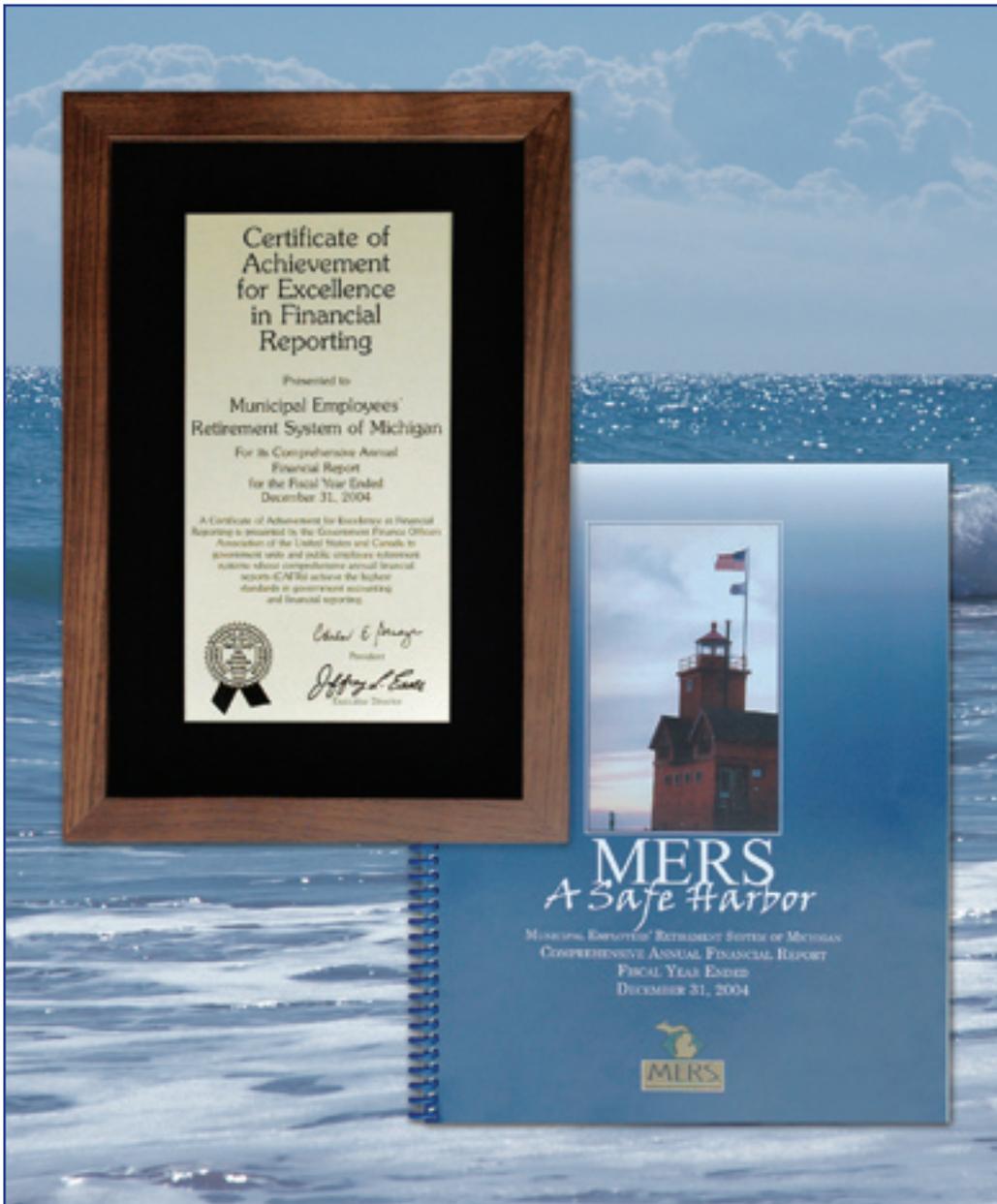

INTRODUCTORY SECTION



MERS received the Certificate of Achievement for Excellence in Financial Reporting from the Government Finance Officer's Association for the December 31, 2004 Comprehensive Annual Financial Report. This marks the 17th consecutive year MERS has received this honor.

INTRODUCTORY SECTION

THIS PAGE INTENTIONALLY LEFT BLANK

INTRODUCTORY SECTION

LETTER OF TRANSMITTAL



Our present is your future

June 15, 2006

The Retirement Board
Municipal Employees Retirement System of Michigan
1134 Municipal Way
Lansing, MI 48917

Dear Board Members:

It is with pleasure I submit the 2005 Comprehensive Annual Financial Report (CAFR) of the Municipal Employees' Retirement System of Michigan (MERS) for the fiscal year ended December 31, 2005. MERS has provided retirement plan administration to its member municipalities across the great state of Michigan for almost sixty years.

