,073) | | 1,171,073 | | | - |
| Transfers of employer shares | | (7,540,041) | 7,540,041 | | | - |
| Total other changes in net assets | 1,824,213 | 724,480 | 17,931,409 | - | (20,480,102) | - |
| **Net Increase (Decrease) After Other Changes** | 3,741,368 | (4,621,860) | 3,626,856 | (71,687) | 5,537,412 | 8,212,089 |
| **Net Assets Held in Trust for Pension and Healthcare Benefits:** | | | | | | |
| **Beginning of year** | 39,636,876 | 103,306,512 | 115,253,689 | (43,787) | 61,520,165 | 319,673,455 |
| **End of year** | $ 43,378,244 | $ 98,684,652 | $ 118,880,545 | $ (115,474) | $ 67,057,577 | $ 327,885,544 |

# Supporting Schedules (continued)

## Detail of Changes in Plan Net Assets (Pension and Postemployment Healthcare Benefits)

| | For Year Ended September 30, 1997 (Unaudited) | | | | | |
|---|---|---|---|---|---|---|
| | Member Contributions | Employer Contributions | Retirement Benefits | Health Benefits | Investment Income | Total |
| **Additions:** | | | | | | |
| Member contributions: | | | | | | |
| Military | | | | | | |
| Other | $ 2,928,906 | | | $ 279,729 | | $ 3,208,635 |
| Employer contributions | | | | | | |
| Court fees | | $ 4,080,730 | | | | 4,080,730 |
| Other | | 1,592,853 | | | | 1,592,853 |
| Investment income: | | | | | | |
| Investment income | | | | | $ 61,569,938 | 61,569,938 |
| Securities lending income | | | | | 422,324 | 422,324 |
| Less investment expenses: | | | | | | |
| Real estate operating expenses | | | | | (10,508) | (10,508) |
| Securities lending expenses | | | | | (408,348) | (408,348) |
| Other investment expenses | | | | | (79,223) | (79,223) |
| Miscellaneous | | | | | 282 | 282 |
| **Total additions** | 2,928,906 | 5,673,583 | | 279,729 | 61,494,465 | 70,376,683 |
| **Deductions:** | | | | | | |
| Benefits and refunds paid to plan members and beneficiaries | | | | | | |
| Retirement benefits | | | $ 13,839,289 | | | 13,839,289 |
| Health benefits | | | | 317,751 | | 317,751 |
| Refunds of contributions | 160,696 | 75,630 | | | | 236,326 |
| Administrative expenses | | | | | 395,428 | 395,428 |
| **Total deductions** | 160,696 | 75,630 | 13,839,289 | 317,751 | 395,428 | 14,788,794 |
| **Net increase (decrease)** | 2,768,210 | 5,597,953 | (13,839,289) | (38,022) | 61,099,037 | 55,587,889 |
| **Other changes in net assets:** | | | | | | |
| Interest allocation | 2,886,177 | 6,244,437 | 7,496,352 | | (16,626,966) | |
| Transfers upon retirements | (4,783,715) | | 4,783,715 | | | |
| Transfers of employer shares | | (4,503,342) | 4,503,342 | | | |
| Total other changes in net assets | (1,897,538) | 1,741,095 | 16,783,409 | | (16,626,966) | |
| **Net Increase (Decrease) After Other Changes** | 870,672 | 7,339,048 | 2,944,120 | (38,022) | 44,472,071 | 55,587,889 |
| **Net Assets Held in Trust for Pension and Healthcare Benefits :** | | | | | | |
| **Beginning of year** | 38,766,204 | 95,967,464 | 112,309,569 | (5,765) | 17,048,094 | 264,085,566 |
| **End of year** | $ 39,636,876 | $ 103,306,512 | $ 115,253,689 | $ (43,787) | $ 61,520,165 | $ 319,673,455 |

# INVESTMENT SECTION

## Report on Investment Activity

### INTRODUCTION

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

The IAC 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 Consumer and Industry Services and the Director of the Department of Management and Budget are ex-officio members. The members of the IAC are as follows: Mr. Samuel Valenti III (public member), Farris W. Womack (public member), Jerry L. Tubergen (public member), Kathleen M. Wilbur (ex-officio member), and Janet E. Phipps (ex-officio member). The public members serve without pay, but are paid actual and necessary travel and other expenses.

### INVESTMENT POLICY & GOAL

The primary function of the MJRS 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 fund are:

1. To outperform the actuarial assumption over the long-term.
2. To produce competitive results at a low cost.
3. To achieve a delicate balance between risk and return.
4. To perform in the top half of the Capital Resource Advisors public plan universe.
5. To exceed individual asset class benchmarks over the long-term.

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

| | Asset Allocation | |
|---|---|---|
| **Investment Category** | **As of 9/30/98 Actual %** | **Target %** |
| Mortgages | 0.1% | 0.0% |
| International Equity | 4.1% | 7.5% |
| Real Estate | 8.0% | 8.5% |
| Alternative Investments | 8.8% | 7.5% |
| Short Term Investments | 3.5% | 1.5% |
| Fixed Income | 25.0% | 25.5% |
| Domestic Equity | 50.5% | 49.5% |
| TOTAL | 100.0% | 100.0% |

## Report on Investment Activity

**STATE LAW**

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 Act 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.

**PROXY VOTING POLICY**

MJRS' Proxy Voting Policy sets forth directives on the following issues: Board of Directors, Corporate Governance, Social Issues, corporate restructurings and defenses. All proxies are reviewed and voted in accordance with the above mentioned items.

**INVESTMENT RESULTS**

***Total Portfolio Result***

For the fiscal year ended September 30, 1998, the total portfolio returned 8.3%, compared to the median of 6.6% of state plans, including MJRS, as compiled by Capital Resource Advisors. For the three-year period, the fund returned 15.5%, and for the five-year period the fund returned 13.0%. This compares with the median fund return of 12.9% for the three-year period and 11.9% for the five-year period.

During the fiscal year ending September 30, 1998, the nation's economy was characterized by full employment, low inflation, declining interest rates, and moderate economic growth. The equity markets experienced a significant correction in the quarter ending September 30, 1998. The S&P 500 was off 9.9% while the Dow Jones Industrial Average fell 12.0% during this time frame. This tended to reduce the one-year return on the S&P 500 to 9.1%, with the Dow Jones Industrial Average returning 0.5%. Because of declining interest rates, the Lehman Brothers Government/Corporate Bond Index experienced a return of 12.8% for the year ending September 30, 1998, and the Salomon Brothers Broad Grade Index experienced a return of 11.5%.

The returns were calculated using a time weighted rate of return in accordance with Standards of the Association for Investment Management and Research (AIMR), unless a modification is described in the discussion of the return.

