

MUNICIPAL EMPLOYEES'
RETIREMENT SYSTEM
OF MICHIGAN



SUMMARY ANNUAL FINANCIAL REPORT

For the Fiscal Year Ended
December 31, 2006



Celebrating
MERS Growth



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This booklet provides a summary of the MERS Comprehensive Annual Financial Report for the fiscal year ended December 31, 2006. The Annual Report is prepared in accordance with Generally Accepted Accounting Principles (GAAP) and is subject to external audit. The complete 2006 Comprehensive Annual Financial Report can be obtained by contacting MERS:

By mail: Municipal Employees' Retirement System of Michigan
1134 Municipal Way
Lansing, MI 48917

By phone: (800) 767-6377

Web site: www.mersofmich.com

The financial statements were audited by Andrews Hooper & Pavlik P.L.C.

This Summary Annual Financial Report is also available on our Web site at www.mersofmich.com.

MERS celebrated a significant year in 2006 - its 60th and 10th anniversary. MERS was established by the state of Michigan in 1946 and gained independence from the state in 1996. The theme for the year was "Firmly Rooted and Still Growing." It described MERS solid history and promising future.

Matt Borghi, MERS Web designer, donated the picture of the White Pine, Michigan's state tree.

Dear MERS Members:

I am pleased to present this consolidated version of the Comprehensive Annual Financial Report (CAFR) of the Municipal Employees' Retirement System (MERS) for the fiscal year ended December 31, 2006. Last year, we celebrated 60 years of operation and 10 years of being an independent system. The theme was MERS 60&10 Anniversary: Celebrating MERS Growth.

Goals

The Retirement Board set very strategic goals for MERS in 2006. These goals included providing all members with accurate information, excellent service and a cost-effective plan. With these objectives in mind, MERS pursues new ideas and develops programs to benefit all our members.

Membership

MERS is the choice for more than 700 communities across the state to pool their resources and provide solid retirement plans for their employees.

Investments – Defined Benefit Portfolio

The overall portfolio returned 13.6 % for one year, 10.1% for two years, 9.8% for five years and 8.8% for ten years. The portfolio ranked in the 42nd percentile for the five year period in The Northern Trust Universe of Public Funds. A combination of strong U.S. equity markets and the international equity allocation boosted the returns nicely in the fourth quarter. International equities returned 16.3 % making it the third year for a good run in foreign stocks. This type of performance makes your fund more secure while also reducing future costs to the taxpayers.

Funding

The December 31, 2006, Actuarial Valuation reports the consolidated funding to be 76.4%. 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.

Group Health Solutions Programs (Four Insurance Programs)

MERS Group Life and Disability Insurance Program, a program that allows members to collectively purchase various life and disability insurance products, has grown to over 120 member municipalities. The Health Care Savings Program (HCSP) has 56 member groups with \$6.8 million. The Retiree Health Funding Vehicle (RHFV) has 40 member groups with \$46 million in assets. MERS Premier Health, with the oversight provided by a duly elected Board, provides group health coverage for public employers. By year-end 2006, MERS Premier Health covers approximately 4,000 lives.

Education

More than 5,000 members attended one of MERS educational programs in 2006. The programs, mostly conducted by MERS staff, include: Regional Meetings, featuring pension and insurance topics of interest for employers and employees; Retirement workshops for members contemplating retirement in the next three to five years; the newly introduced Successful Retirement Seminar designed to offer topics such as financial planning, Social Security and health care.

Technology

MERS Automated Pension System (MAPS) software is scheduled to begin testing mid-2007 with a target to finish by year-end 2007. The goal of this project is to expand our capabilities to capture information, eliminate redundant entry, and achieve superior data integrity.

Awards

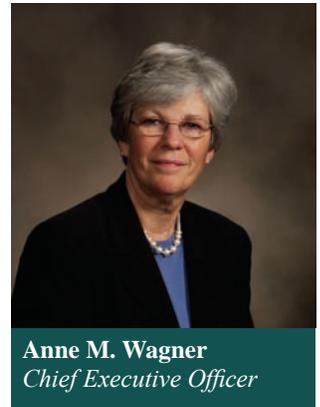
The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to MERS for its Popular Annual Financial Report for the year ended December 31, 2005. This is the third consecutive year that MERS has earned this prestigious award.

