

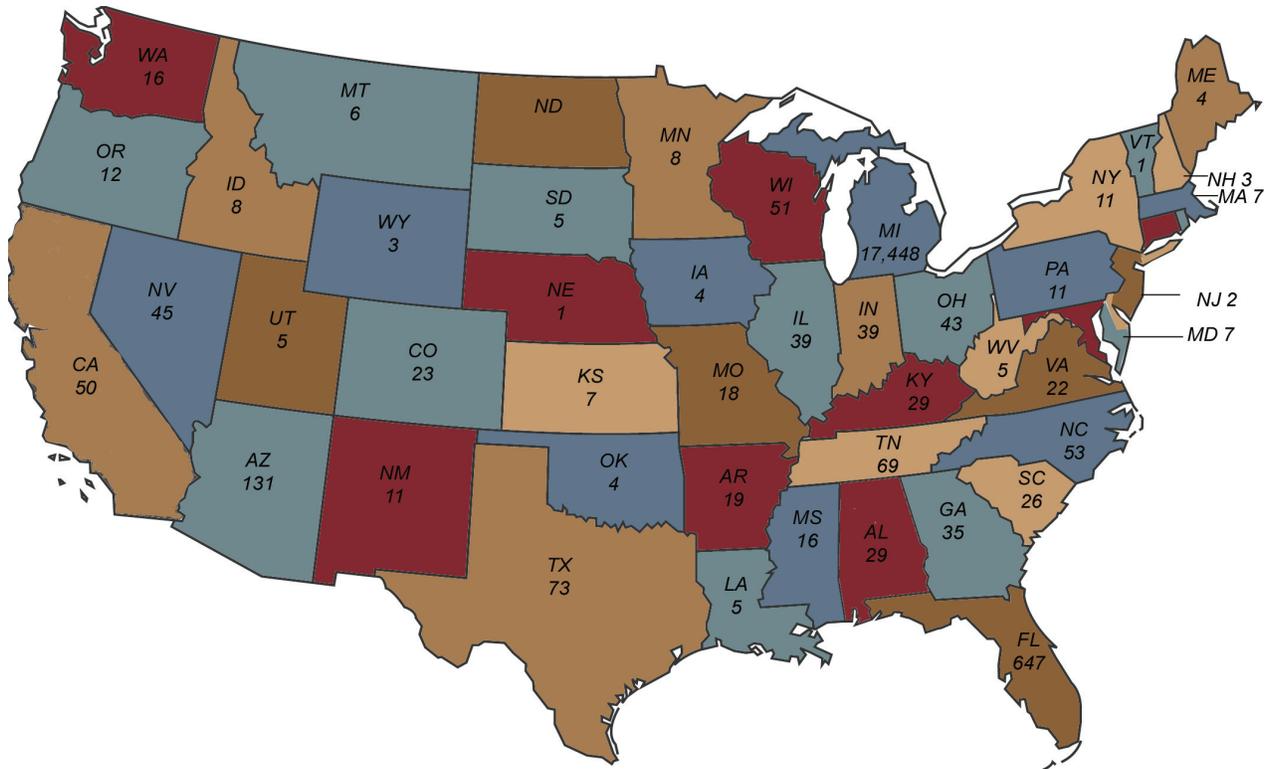
MERS

A Safe Harbor

MUNICIPAL EMPLOYEES' RETIREMENT SYSTEM OF MICHIGAN
SUMMARY ANNUAL FINANCIAL REPORT
FISCAL YEAR ENDED
DECEMBER 31, 2004



Distribution of MERS Benefit Recipients by Location



Recipients Outside Continental United States

Alaska	7	Nova Scotia, Canada	1	Ireland	2
Hawaii	7	Ontario, Canada	4	Israel	1

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Cover: Holland Harbor South Pier Lighthouse, State Historic Preservation Office, Michigan Historical Center, Department of History, Arts and Libraries, www.michigan.gov/shpo

Lighthouse theme suggested by MERS staff members:
Mark Drury, Jennifer Mausolf, Michael Moquin, Sheila Parsons.