The MJRS is well diversified among asset classes. As of September 30, 1998, the portfolio consisted of 50.5% domestic equities, 25.1% fixed income (includes 0.08% in mortgages), 8.8% alternative investments, 8.0% real estate, 3.5% short-term investments, and 4.1% international equities.

***Domestic Stocks - Active***

The objective of the actively-managed domestic stock division is long-term capital appreciation by investing primarily in publicly-traded stocks of U.S.-based companies.

Fiscal year 1998 witnessed considerable volatility in the equity markets as competing factors pulled in different directions. On the positive side, low inflation, declining interest rates, low unemployment, and moderate growth in the U.S. economy helped the markets achieve new highs. On the negative side, concerns about corporate earnings growth, deflation fears, questions about presidential integrity, and worries about the health of a number of international economies and financial markets caused some temporary market declines.

Domestic stock returns closed the fiscal year with a 5.1% increase, compared with a 9.1% increase for the S&P 500 Index, and a 0.5% increase for the Dow Jones Industrial Average. This compared with a median return of 3.7% for state plans,

## Report on Investment Activity

including MJRS, as compiled by Capital Resource Advisors. The markets were led by a 44.0% gain for communication stocks, followed by 38.3% for health care, and 31.0% for utilities. Three-year and five-year results for the actively-managed domestic stock portfolio were 20.6% and 17.4%, respectively, on an annualized basis. This compared with 22.6% and 19.9% for the S&P 500, and 12.9% and 11.9% for the median state plans.

At the end of the fiscal year, actively-managed domestic stocks represented 38.3% of total assets, compared with 37.5% at the end of 1997, and 35.5% at the close of 1996.

***Domestic Stocks - Passive***

The objective of the enhanced S&P 500 and S&P MidCap Index Funds is to closely match the return performance of their benchmarks. The S&P 500 Index return for the fiscal year was 10.1% versus the benchmark's 9.1%. The S&P MidCap Index Fund return for the fiscal year was a negative 4.3% versus its benchmark of a negative 6.3%. The enhancements to the returns were the result of strategic allocations of additional funds to passive equity investments during market corrections and the opportunistic use of derivative programs. At the end of fiscal year, passive domestic stock portfolios represented 12.2% of total assets, with the S&P 500 Index Fund accounting for 11.3% and the S&P MidCap Index Fund accounting for 0.9%. Indexed stock portfolios represented 10.5% of total assets at the end of the prior fiscal year.

***International Equities***

Passive exposure to international equity returns is achieved 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 index returns, and the notional amount of the swap agreements is held in the approximate proportions of the Salomon Smith Barney Broad Market Index (BMI) Europe and Pacific Composite (EPAC) country weightings for the larger component countries. The passive investment program using swap agreements was established in 1993. During fiscal 1998, $2 million of exposure was withdrawn from the combination structure, lowering international equity investments to 4.1% of the portfolio.

The benchmark used to evaluate international equity returns is a custom version of the Salomon Smith Barney BMI-EPAC adjusted for net dividends. Fifty percent of the benchmark is hedged to the U.S. dollar and the other 50% is impacted by foreign currency exchange rate changes. The composite international equity return of a negative 4.7% in fiscal year 1998 compared favorably with the Salomon Smith Barney BMI-EPAC return of a negative 8.1%. The composite international equity return of 8.4% for 3 years compared well with the benchmark's return of 6.6% over the same period.

The international equity exposure through the combination of fixed income LIBOR notes and equity swap agreements was valued at $13 million on September 30, 1998. That valuation included a net unrealized loss on equity index exposures of $.4 million and an unrealized loss of $0.1 million on LIBOR note investments held. Unrealized equity losses reflect both the decline of several targeted international equity indices later in the year and the increase in index exposure cost levels throughout the year. As older swap agreements matured, equity gains were realized and new replacement swap exposures were established at higher index levels. At the end of September, total realized gains and net interest received in excess of counterparty obligations reached a record $3.9 million since the program began. During fiscal 1998, $2.5 million of gains on equity exposures were realized, and $0.5 million of interest in excess of obligations on completed swaps was also recognized.

***Fixed Income (Excluding Mortgages)***

For the fiscal year ending September 30, 1998, the fixed income portfolio returned 10.2% compared to the median of 11.5% for the state plans, including MJRS, as compiled by Capital Resource Advisors evaluations. For the three year period, the portfolio returned 8.7%, and for the five-year period the portfolio returned 7.7%. This compares with the median portfolio return of 8.7% for the three-year period and 7.2% for the five-year period.

As the year progressed, rates declined and quality spreads widened as investors purchased the long-term treasury issues in a flight to quality. The fixed income market, therefore, rewarded higher grade, longer-term issues. MJRS' fixed income portfolio had a shorter duration than the Lehman Government and Corporate Index. As a result, the fund under-performed the Lehman Index for the one-year period, 10.2% versus 12.8%, but was still in line for the three-year period, 8.7% versus 8.9%, and out-performed the index for the five-year period, 7.7% versus 7.2%. Relative to the Salomon Brothers Broad Grade Index, MJRS' fixed income portfolio under-performed in the one-year time horizon, 10.2% to 11.5%, matched in the three year period, 8.7% to 8.7%, and was ahead in the five-year period 7.7% to 7.2%.

Fixed Income represented 25.0% of the total portfolio compared with 25.4% last year. The corporate sector represented 45.8% of fixed income securities with government securities representing 54.2%. Last year, corporates represented 39.2% of the total with governments representing 60.8%. The high level of corporates was due to a concerted strategy to acquire investment grade issues where spreads had widened significantly. The lower holding of government securites can be attributed to a substantial increase in the number of issues called, particularly government sponsored enterprises.

***Real Estate Equity***

As of the year ending September 30, 1998, 8.0% of the total portfolio was invested in equity real estate. This compares to 6.2% and 6.1% for the fiscal years ending September 30, 1997 and 1996, respectively. The asset allocation for equity real estate investment was increased to 8.5% of the portfolio from 7.5% for fiscal year ending September 30, 1997.

The one-year, three-year and five-year total equity real estate net returns for the fiscal year ending September 30, 1998, were 11.5%, 12.0% and 8.4%, respectively, as quoted by Capital Resource Advisors. This compares to the National Council of Real Estate Investment Fiduciaries (NCREIF) Property Index returns of 17.3%, 12.5% and 9.9% relating to the same time periods. The NCREIF portfolio of properties is heavily weighted in the office sector, 41.3% versus the MJRS portfolio at 28.9%. However, the historical volitility of the office sector returns make it a more risky asset class. This variation in portfolio weighting gives the NCREIF portfolio a much higher level of risk than MJRS has chosen to assume. In addition, the NCREIF Index does not account for fees/overhead, while MJRS' returns quoted above are after fees/overhead.