MERS, from its inception under state legislature in 1945, continues to provide an avenue for local governing bodies to pool their resources to provide retirement benefits for the welfare of their member employees. The MERS staff, in partnership with the Retirement Board, has worked diligently over the years to improve the benefits and services to members. The focus remains to bring economies of scale to the member municipalities across Michigan.

MERS, as a voluntary statewide organization, continues to add to the membership roster. Examples of our continuous growth may be found in the **Introductory Section**. This section includes the Letter of Transmittal, Letter from the Chairperson of the Retirement Board, the GFOA Certificate of Achievement, administrative organization details and a review of MERS activities covering the Defined Benefit (DB) Plan, the Defined Contribution (DC) Plan and the MERS Group Health Solutions Programs.

INTRODUCTORY SECTION

The following sections are also included in this CAFR:

- **Financial Section.** Management's Discussion and Analysis (MD&A), report of the independent auditor, and the retirement system's financial statements and supplemental information for the DB Plan.
- **Investment Section.** Summary of investment activity, an explanation of investment policy, portfolio performance information, and various investment schedules for both the DB and DC plans.
- **Actuarial Section.** Actuary's Certification Letter and summaries for the DB Plan.
- **Statistical Section.** Statistical information on all plans.

The responsibility for the accuracy and completeness of the financial data and the fairness of the presentation rests with the Chief Executive Officer and the management of MERS.

As of December 31, 2005, MERS members included employees from 659 municipalities across the state (see page 31).

Financial

The basic financial statements have been prepared in accordance with Generally Accepted Accounting Principals (GAAP) applied on a consistent basis as promulgated by the Governmental Accounting Standards Board and its predecessor, the National Council on Government Accounting. The MD&A provides a narrative introduction, overview and analysis to accompany the basic financial statements. This Letter of Transmittal is designed to complement the MD&A and should be read in conjunction with it. The MD&A can be found in the Financial Section immediately following the independent auditor's report (see pages 20-25).

Investments – Defined Benefit Portfolio

The U.S. economy shifted slightly to a lower pace of growth during the year but the Federal Reserve Bank (Fed) continued to raise the overnight interest rates in response to inflationary fears. On a gross of fee basis, the overall portfolio returned 6.8% for one year, 10.8% for two years, 6.6% for five years and 8.7% for ten years.

The portfolio ranked in the 23rd percentile for the five year period in The Northern Trust universe of public funds. This universe is comprised of 34 plans with a total market value of \$237 billion. The plans range in size from \$56 million to \$36 billion with a median market value of \$3.7 billion. The portfolio ended the fiscal year with \$4.9 billion in assets.

Stellar performance in the non-U.S. equity markets summarized the equity returns for the 2005 calendar year. The international equity sector returned 19.3% versus the domestic portfolio at 3.8%.

The fixed income theme for the year was the flattening of the yield curve as short rates rose in response to the Fed tightening. The portfolio continued a modest pace during the year, providing marginally positive returns for the year at 2.2% versus the Lehman Aggregate Bond Index at 2.4%. The high yield segment produced returns of 6.0% versus the Merrill Lynch High Yield Master II Index at 2.7%. MERS strictly adheres to its strategic asset allocation model. This provides discipline as well as the ability to take advantage of opportunities that occur in the global market place. The MERS staff concluded the strategic asset allocation study which occurs every five years with recommendations to begin a commodities manager search and pursue a global high yield bond mandate. The portfolio is rebalanced annually to the selected target asset allocation model.

Please refer to the **Investment Section** for more detailed comments on the portfolio.

Funding

The December 31, 2004, Actuarial Valuation reports the consolidated funding percentage of 77%. 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.

Group Health Solutions Programs

MERS expanded into the health care arena in the fall of 2003 by introducing the Group Life and Disability Insurance Program. The program pools the buying power of the MERS membership to collectively purchase various life and disability insurance products through The Standard Insurance Company. At the close of 2005, there are a total of 101 employers enrolled in this program covering 6,600 lives with average savings of 35%. In 2004, MERS continued to broaden our benefits in response to the new Governmental Accounting Standards Board (GASB), Other Post Employment Benefits (OPEB) standards by creating the Health Care Savings Program and Retiree Health Funding Vehicle. The Health Care Savings Program covers over 800 members in twenty-nine municipalities across Michigan with over \$4 million in assets. The Retiree Health Funding Vehicle has twenty-two employers enrolled with over \$13 million being invested and saved for retiree health care costs.