Letter of Transmittal



Dear MERS Members:

I am pleased to present this consolidated version of the Comprehensive Annual Financial Report (CAFR) of the Municipal Employees' Retirement System of Michigan (MERS) for the fiscal year ended December 31, 2004.

It was a hallmark year! Over the years many advances have been made to improve the benefits and services to members. In 2004, MERS offered several new insurance products. MERS is eager to help employees receive affordable health care.

Last year marked the 58th year that MERS has continued to provide retirement plan administration to its member municipalities across Michigan. As a voluntary statewide organization, we continue to add to our membership roster. As of December 31, 2004, MERS members included more than 45,000 employees from 619 municipalities across the state.

Investment growth

MERS strict adherence to its strategic asset allocation model provides discipline as well as the ability to take advantage of opportunities that occur in the global market place. MERS conducts a strategic asset allocation study every five years and annually rebalances the assets to the selected target asset allocation model.

The portfolio returned 14.9 percent for the one-year period ending December 31, 2004, and 9.4 percent for the ten-year period. MERS domestic equity managers outperformed the Russell 3000 by .93 percent. This plus performance significantly contributed to the portfolio's stellar returns. The portfolio ended the fiscal year with \$4.6 billion in assets.

Funding

The most recent Actuarial Valuation, as of December 31, 2003, revealed that the DB Plan has a funding percentage of 78 percent. MERS receives no state-funded contributions. Each member municipality is legally responsible for funding the pensions earned by their employees under the provisions of the Michigan Constitution and the MERS Plan Document. Each municipality is a separate trust account in MERS. The pension obligations are paid from that account. MERS does not fund or borrow from one municipality's account to cover another municipality's obligation to pay its pensioners.

New health care programs

After an extensive three-year period of discovery, MERS expanded the retirement fund's capabilities to include health care, specifically the Health Care Savings Program, the Retiree Health Funding Vehicle for Other Postemployment Benefits (OPEB), and MERS Premier Health. These programs became available to the membership for the first time during the fiscal year and now join the Group Life and Disability Insurance program that was introduced in the fall of 2003.

Technology

MERS continues to expand the use of web-based capabilities to ensure effective communication with the membership. We look back over MERS history with satisfaction and pride, while at the same time remain committed to proactively address the future. We continue to work hard to provide excellent service and retain the trust of our membership.

The new Pension Administration software, "MERS Automated Pension System" (MAPS), is being developed. This software will replace "PeopleSoft" currently in use. The goal is to expand our capabilities to capture information, eliminate redundant entry, and achieve superior data integrity.

Awards

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to MERS for its Summary Financial Report for the year ended December 31, 2003. In 2004, MERS was also awarded the GFOA budget award for its 2003 budget submission.

Acknowledgments

This booklet reflects the best combined efforts of the MERS staff under the leadership of the MERS Retirement Board. I want to express my gratitude to the staff, advisors and many other people and organizations that have worked so conscientiously to assure the success of the Municipal Employees' Retirement System of Michigan.

Respectfully submitted,

Anne M. Wagner

Chief Executive Officer

Investment Overview

MERS has a Defined Benefit Plan (DB) and a Defined Contribution Plan (DC). As of December 31, 2004, the DB Plan had net assets of \$4,583,675,019 and 61,346 members. The DC Plan had net assets of \$142,892,121.78 and 5,754 members.

MERS Participating Municipalities As of December 31, 2004

Counties	65
Cities and Villages	241
Townships	64
County Road Commissions	56
Authorities, District and Others	177
Closed Groups	16
Total	619

internal and external resources without negatively affecting the performance of the portfolio.