The real estate investments are broadly diversified geographically, across the country, by type of property, and by class of property, to reduce risk. Major property types include the following: Central Business District (CBD) office, suburban office, regional malls, neighborhood and community shopping centers, industrial/warehouse buildings and apartments. MJRS, through its advisors and private real estate operating companies it controls, acquires, develops, redevelops and disposes of real estate with the goal of maximizing returns while maintaining an ***acceptable*** level of risk. The properties are held in various investment vehicles: Partnerships, LLC's, Trusts, Commingled funds, and REIT stock. These legal entities allow MJRS to enjoy the benefits of real estate ownership while limiting the liability associated with this asset class. In all new investments, MJRS retains approval rights over critical decisions. The properties are regularly valued by independent appraisers to establish market values. The market values established by the appraisers are utilized in computing the real estate portfolio appreciation return. The appreciation return coupled with the income return produced from the real estate holdings are utilized to derive the equity real estate portfolio total return.

***Real Estate Debt (Mortgages)***

As of the year ending September 30, 1998, 0.08% of the total portfolio was invested in mortgages. This compares to 0.2% and 2.8% for the fiscal years ending September 30, 1997 and 1996, respectively. The asset allocation objective is to reduce mortgage holdings to 0% over time. In the current interest rate environment, MJRS cannot meet actuarial return requirements in new mortgage loans.

The one-year, three-year and five-year total returns for the mortgage portfolio, for the fiscal year ending September 30, 1998, were 15.1%, 7.2% and 6.9%, respectively. This compares to Salomon Brothers Broad Grade Index returns of 11.5%, 8.7% and 7.2% relating to the same time periods. Since the majority of the mortgage portfolio is federally insured mortgages, and therefore less risky, the returns generated by the mortgage portfolio would normally be less than the index.

## Report on Investment Activity

During the previous year, the majority of the mortgage portfolio was sold to take advantage of the favorable low interest rate environment. The low interest rates, existing in the overall economy, resulted in premium prices being paid for the mortgages sold. The sale of the mortgages resulted in realized gains to the portfolio. On average, MJRS received sale prices between 101% and 105% of the unpaid principal balance of the notes compared to purchase prices of between 55% and 60% of face value for these same loans when purchased back in the late 1970's and early 1980's. The remaining mortgage holdings are mainly comprised of federally insured multifamily mortgages and a few multi-tenant commercial office buildings. The mortgage portfolio is concentrated in Michigan and the Midwest.

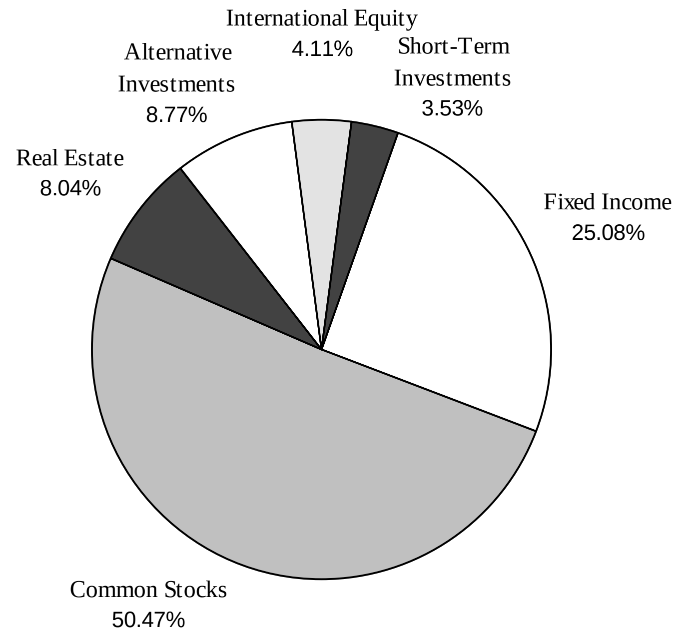
***Alternative Investments***

Alternative Investments are investments in the private equity market, either directly in companies or indirectly through limited partnerships. Through September 30, 1998, approximately 90% of alternative investments were made through limited partnerships. Of the investments in limited partnerships, approximately 8% were in partnerships investing internationally. The remaining 10% were direct private equity investments and public stock distributions received from the limited partnerships. The percentage of assets in alternative investments has consistently increased from 4.8% as of September 30, 1993, to 8.8% as of September 30, 1998. The asset allocation for alternative investments is 8.8% while the long-term target asset allocation is 7.5%.

The one-year, three-year and five-year total alternative investment returns for the fiscal year ending September 30, 1998, were 26.4%, 25.7% and 21.9%, respectively.

**Report on Investment Activity**

## Asset Allocation




## Investment Results Periods Ending September 30, 1998

| Investment Category | Current Year | Annualized Rate of Return 3 Years | 5 Years | 10 Years |
|---|---|---|---|---|
| Total Portfolio | 8.3 % | 15.5 % | 13.0 % | 11.4 % |
| Median | 6.6 | 12.9 | 11.9 | 11.4 |
| Domestic Equities Stock - Active | 5.1 | 20.6 | 17.4 | 13.6 |
| Domestic Equities Stock - Passive* | 8.4 | 22.4 | 19.2 | 17.7 |
| Standard & Poor's (S&P 500) | 9.1 | 22.6 | 19.9 | 17.3 |
| International Equities | (4.7) | 8.4 | 6.6 | N/A |
| Net Salomon BMI - EPAC 50/50 | (8.1) | 6.6 | 6.0 | N/A |
| Fixed Income Bonds (U.S. Corp and Govt) | 10.2 | 8.7 | 7.7 | 9.7 |
| Salomon Brothers Broad Grade Index | 11.5 | 8.7 | 7.2 | 9.3 |
| Real Estate - Debt | 15.1 | 7.2 | 6.9 | N/A |
| Salomon Brothers Broad Grade Index | 11.5 | 8.7 | 7.2 | 9.3 |
| Real Estate - Equity | 11.5 | 12.0 | 8.4 | N/A |
| NCREIF | 17.3 | 12.5 | 9.9 | 5.3 |
| Alternative Investments | 26.4 | 25.7 | 21.9 | 16.0 |

* Passive portfolio consists of a S&P 500 fund and a S&P MidCap fund. The return is a weighted average of the two funds.