Acknowledgments

This brochure reflects the best combined efforts of the MERS staff under the leadership of the MERS Retirement Board. I want to express my appreciation to the staff, advisors and many others who have worked conscientiously to assure the success of MERS.

Respectfully submitted,

Anne M. Wagner
Chief Executive Officer



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Chief Executive Officer

Investment Overview

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.

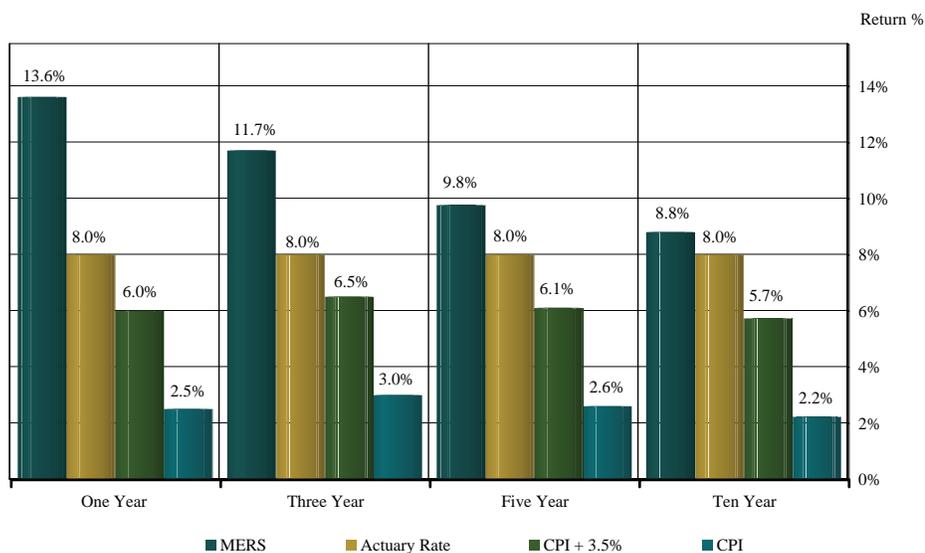
In addition, the Retirement Board has established Investment Guidelines that are updated annually. These guidelines communicate long-term objectives, goals and performance expectations to the staff, investment managers, consultants, and all other interested parties. The Retirement Board strives to add 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 internal and external resources without negatively affecting the performance of the portfolio.

The long-term objectives for the investment assets are:

- Achieve a real rate of return of at least 3.5% annually over the rate of inflation
- Exceed the actuarial assumption rate of 8% annually

The real rate of return is defined as the rate at which the long-term total return on the Retirement System's assets exceeds the long-term inflation rate. The graph below illustrates that MERS has achieved returns greater than the Consumer Price Index (CPI) plus 3.5% and the actuarial assumption rate of 8% over 10 years.

MERS Actual Returns versus Goals (Gross of Fees)



The portfolio is constructed to reduce volatility in down markets, yet still participate significantly when the equity markets rebound. In 2006, MERS Defined Benefit portfolio had a one-year gross return of 13.6% which helps MERS to fund your pension. 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.

MERS has a Defined Benefit Plan and a Defined Contribution Plan. As of December 31, 2006, the Defined Benefit Plan had net assets of \$5,590,042,692 and 65,100 members. The Defined Contribution Plan had net assets of \$203,115,102 and 6,831 members.

| MERS Participating Municipalities As of December 31, 2006 | |
|--|------------|
| Counties | 66 |
| Cities and Villages | 260 |
| Townships | 82 |
| County Road Commissions | 57 |
| Authorities, District and Others | 203 |
| Closed Groups | 17 |
| Total | 685 |

Defined Benefit Plan

MERS benchmark offering is our Defined Benefit (DB) retirement plan. MERS DB is a lifetime retirement benefit, which rewards longevity and promotes a strong knowledge base in your community, and is funded by the employer (with or without pre-tax employee contributions).