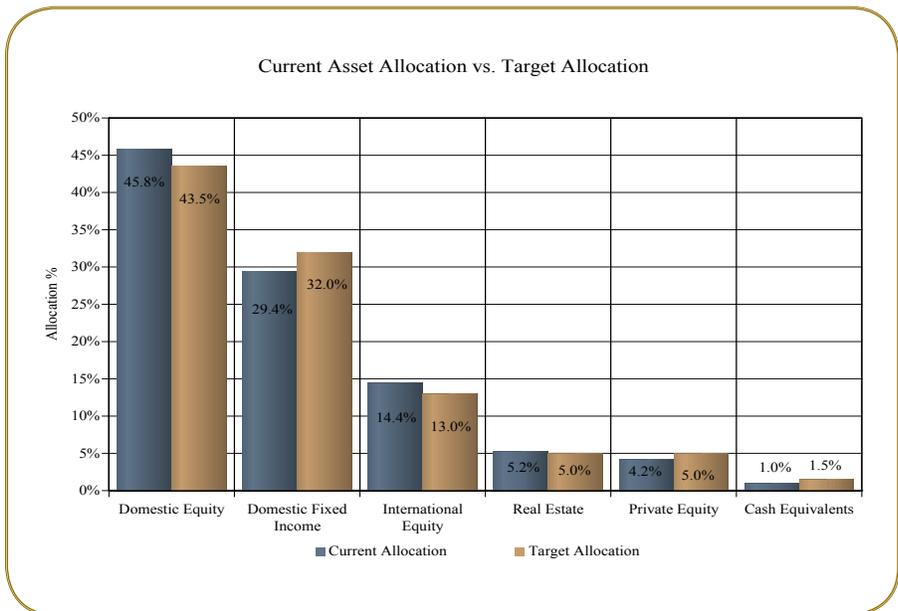
The portfolio is constructed to reduce volatility in down markets, yet still participate significantly when the equity markets rebound. In 2004, MERS Defined Benefit portfolio had a one-year gross return of 14.9 percent, allowing MERS to exceed its actuarial assumption rate of return for the ten-year period. The combination of passive and active management, diversification across asset classes, and disciplined adherence to its asset allocation plan has allowed MERS to provide value through multiple market cycles.

With long-term investment objectives as the central focus, the Retirement Board conducts a periodic asset allocation study to select a strategic asset allocation plan. The allocation plan designs a portfolio with the optimal mix of asset classes over the long-term horizon. The characteristics of expected return, risk, and correlation of return for various asset categories are carefully projected. The result is a portfolio that is broadly diversified in domestic and international stocks, domestic fixed income securities, high yield bonds, real estate, private equity, and cash equivalents.

Defined Benefit Plan

The primary investment objective is to maximize the long-term total rate of return on investments with a high degree of prudence and sufficient diversification to eliminate inordinate risks in conformity with the Michigan Public Employee Retirement System's Investment Act, 1965, PA 314, as amended.