Report on Investment Activity

# Largest Assets Held

## Largest Stock Holdings (By Market Value)
September 30, 1998

| Rank | Shares | Stocks | Market Value |
|---|---|---|---|
| 1 | 56,583 | Microsoft Corporation | $ 6,227,666 |
| 2 | 72,048 | General Electric Corporation | 5,732,319 |
| 3 | 62,179 | Warner-Lambert Company | 4,694,515 |
| 4 | 42,356 | Pfizer Incorporated | 4,479,147 |
| 5 | 60,843 | Amoco Corporation | 3,277,917 |
| 6 | 54,044 | McDonald's Corporation | 3,225,751 |
| 7 | 65,206 | Chrysler Corporation | 3,121,737 |
| 8 | 40,151 | Federal National Mortgage Association | 2,579,702 |
| 9 | 82,276 | Compaq Computer Corporation | 2,601,979 |
| 10 | 48,249 | Wal-Mart Stores Incorporated | 2,635,602 |

## Largest Bond Holdings (By Market Value)
September 30, 1998

| Rank | Par Amount | Bonds & Notes | Market Value |
|---|---|---|---|
| 1 | $ 5,181,000 | U.S. Treasury Bonds at 9.125% Due 5-15-2009 | $ 6,334,601 |
| 2 | 2,496,780 | U.S. Treasury 0% Callable Principle Due 5-15-2011 | 1,767,970 |
| 3 | 2,145,000 | U.S. Treasury 0% Coupon Strips Due 8-15-2003 | 1,737,193 |
| 4 | 1,560,000 | Morgan, J.P. FRN Due 3-13-2000 | 1,552,200 |
| 5 | 1,770,600 | U.S. Treasury 0% Callable Principal Due 11-15-2011 | 1,223,272 |
| 6 | 1,170,000 | FHLMC Debenture 6.70% Due 7-23-2008 | 1,184,859 |
| 7 | 1,244,000 | U.S. Treasury Tiger 14 0% Due 8-15-2004 | 959,199 |
| 8 | 887,250 | FHLMC Debenture 6.51% Due 8-18-2008 | 896,540 |
| 9 | 786,904 | First Chicago FRN Due 7-28-2003 | 797,700 |
| 10 | 780,000 | FHLMC - Debenture 6.55% Due 11-13-2001 | 781,459 |

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

**Report on Investment Activity**

# 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 8.5% of the total investment portfolio is managed by fully discretionary outside advisors. Outside advisor's 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 $54.5 thousand or less than two basis points (.02%) of the average fair market value of the portfolio.

## Schedule of Investment Fees

***Investment Managers' Fees*:**

| | Assets under Management (in thousands) | Fees (in thousands) | Basis Points * |
|---|---|---|---|
| State Treasurer | $298,867.8 | $ 54.5 | 1.8 |
| Outside Advisors - Alternative | 26,232.0 | 177.2 | 67.6 |
| Real Estate | 1,415.7 | - | - |
| Total | $326,515.5 | | |

***Other investment Services Fees:***

| | Assets in Custody** | |
|---|---|---|
| Custody Fees | $235,987.3 | 1.1 |
| Security Lending Fees | 13,552.6 | 574.4 |

* Outside Advisors Fees are netted against the income of the partnership and trust income. The partnership agreements 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 ranges from 25 to 90 basis points and is netted against current year's income.

** Other investment service fees are charged on assets managed by the State Treasurer held at its custodial bank in the amount of $.2 million; $13.6 million of the assets were on loan at fiscal year end.

Report on Investment Activity

# Schedule of Commissions

| | Fiscal Year Ended 9-30-98 | | |
|---|---|---|---|
| | Number of Shares Traded | Commissions Paid (1) | Average Commission Rate per Share |
| **Investment Performance Measurement Consultant:** | | | |
| Capital Resource Advisors | | | |
| (Directed brokerage included below) | 13,552 | $ 813 | 0.06 |
| **Investment Brokerage Firms:** | | | |
| Merrill Lynch & Company | 91,200 | $ 5,235 | 0.06 |
| Salomon Smith Barney, Inc. | 69,020 | 4,141 | 0.06 |
| Paine Webber, Inc. | 62,795 | 3,768 | 0.06 |
| Bear Stearns & Company | 55,222 | 3,147 | 0.06 |
| Donaldson, Lufkin & Jenrette Securities Corp. | 43,682 | 2,621 | 0.06 |
| Bridge Trading Company | 39,098 | 2,346 | 0.06 |
| Schroder & Company | 38,667 | 2,276 | 0.06 |
| Sanford C. Bernstein & Company | 31,698 | 1,902 | 0.06 |
| C.S. First Boston Corporation | 28,120 | 1,687 | 0.06 |
| Prudential Securities Inc. | 24,692 | 1,482 | 0.06 |
| Goldman, Sachs & Company | 24,782 | 1,446 | 0.06 |
| Lehman Brothers, Inc. | 24,334 | 1,421 | 0.06 |
| Morgan Stanley & Company | 21,867 | 1,307 | 0.06 |
| Oppenheimer & Company | 21,511 | 1,252 | 0.06 |
| J.P. Morgan Securities, Inc. | 20,326 | 1,220 | 0.06 |
| Capital Inst. Services | 17,098 | 1,026 | 0.06 |
| S.G. Cowen & Company | 15,360 | 922 | 0.06 |
| Charles Schwab & Company, Inc. | 14,877 | 893 | 0.06 |
| The Citation Group | 12,694 | 746 | 0.06 |
| Wilshire Associates | 12,154 | 729 | 0.06 |
| Everen Securities | 11,702 | 702 | 0.06 |
| Standard & Poor's Securities | 11,632 | 698 | 0.06 |
| Montgomery Securities | 8,202 | 492 | 0.06 |
| Deutsche/Morgan/Grenfell | 7,452 | 447 | 0.06 |
| SoundView Financial Group | 5,146 | 309 | 0.06 |
| Subtotal (25 highest) | 713,331 | $ 42,215 | 0.06[2] |
| All Other Brokerage Firms | 9,399 | 564 | 0.06[3] |
| Total | 722,730 | $ 42,779 | 0.06[4] |

(1) These amounts are included in purchase and sale prices of investments.
(2) The average commission rate per share for the top 25 brokerage firms.
(3) The average commission rate per share for all other brokerage firms, excluding the top 25 brokerage firms.
(4) The average commission rate per share for all brokerage firms.

Report on Investment Activity

# Investment Summary

| | 1998 | | 1997 | |
|---|---|---|---|---|
| | Market Value* | Percent of Total Market Value | Market Value* | Percent of Total Market Value |
| Fixed Income: | | | | |
| Government Bonds | $ 44,338,352 | 13.55 % | $ 49,028,336 | 15.41% |
| Corporate Bonds & Preferred Stocks | 37,486,684 | 11.45 | 31,554,150 | 9.92 |
| Convertible Bonds | 0 | 0 | 160,383 | 0.05 |
| Mortgages | 272,032 | 0.08 | 527,692 | 0.17 |
| Total Fixed Income | $ 82,097,068 | 25.08 % | $ 81,270,561 | 25.55 % |
| Common Stock | 165,156,856 | 50.47 | 153,112,064 | 48.12 |
| Real Estate | 26,305,950 | 8.04 | 19,708,357 | 6.19 |
| Alternative | 28,689,415 | 8.77 | 20,249,939 | 6.36 |
| International Equity | 13,446,821 | 4.11 | 16,773,619 | 5.27 |
| Short-Term Investments** | 11,564,536 | 3.53 | 27,071,191 | 8.51 |
| **Total** | $ 327,260,646 | 100.00 % | $ 318,185,731 | 100.00 % |

* Short-term investments are at cost, which approximates market.