Defined Contribution Plan

The Defined Contribution Plan (DC) is a pension plan having terms that specify how contributions to a plan member's account are to be determined, rather than the amount of retirement income the member is to receive. The amount received by a member will depend only on the amount contributed to the member's account, earnings on investments of those contributions, and forfeitures of contributions made for other members that may be allocated to the member's account.

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.

Health Care Savings Program

The post employment Health Care Savings Program is an employer sponsored savings account designed to help employees set aside money to cover the escalating costs of post employment health care. Under the program, employers may make tax-free contributions to an employee's individual account. Upon leaving employment, the employee's account balance is available for tax-free reimbursement of medically related expenses, including health insurance premiums for the employee and eligible dependents.

Defined Benefit Plan Member Characteristics

| Item | December 31, 2005 | December 31, 2004 | December 31, 2003 |
|-----------------------------------|----------------------|----------------------|----------------------|
| Active Members | | | |
| Number of DB Active Members | 36,467 | 36,766 | 37,159 |
| Average Age | 44.9 | 44.6 | 44.3 |
| Average Benefits Service | 11.1 | 10.8 | 10.5 |
| Average Compensation | \$ 40,102 | \$ 39,091 | \$ 37,170 |
| Vested Former Member | | | |
| Number of Members | 6,126 | 5,804 | 5,575 |
| Average Age | 48.8 | 48.5 | 48.0 |
| Average Annual Deferred Benefit | \$ 7,165 | \$ 6,990 | \$ 6,680 |
| Retirees and Beneficiaries | | | |
| Number of Pensioners | 20,155 | 19,271 | 18,443 |
| Average Age | 69.2 | 68.4 | 69.4 |
| Average Annual Benefit | \$ 14,292 | \$ 13,607 | \$ 12,828 |

Summary Plan Net Assets and Changes

Summary Comparative Statements of Plan Net Assets

| Assets | As of | As of | Increase (Decrease) | Increase (Decrease) |
|---|-------------------------|-------------------------|-----------------------|---------------------|
| | December 31, 2006 | December 31, 2005 | Amount | Percent |
| Cash and Short-Term Investments | \$ 225,530,136 | \$ 266,259,383 | \$ (40,729,247) | -15.30% |
| Receivables | 224,851,017 | 157,534,335 | 67,316,682 | 42.73% |
| Interfund Receivables | 1,202,304 | 434,593 | 767,711 | 176.65% |
| Investments, at fair value | 5,769,420,916 | 4,985,756,769 | 783,664,147 | 15.72% |
| Invested Securities Lending Collateral | 905,007,240 | 719,094,377 | 185,912,863 | 25.85% |
| Other Assets/Prepays | 337,474 | 433,475 | (96,001) | -22.15% |
| Net Capital Assets | 6,641,104 | 3,878,603 | 2,762,501 | 71.22% |
| Total Assets | 7,132,990,191 | 6,133,391,535 | 999,598,656 | 16.30% |
| Liabilities | | | | |
| Purchase of Investments | 348,526,226 | 317,984,276 | 30,541,950 | 9.60% |
| Securities Lending Collateral | 905,007,240 | 719,094,377 | 185,912,863 | 25.85% |
| Administrative and Investment Costs | 15,890,222 | 6,563,876 | 9,326,346 | 142.09% |
| Interfund Payables | 1,202,304 | 434,593 | 767,711 | 176.65% |
| Other Accounts Payable | 16,843 | 711 | 16,132 | 2268.95% |
| Total Liabilities | 1,270,642,835 | 1,044,077,833 | 226,565,002 | 21.70% |
| Net Assets Held in Trust for Pension and Health Benefits and Investment Accounts Held for Others | \$ 5,862,347,356 | \$ 5,089,313,702 | \$ 773,033,654 | 15.19% |

The Statements of Plan Net Assets are summaries of what MERS owns and what it owes as of the end of the fiscal year.