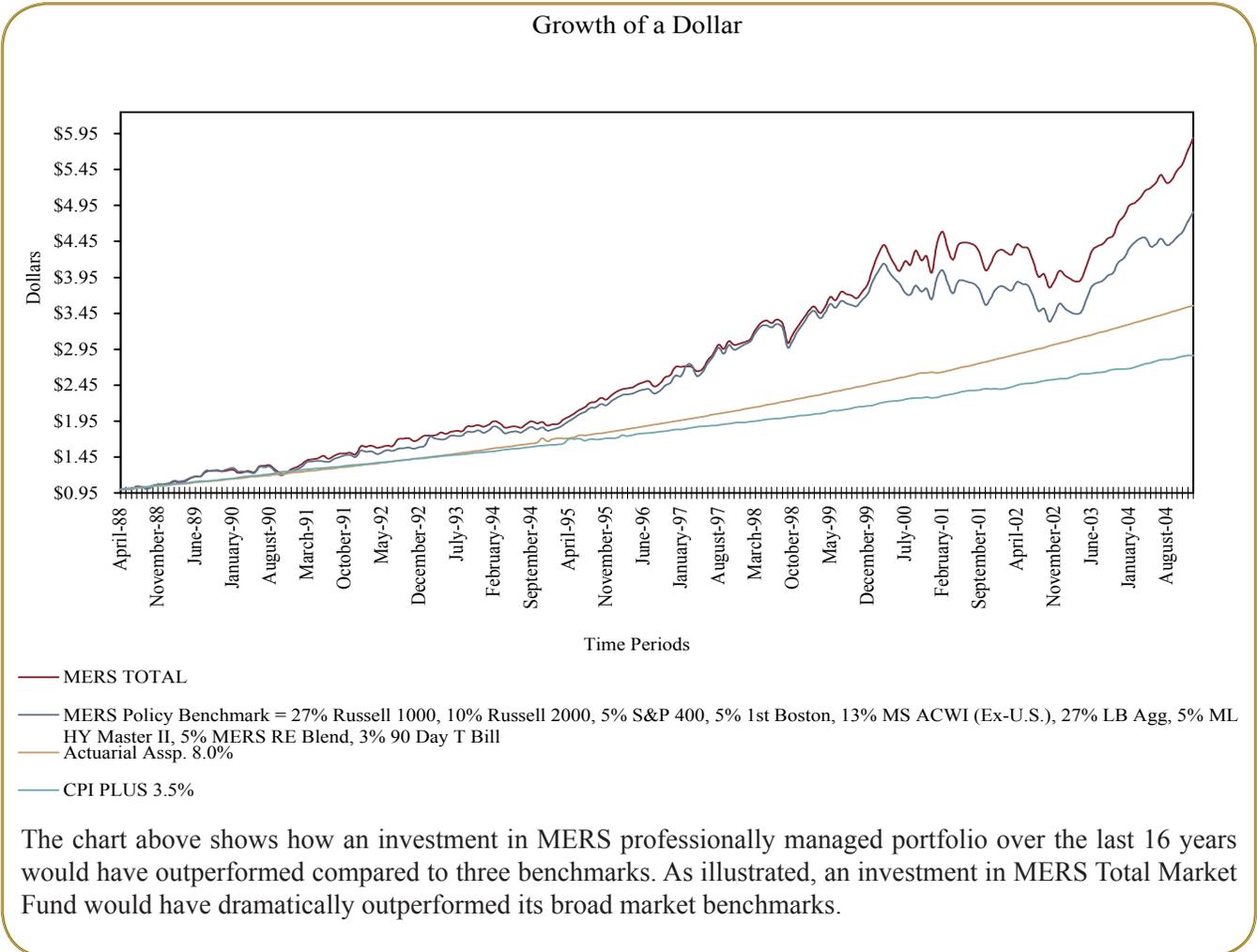
In addition, the Retirement Board has established Investment Guidelines that are updated annually. These guidelines communicate long-term objectives, goals, and performance expectations to the staff, investment managers, consultants, and all other interested parties. The Retirement Board strives to add incremental return relative to the market by employing active management strategies where appropriate. Every effort is made to minimize costs to the portfolio with the use of skilled



MERS Defined Contribution Plan

The plan is available for adoption by all MERS member municipalities. It is an alternative option to MERS Defined Benefit Plan. Each member is responsible for directing the investment of his or her accumulated account balance. Members receive investment performance information from MERS third-party administrator.