** Includes equity in the State Treasurer's Common Cash Fund, but excludes amounts payable and receivable for sales and purchases of securities with a settlement date after September 30 for each fiscal year. Amount also excludes $13,623,046 and $11,552,820 in cash collateral for security lending for fiscal year 1998 and 1997 respectively.

# ACTUARIAL SECTION

Actuary's Certification
Summary of Actuarial Assumptions and Methods
Schedule of Active Member Valuation Data
Schedule of Changes in Retirement Rolls
Prioritized Solvency Test
Summary of Plan Provisions

# Actuary's Certification

*THE SEGAL COMPANY*

One Park Avenue
New York, New York
10016-5895
212-251-5321
FAX: 212-251-5490

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

January 22, 1999

Ms. Janet E. Phipps
Director
Department of Management and Budget
and
Retirement Board
Michigan Judges Retirement System
P.O. Box 30176
Lansing, Michigan 48909

Ladies and Gentlemen:

The Michigan Judges Retirement System (MJRS) is funded on an actuarial reserve basis. The basic financial objective of MJRS 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 MJRS'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, 1998 included a total of 1,138 members of MJRS. The actuarial value of MJRS's assets amounted to approximately $289 million on September 30, 1998.

The actuarial assumptions used in the 1998 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 MJRS as of September 30, 1998 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 1998 valuation results, it is also our opinion that the Michigan Judges 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

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

# 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, the 8% investment return rate translates to an assumed real rate of 3%. Adopted 1981.

2. The mortality table used in evaluating allowances to be paid was the 1971 Group Annuity Mortality Table, projected to the year 2010 using projection scale D, set back no years for men and 6 years for women. Adopted 1993.

3. Sample probabilities of retirement with an age and service allowance are shown in Schedule 1 on the next page.

4. Sample probabililties of withdrawal from service and disability, together with individual pay increase assumptions, are shown in Schedule 2 on the next page.

5. Total active member payroll is assumed to increase 5.0% per year, which is the portion of the individual pay increase assumptions attributable to inflation. In effect, this assumes no change in the number of active members. Adopted 1993.

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 gain and losses, are financed over a period of 40 years from October 1, 1996.

7. Valuation assets (cash and investment) were valued using a five year smoothed market value method. For the 1993 valuation and later, 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 five years. Adopted 1993.

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 was 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.

# Summary of Actuarial Assumptions and Methods (Continued)

## SCHEDULE 1

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

| Retirement Ages | Percent of Eligible Active Members Retiring Within Next Year |
|---|---|
| 55-59 | 10 % |
| 60-64 | 10 |
| 65-69 | 10 |
| 70 | 100 |

## SCHEDULE 2

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

| Sample Ages | Percent of Active Members Withdrawing Within Next Year (Men and Women) | Percent of Active Members Becoming Disabled Within Next Year | | Percent Increase In Pay During Next Year |
|---|---|---|---|---|
| | | Men | Women | |
| 20 | | 0.08 % | 0.10 % | 5.5 % |
| 25 | | 0.08 | 0.10 | 5.5 |
| 30 | 2.0 % | 0.08 | 0.10 | 5.5 |
| 35 | 2.0 | 0.08 | 0.10 | 5.5 |
| 40 | 2.0 | 0.20 | 0.36 | 5.5 |
| 45 | 2.0 | 0.26 | 0.41 | 5.5 |
| 50 | 2.0 | 0.49 | 0.57 | 5.5 |
| 55 | 2.0 | 0.89 | 0.77 | 5.5 |
| 60 | 2.0 | 1.41 | 1.02 | 5.5 |

# Actuarial Valuation Data

## Schedule of Active Member Valuation Data

| Valuation Date Sept. 30 | Inactive Members Number | Active Members Number | Active Reported Annual Payroll | Active Average Annual Pay | Active % Increase | Active Average Age | Active Average Service |
|---|---|---|---|---|---|---|---|
| 1989 | 26 | 590 | $ 41,895,056 | $ 71,008 | 18.0 | 52.4 years | 10.2 years |
| 1990 | 26 | 590 | 43,081,777 | 73,020 | (10.1) | 53.0 | 10.8 |
| 1991 | 32 | 603 | 43,905,860 | 72,812 | (0.3) | 52.1 | 10.2 |
| 1992 | 28 | 604 | 43,840,733 | 72,584 | (0.3) | 52.8 | 10.6 |
| 1993 | 25 | 611 | 44,472,833 | 72,787 | 0.2 | 52.8 | 10.5 |
| 1994 | 26 | 608 | 46,276,785 | 76,113 | 4.5 | 53.4 | 10.5 |
| 1995 | 26 | 614 | 48,195,528 | 78,494 | 3.1 | 52.8 | 10.9 |
| 1996 | 28 | 610 | 49,350,572 | 80,903 | 3.1 | 53.6 | 11.7 |
| 1997 | 25 | 609 | 49,000,856 | 80,461 | (0.5) | 52.8 | 11.4 |
| 1998 | 24 | 600 | 48,865,572 | 81,443 | 1.2 | 53.6 | 12.2 |

## Schedule of Changes in the Retirement Rolls

| Year Ended Sept. 30 | Added to Rolls No. | Added to Rolls Annual Allowances | Removed from Rolls No. | Removed from Rolls Annual Allowances | Rolls–End of Year No. | Rolls–End of Year Annual Allowances | % Increase in Annual Allowances | Average Annual Allowances |
|---|---|---|---|---|---|---|---|---|
| 1989 | 43 | $1,354,584 | 10 | $ 164,559 | 356 | $ 7,604,861 | 18.6 % | $21,362 |
| 1990 | 20 | 642,636 | 15 | 316,220 | 361 | 7,931,277 | 4.3 | 21,970 |
| 1991 | 45 | 1,616,652 | 17 | 322,898 | 389 | 9,225,031 | 16.3 | 23,715 |
| 1992 | 29 | 816,203 | 12 | 217,417 | 406 | 9,823,817 | 6.5 | 24,197 |
| 1993 | 29 | 1,023,871 | 1 | 16,135 | 434 | 10,831,553 | 10.3 | 24,957 |
| 1994 | 24 | 794,810 | 12 | 303,091 | 446 | 11,323,272 | 4.5 | 25,389 |
| 1995 | 50 | 1,700,945 | 15 | 409,064 | 481 | 12,615,153 | 11.4 | 26,227 |
| 1996 | 19 | 708,409 | 19 | 424,164 | 481 | 12,899,398 | 2.3 | 26,818 |
| 1997 | 40 | 1,663,656 | 9 | 359,441 | 512 | 14,203,613 | 10.1 | 27,741 |
| 1998 | 26 | 696,745 | 24 | 556,833 | 514 | 14,343,525 | 1.0 | 27,906 |

# Prioritized Solvency Test

MJRS' 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 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 byproduct of level percent of payroll funding methods.