Summary Comparative Statements of Changes in Plan Net Assets

| Additions | Year ended | Year ended | Increase (Decrease) | Increase (Decrease) |
|---|-------------------------|-------------------------|-----------------------|---------------------|
| | December 31, 2006 | December 31, 2005 | Amount | Percent |
| Contributions | \$ 439,052,040 | \$ 312,245,705 | \$ 126,806,335 | 40.61% |
| Transfers from Defined Benefit Plan | 751,160 | 22,573 | 728,587 | 3227.69% |
| Transfers from Other Plans and Other Items | 8,112,862 | 2,084,281 | 6,028,581 | 289.24% |
| Investment net income investing activities | 656,892,178 | 300,666,864 | 356,225,314 | 118.48% |
| Investment net income-securities lending | 2,524,348 | 2,135,791 | 388,557 | 18.19% |
| Miscellaneous Income | 790,789 | 6,026,437 | (5,235,648) | -86.88% |
| Total Additions | 1,108,123,377 | 623,181,651 | 484,941,726 | 77.82% |
| Deductions | | | | |
| Benefits | 314,764,086 | 283,629,190 | 31,134,896 | 10.98% |
| Refunds of Contributions | 4,711,038 | 4,157,567 | 553,471 | 13.31% |
| Special Expenses and Fees | 542,942 | 398,690 | 144,252 | 36.18% |
| Transfers to Defined Contribution Plan | 751,161 | 22,573 | 728,588 | 3227.70% |
| Medical Disbursements Paid to Members | 144,699 | 51,832 | 92,867 | 179.17% |
| Disbursements Paid to Municipalities | 1,109,386 | 95,470 | 1,013,916 | 1062.03% |
| Forfeited Employer Contributions | 44,724 | | 44,724 | 100.00% |
| Administrative Expense | 13,021,687 | 11,833,630 | 1,188,057 | 10.04% |
| Total Deductions | 335,089,723 | 300,188,952 | 34,900,771 | 11.63% |
| Net Increase | 773,033,654 | 322,992,699 | 450,040,955 | 139.33% |
| Net Assets Held in Trust for Pension and Health Benefits and Investment Accounts Held for Others | | | | |
| Balance Beginning of Year | 5,089,313,702 | 4,766,321,003 | 322,992,699 | 6.78% |
| Balance End of Year | \$ 5,862,347,356 | \$ 5,089,313,702 | \$ 773,033,654 | 15.19% |

The Statements of Changes in Plan Net Assets summarize the flow of money in and out of the fund throughout the fiscal year.



Municipal Employees’ Retirement System of Michigan

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MERS Retirement Board - 2006

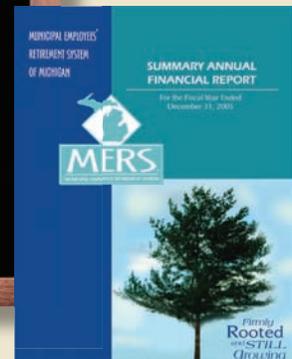
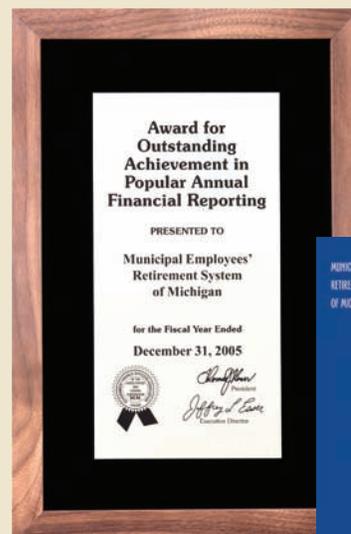
MERS is administered solely by this nine member Retirement Board consisting of members from a different county at the time of election. Members of the Retirement Board are volunteers who serve without compensation with respect to their duties. They are reimbursed by the Retirement System for their actual 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.



Standing left to right: Dennis Murphy, Public Member, Novi; John Ogden, Officer Member, City of Port Huron; Harold Hailey, Officer Member, Ingham County; Bruce Johnson, Public Member, Holland; Sally Dreves, Employee Member, Grand Traverse County; Larry Opelt, Retiree Member - Chairperson ProTem, Adrian.
Seated left to right: Sue Stahl, Employee Member, City of Bad Axe; Anne Wagner, MERS Chief Executive Officer; Dale Walker, Chairperson, City of Cadillac; Raymond Klosowski, Employee Member, Isabella County.

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, 2005, Summary Annual Financial Report. This is the third year MERS has received this award.