Example of Growth of \$5000 in MERS Defined Benefit Portfolio over 16 Years



MERS Customer Service for the year ended December 31, 2004

Service	Customers Served
Phone calls processed by the "Call Center"	22,000
Retirement seminar attendees	297
New membership applications	2,000
New retirees added during the year	1,550
New retirement applications processed	1,305
Deferred applications completed	1,053
Benefit estimates completed	2,042
Address changes	4,698
Refunds processed	795
Electronic fund transfer changes	2,000
Federal income tax withholding changes	2,000
Retirees receiving payroll checks	3,138
Retirees receiving electronic fund transfers	15,967

Statement of Plan Net Assets

This booklet provides a summary of the MERS Comprehensive Annual Financial Report for the fiscal year ended December 31, 2004. The Annual Report is prepared in accordance with generally accepted accounting principles (GAAP) and is subject to external audit. The complete 2004 Annual Financial Report can be obtained by contacting MERS at:

MERS of Michigan
1134 Municipal Way
Lansing, MI 48917
(800) 767-6377
Web site: www.mersofmich.com

Assets are investments held by the plan. The investments are stated at market value. The plan assets increased in 2004 primarily due to the new gains in investments of \$597 million dollars. Liabilities represent “debts” of the plan, mostly investments MERS has agreed to purchase after December 31, 2004. Net assets held in trust for pension benefits are maintained in several funds or accounts. Separate funds are maintained for (1) employee contributions; (2) employer contributions; (3) expenses of administration and maintenance of the plan; and (4) investment income and expenses to the plan.

MUNICIPAL EMPLOYEES' RETIREMENT SYSTEM OF MICHIGAN Statement of Plan Net Assets As of December 31, 2004

	December 31, 2004				December 31, 2003	
	Defined Benefit Plan	Defined Contribution Plan	Health Care Savings Program	Retiree Health Funding Vehicle	Total Trust Funds	Total Trust Funds
Assets						
Cash and Short-Term Investments	\$ 175,271,234	\$ 21,808,563	\$ 15,000		\$ 197,094,797	\$ 249,823,568
Receivables	118,385,163	1,191,449	129,272	108,697	119,814,581	164,218,943
Investments, at fair value	4,486,535,030	121,083,559	1,375,446	1,312,525	4,610,306,560	4,035,732,696
Invested Securities Lending Collateral	659,513,777				659,513,777	401,662,820
Prepaid Expenses	465,270				465,270	608,994
Fixed Assets, at cost, net of accumulated depreciation	2,772,594				2,772,594	3,010,286
Total Assets	5,442,943,068	144,083,571	1,519,718	1,421,222	5,589,967,580	4,855,057,307
Liabilities	823,447,407	-	196,599	2,570	823,646,576	665,578,950
Net assets held in trust for pension benefits	\$ 4,619,495,661	\$ 144,083,571	\$ 1,323,119	\$ 1,418,652	\$ 4,766,321,003	\$ 4,189,478,357

Statement of Changes in Plan Net Assets

The Statement of Changes in Plan Net Assets summarizes the inflows and outflows of money to the plan throughout the year. Most of the additions are comprised of employee and employer contributions to MERS along with income earned from MERS investments. Over the past few years, contributions have been increasing, generally attributable to municipalities adopting enhanced benefits and the market declines of 2000-2002. The outflows are comprised of payments to retirees, refunds of contributions to withdrawing members, and administrative expenses. The increase in benefits paid to retirees and beneficiaries has increased over the past ten years primarily due in large part to baby boomers reaching retirement age and drawing pension benefits. The financial statements were audited by Andrews Hooper & Pavlik P.L.C.

MUNICIPAL EMPLOYEES' RETIREMENT SYSTEM OF MICHIGAN Statement of Changes in Plan Net Assets For the Year Ended December 31, 2004