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

| | Actuarial Present Value of Accrued Liabilities ($ in Millions) | | | | Portion of Present Value Covered by Assets | | | |
|---|---|---|---|---|---|---|---|---|
| Valuation Date Sept. 30 | (1) Active Member Contributions | (2) Retirants and Beneficiaries | (3) Active Members (Employer Financed Portion) | Valuation Assets | (1) | (2) | (3) | (4)[**] |
| 1989 | $ 18,995 | $65,824 | $ 70,598 | $139,436 | 100% | 100% | 77.0% | 90.0% |
| 1990 | 21,760 | 67,449 | 73,898 | 150,024 | 100 | 100 | 82.3 | 92.0 |
| 1991 | 23,422 | 78,438 | 69,420 | 162,053 | 100 | 100 | 86.7 | 94.6 |
| 1992 | 26,364 | 82,451 | 70,681 | 171,969 | 100 | 100 | 89.4 | 95.8 |
| 1993 | 28,922 | 89,163 | 74,878 | 187,737 | 100 | 100 | 93.0 | 97.3 |
| 1993[*] | 28,922 | 89,163 | 74,342 | 189,134 | 100 | 100 | 95.6 | 98.3 |
| 1994 | 32,364 | 89,649 | 74,978 | 202,371 | 100 | 100 | 107.2 | 102.7 |
| 1995 | 34,358 | 96,574 | 73,395 | 222,230 | 100 | 100 | 124.4 | 108.8 |
| 1996 | 38,766 | 96,633 | 76,102 | 243,248 | 100 | 100 | 141.7 | 115.0 |
| 1997 | 39,637 | 118,717 | 72,157 | 271,458 | 100 | 100 | 156.7 | 117.8 |
| 1998 | 43,378 | 116,264 | 76,879 | 288,671 | 100 | 100 | 167.8 | 122.0 |

# Revised actuarial assumptions and asset valuation method.

** Percents funded on a total valuation asset and total actuarial accrued liability basis.

# Summary Of Plan Provisions

Our actuarial valuation of MJRS as of September 30, 1998 is based on the present provision of Public Act No. 234 of 1992.

***Regular Retirement***

<u>Eligibility</u> — Age 60 with 8 years credited service; or age 55 with 18 years credited service, or 25 years with no age requirement.

<u>Annual Amount</u> — If less than 12 years of credited service, 3% of final annual compensation times years of credited service; for 12 or more years of credited service, 50% of final annual compensation plus 2.5% of such compensation for each year of credited service in excess of 12 years to a maximum of 60%. Former MJRS members receive 3% of final annual compensation times years of credited service to a maximum of the greater of 40% of final annual compensation or $15,000, but not to exceed 66 2/3% of final annual compensation when added to a local retirement system benefit; or 3.5% of final annual compensation times years of credited service to a maximum of 66 2/3% of final annual compensation if elected.

<u>Final Annual Compensation</u> — Annual state salary at time of retirement plus state salary standardization, if any. For former MJRS members, final annual compensation is member's certified salary at time of retirement. For 36th District Court judges, final annual compensation is total state and district control unit salary at time of retirement. For probate judges serving in a single county of less than 15,000 population, final annual compensation is total judicial salary at the time of retirement.

***Early Retirement (age reduction factor used)***

<u>Eligibility</u> — Age 55 with 12 but less than 18 years credited service.

<u>Annual Amount</u> — Regular retirement benefit, reduced by 1/2% for each month by which the commencement age is less than 60.

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

<u>Eligibility</u> — 8 years of credited service.

<u>Annual Amount</u> — Regular retirement benefit. If less than 12 years of credited service, payable at age 60; if 18 or more years of credited service payable at age 55; if more than 12 but less than 18 years of credited service reduced amount payable at age 55.

***Disability Retirement***

<u>Eligibility</u> — 8 years of credited service.

<u>Annual Amount</u> — Regular retirement benefit, based upon member's credited service and final salary at time of disability.

***Death Before or After Retirement (Spouse or Dependent Children)***

<u>Eligibility</u> — 8 years of credited service.

<u>Annual Amount</u> — 50% of the members accrued pension.

# Summary Of Plan Provisions (Continued)

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

None, except judges who were active judges prior to September 8, 1961 (and their survivors) have their benefits adjusted as active judges' salaries change.

***Member Contributions***

Non-Trial Judges: 5% of salary (1.5% for health benefits).

Trial Judges with Full Standardization: 7% of salary.

Trial Judges without Full Standardization: 3.5% of salary.

Probate Judges under 3% Formula: 7% of salary to maximum of $980.00

Probate Judges under 3.5% Formula: 7% of salary (no maximum).

District Court Judges of the Thirty-sixth District: 3.5% of salary.

***Defined Contribution Legislation -- SB 248 of 1996***

New employees hired on or after March 31, 1997 become participants in Tier 2 (i.e. a defined contribution plan) rather than Tier 1 (i.e. the above described defined benefit plan).

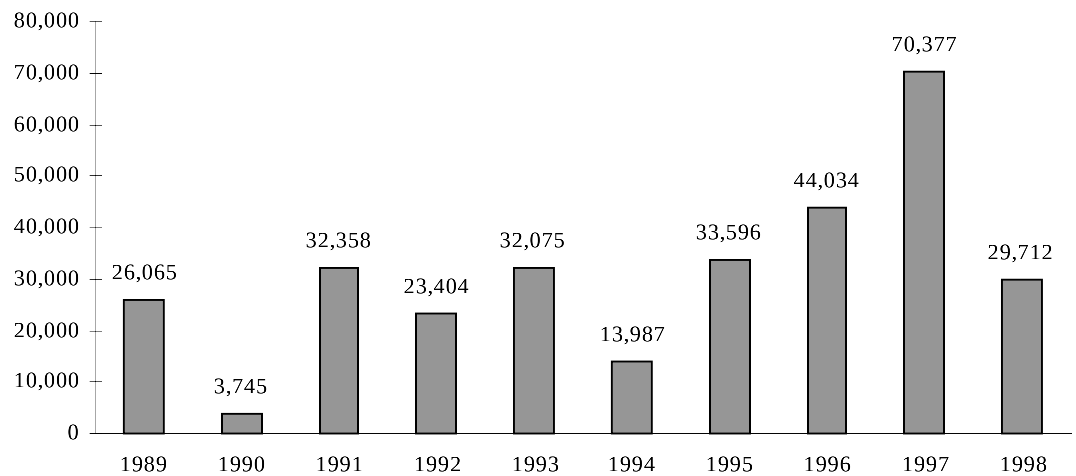
Active members on March 30, 1997, had an opportunity to irrevocably elect to terminate membership in Tier 1 and become participants in Tier 2. Elections were in writing and submitted between January 2, 1998 and April 30, 1998. Such members became Tier 2 participants on June 1, 1998, and had the actuarial present value of their Tier 1 accrued benefit transferred into Tier 2 by September 30, 1998.

# STATISTICAL SECTION

## Schedule of Revenues by Source

| Fiscal Year Ended Sept. 30 | Member Contributions | Net Court Fees | Employer Contributions Dollars | Employer Contributions % of Annual Covered Payroll | Net Investment & Oher Income | Total |
|---|---|---|---|---|---|---|
| 1989 | $ 2,334,803 | $ 5,149,672 | $ 1,386,123 | 3.31 % | $ 17,193,911 | $ 26,064,509 |
| 1990 | 2,450,879 | 5,329,496 | 1,486,911 | 3.45 | (5,522,705) | 3,744,581 |
| 1991 | 2,705,409 | 5,661,204 | 1,505,192 | 3.43 | 22,486,378 | 32,358,183 |
| 1992 | 2,447,047 | 5,719,623 | 1,519,483 | 3.47 | 13,718,217 | 23,404,370 |
| 1993 | 2,833,083 | 6,101,841 | 1,588,274 | 3.57 | 21,551,382 | 32,074,580 |
| 1994 | 2,811,231 | 4,926,397 | 1,650,598 | 3.57 | 4,598,657 | 13,986,883 |
| 1995 | 2,915,335 | 5,263,144 | 1,614,633 | 3.35 | 23,803,055 | 33,596,167 |
| 1996 | 2,975,239 | 4,635,563 | 1,556,044 | 3.15 | 34,867,041 | 44,033,887 |
| 1997 | 3,208,635 | 4,080,730 | 1,592,853 | 3.25 | 61,494,465 | 70,376,683 |
| 1998 | 3,214,706 | 0 | 246,659 | 0.50 | 26,250,205 | 29,711,570 |

**Total Revenues**
**(In Thousands)**

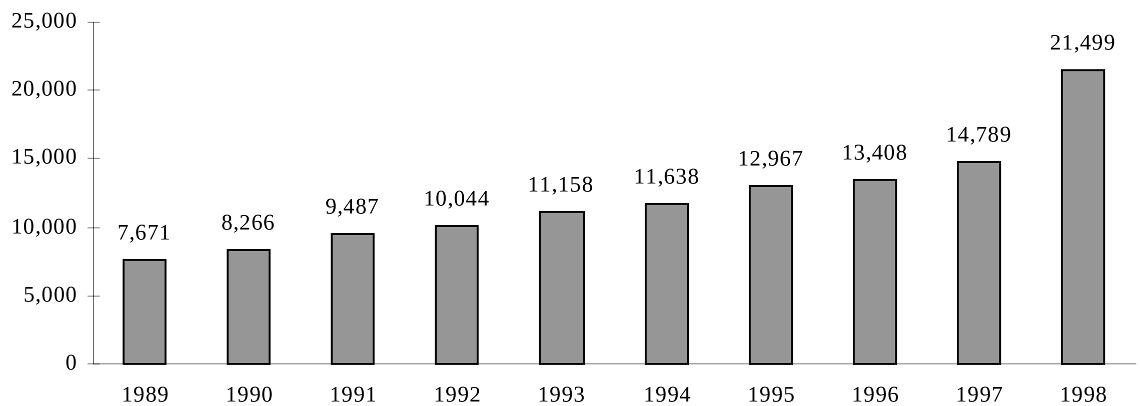


## Schedule of Expenses by Type

| Fiscal Year Ended Sept. 30 | Benefit Payments* | Refunds and Transfers | Administrative Expenses | Total |
|---|---|---|---|---|
| 1989 | $ 7,277,062 | $ 101,563 | $ 292,043 | $ 7,670,668 |
| 1990 | 7,884,438 | 72,319 | 309,058 | 8,265,815 |
| 1991 | 8,987,239 | 120,343 | 379,034 | 9,486,616 |
| 1992 | 9,631,114 | 18,366 | 394,632 | 10,044,112 |
| 1993 | 10,733,285 | 25,639 | 399,530 | 11,158,454 |
| 1994 | 11,173,171 | 28,444 | 436,764 | 11,638,379 |
| 1995 | 12,404,307 | 91,861 | 470,760 | 12,966,928 |
| 1996 | 12,877,528 | 16,266 | 514,406 | 13,408,200 |
| 1997 | 14,157,040 | 236,326 | 395,428 | 14,788,794 |
| 1998 | 14,660,076 | 6,641,662 | 197,743 | 21,499,481 |

* Includes health benefits.