	Year Ended December 31, 2004					Year Ended December 31, 2003
	Defined Benefit Plan	Defined Contribution Plan	Health Care Savings Program	Retiree Health Funding Vehicle	Total Trust Funds	Total Trust Funds
Additions						
Contributions and Transfers	\$ 223,351,641	\$ 22,645,112	\$ 1,388,987	\$ 1,312,526	\$ 248,698,266	\$ 242,690,365
From Investment Activities						
Net Appreciation in Fair Value of Plan						
Investments	526,860,970	10,410,317	128,680	108,716	537,508,683	754,270,000
Interest and Dividends	65,353,541		1,340		65,354,881	43,599,842
Other	5,206,142				5,206,142	4,151,174
Total Investing Activity Income	597,420,653	10,410,317	130,020	108,716	608,069,706	825,848,876
Less Investment Expenses	12,061,649				12,061,649	9,738,809
Net Investment Income from Investing Activities	585,359,004	10,410,317	130,020	108,716	596,008,057	816,110,067
From Security Lending Activities						
Security Lending Income	7,513,231				7,513,231	5,294,319
Security Lending Expenses	6,171,892				6,171,892	4,467,121
Net Income from Security Lending Activities	1,341,339				1,341,339	827,198
Total Net Investment Income	586,700,343	10,410,317	130,020	108,716	597,349,396	816,937,265
Miscellaneous Income	819,466				819,466	822,347
Total Additions	810,871,450	33,055,429	1,519,007	1,421,242	846,867,128	1,060,449,977
Deductions						
Benefits	247,454,263	6,453,035	11,484		253,918,782	225,227,429
Refunds of Contributions	5,252,652				5,252,652	3,542,264
Transfers, Special Expenses and Fees	708,997				708,997	4,217,630
Administrative Expense	9,957,057		184,404	2,590	10,144,051	8,049,500
Total Deductions	263,372,969	6,453,035	195,888	2,590	270,024,482	241,036,823
Net Increase	547,498,481	26,602,394	1,323,119	1,418,652	576,842,646	819,413,154
Net assets held in trust for pension benefits						
Balance Beginning of Year	4,071,997,180	117,481,177	-	-	4,189,478,357	3,370,065,203
Balance End of Year	<u>\$ 4,619,495,661</u>	<u>\$ 144,083,571</u>	<u>\$ 1,323,119</u>	<u>\$ 1,418,652</u>	<u>\$ 4,766,321,003</u>	<u>\$ 4,189,478,357</u>



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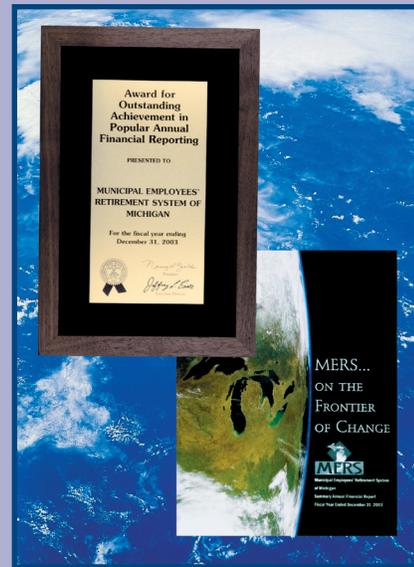
MERS RETIREMENT BOARD - 2004



Pictured are:
Standing (left to right): Dennis Murphy, Public Member; Raymond Klosowski, Employee Member; Bruce Johnson, Public Member; Larry Opelt, Retiree Member; Gary Murphy, Officer Member; John Ogden, Officer Member.
Seated (left to right): Barbara Fandell, Employee Member; Dale Walker, Chairperson-Officer Member; Kristen Wade, Chairperson Pro-Tem, Employee Member.

MERS is administered solely by this nine member Retirement Board consisting of members from a different county at the time of election. Members of the Retirement Board are volunteers who serve without compensation with respect to their duties. They are reimbursed by the Retirement System for their actual and necessary expenses (chiefly travel) incurred in the performance of their duties. The regular term of office for members of the Retirement Board is three years.

AWARD FOR OUTSTANDING ACHIEVEMENT FROM THE GOVERNMENT FINANCE OFFICER'S ASSOCIATION



MERS received the Award for Outstanding Achievement in Popular Annual Financial Reporting from the Government Finance Officer's Association for the December 31, 2003, Summary Annual Financial Report. This was the first year MERS received this award.