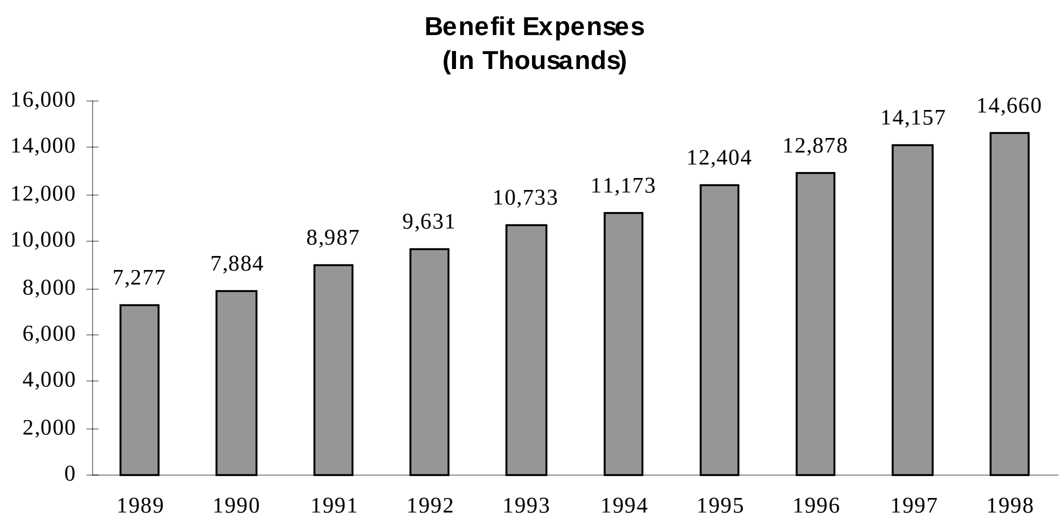
**Total Expenses**
**(In Thousands)**



## Schedule of Benefit Expenses by Type

| Fiscal Year Ended Sept. 30 | Regular Benefits | Disability Benefits | Health Benefits** | Total |
|---|---|---|---|---|
| 1989 | $ 7,236,904 | * | $ 40,158 | $ 7,277,062 |
| 1990 | 7,811,812 | * | 72,626 | 7,884,438 |
| 1991 | 8,905,532 | * | 81,707 | 8,987,239 |
| 1992 | 9,522,704 | * | 108,410 | 9,631,114 |
| 1993 | 10,598,915 | * | 134,370 | 10,733,285 |
| 1994 | 11,041,755 | * | 131,416 | 11,173,171 |
| 1995 | 12,012,426 | $ 273,424 | 118,457 | 12,404,307 |
| 1996 | 12,464,285 | 294,976 | 118,267 | 12,877,528 |
| 1997 | 13,491,097 | 348,192 | 317,751 | 14,157,040 |
| 1998 | 13,922,718 | 381,835 | 355,523 | 14,660,076 |

* Disability benefits included with regular benefits.
**Includes vision and dental benefits.



# Schedule of Retired Members by Type of Benefit
# September 30, 1998

| Amount Monthly Benefit | Number of Retirees | Type of Retirement * 1 | 2 | 3 | 4 | 5 | Selected Option** Opt. 1 | Opt. 2 | Opt. 3 |
|---|---|---|---|---|---|---|---|---|---|
| $ 001 - 400 | 8 | 3 | 2 | 3 | 0 | 0 | 8 | 0 | 0 |
| 401 - 800 | 61 | 13 | 38 | 9 | 1 | 0 | 56 | 5 | 0 |
| 801 - 1,200 | 52 | 28 | 16 | 5 | 3 | 0 | 37 | 13 | 2 |
| 1,201 - 1,600 | 71 | 30 | 28 | 12 | 1 | 0 | 61 | 9 | 1 |
| 1,601 - 2,000 | 48 | 25 | 15 | 7 | 1 | 0 | 42 | 6 | 0 |
| 2,001 - 2,400 | 32 | 22 | 7 | 1 | 2 | 0 | 16 | 16 | 0 |
| 2,401 - 2,800 | 45 | 39 | 4 | 1 | 1 | 0 | 36 | 8 | 1 |
| 2,801 - 3,200 | 39 | 37 | 1 | 0 | 1 | 0 | 29 | 10 | 0 |
| 3,201 - 3,600 | 59 | 57 | 2 | 0 | 0 | 0 | 46 | 12 | 1 |
| 3,601 - 4,000 | 61 | 59 | 1 | 0 | 1 | 0 | 57 | 4 | 0 |
| Over 4,000 | 38 | 36 | 0 | 0 | 2 | 0 | 36 | 2 | 0 |
| Totals | 514 | 349 | 114 | 38 | 13 | 0 | 424 | 85 | 5 |

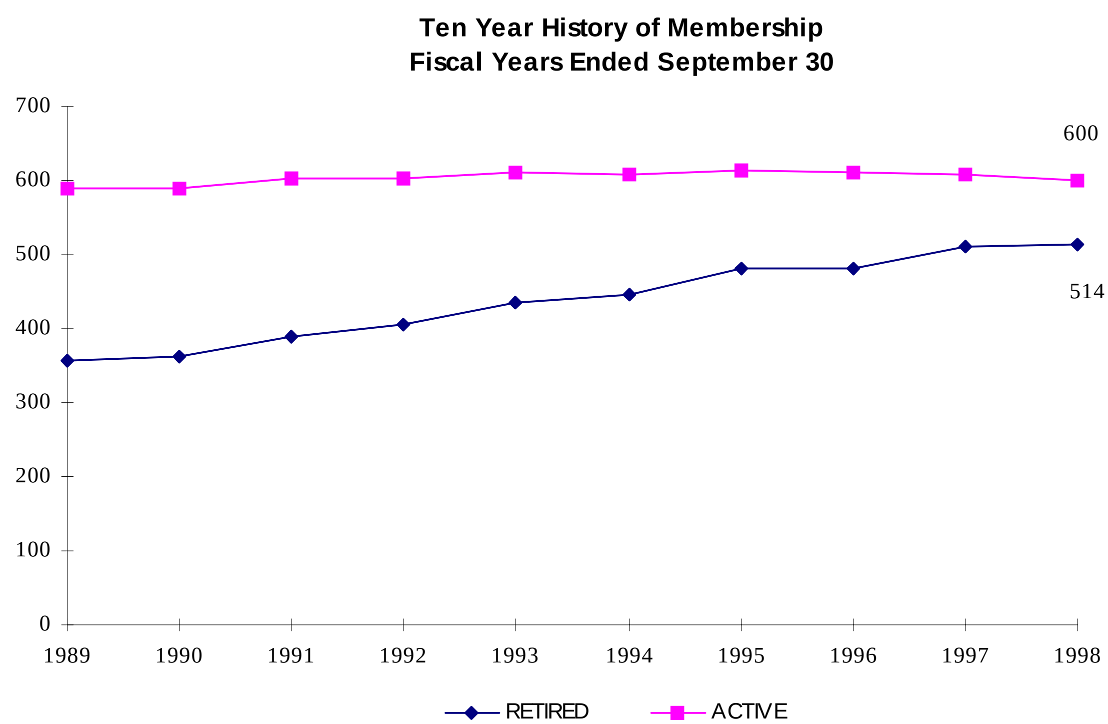
* Type of Retirement
1 - Normal retirement for age & service
2 - Survivor payment - normal retirement
3 - Survivor payment - Death in sevice
4 - Non-duty disability retirement
5 - Survivor payment - Disability retirement

**Selected Option
Opt. 1. - Straight life allowance
Opt. 2 - 100% survivor option
Opt. 3 - 50% survivor option

## Schedule of Average Benefit Payments

| Retirement Effective Dates | Average Monthly Benefit | Number of Active Retirants |
|---|---|---|
| Period 10/01/91 to 09/30/92 | $ 2,016 | 406 |
| Period 10/10/92 to 09/30/93 | 2,080 | 434 |
| Period 10/01/93 to 09/30/94 | 2,116 | 446 |
| Period 10/01/94 to 09/30/95 | 2,186 | 481 |
| Period 10/01/95 to 09/30/96 | 2,235 | 481 |
| Period 10/01/96 to 09/30/97 | 2,312 | 512 |
| Period 10/01/97 to 09/30/98 | 2,325 | 514 |

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



## ACKNOWLEDGMENTS

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