MERS Premier Health, with oversight by an interim board, provides group health coverage for public employers including employee and retiree medical, prescription drug, dental and vision

INTRODUCTORY SECTION

benefits. MERS Premier Health is a municipal risk pool for employee health benefits and is regulated and authorized (licensed) by the state of Michigan as the first Public Multiple Employer Welfare Arrangement (MEWA). The innovative health plan began partnering with municipalities in May 2005 and, by year end, had already enrolled 14 municipalities.

Michigan communities are facing budget problems due to declining revenues combined with expanding health care costs. MERS remains committed to provide economies of scale, continuity of service, and quality, cost effective benefits for our membership, resulting in much needed relief in the area of health care. We are dedicated to improve the health and economic welfare of our members and the Michigan communities that they support through Group Health Solutions programs.

Technology

MERS Electronic Payroll and Services System (ePASS) project was developed as a custom web-based payroll interface for our employers replacing the old wage and service software. ePASS went live on 10/1/2004 with a phased rollout ending on 9/30/2005. All MERS employers are now using the new software. Almost 90% rank the new program as very easy if not somewhat easy to use. We continue to make minor adjustments as time and resources allow.

MERS Automated Pension System (MAPS) will begin its final year of development in 2006. This comprehensive project is designed to replace the PeopleSoft pension administration software currently in use. The initial valuation component and the benefits calculator were completed and tested this year. The goal is to expand our capabilities to capture information, eliminate redundant entry, and achieve superior data integrity.

Expansion of web-based capabilities continues to remain a top priority at MERS. We continue to explore the use of security-enhanced software to allow communication, provide up-to-date information, and on-line services to our members and prospective members. We look back over MERS history with satisfaction and pride, while at the same time remaining committed to proactively address the future. We continue to work hard to provide excellent service and retain the trust of our membership.

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 Comprehensive Annual Financial Report for the year ended December 31, 2004. This was the 17th consecutive year that MERS has achieved this prestigious award.

In order to be awarded the Certificate of Achievement, a government unit must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy

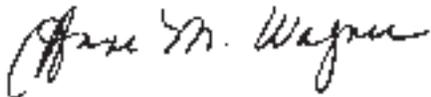
both GAAP and applicable legal requirements. A Certificate of Achievement is valid for a period of one year only. We believe this current report continues to meet the Certificate of Achievement Program requirements, and we are submitting it to the GFOA to determine its eligibility.

In addition, in 2005 MERS was awarded the GFOA Budget Award for its 2004 budget submission, as well as the 2004 Popular Annual Financial Report.

Acknowledgments

This report reflects the best combined efforts of the MERS staff under the leadership of the MERS Retirement Board. I would like to take this opportunity to commend the efforts of the staff in creating another outstanding report. Additionally, I want to express my gratitude to the Retirement Board for their dedication and conscientious service to the System and the many other advisors, organizations, and individuals who have worked so conscientiously to assure the success of the Municipal Employees' Retirement System of Michigan.

Respectfully submitted,



Anne M. Wagner
Chief Executive Officer

LETTER FROM THE CHAIRPERSON



Our present is your future

June 15, 2006

Dear Members:

On behalf of the MERS Retirement Board, I am pleased to present the Municipal Employees' Retirement System's 59th Comprehensive Annual Financial Report (CAFR) for the fiscal year ended December 31, 2005. This financial report provides information on the status of our retirement system.

Diversification was the key in the Defined Benefit portfolio as it delivered a 6.8% return for the one-year period and 8.7% for the ten-year period. These positive returns assist in meeting our actuarial benchmarks. The board's investment policy is reviewed periodically and it continues to focus on preserving the retirement system's assets while maximizing the long-term growth of those assets.

Regional meetings and retirement seminars continued in 2005 both in the home office and around the state. Retirement seminars are designed for those members contemplating retirement in the next three to five years. Regional meetings cover pension, benefit, health care, and insurance topics of interest for employers and employees. The major project undertaken to rewrite the wage and service software, "electronic Payroll and Service System" (ePASS), was completed in September expanding MERS' use of eCommerce to collect payroll information from our participating municipalities.

At the 2005 Annual Meeting in September, delegates elected Mr. Harold Hailey, Human Resource Director at Ingham County, as Officer member for a three-year term (January 1, 2006-January 1, 2009) and Ms. Sue Stahl, Administrator for the City of Bad Axe, to complete the remainder of the term (January 1, 2006-January 1, 2007), left vacant by Ms. Barbara Fandell's resignation from the Board to serve as Treasurer for the City of Ithaca. The Board appointed Mr. Bruce Johnson and Mr. Dennis Murphy as the Public members to three-year terms commencing January 1, 2006. The nine-member Retirement Board works conscientiously to fulfill its fiduciary responsibilities and serve the membership. MERS is the beneficiary of the Board members' diverse expertise and experience. It is a privilege for me to serve as your Chairman and to be able to serve alongside trustees of such high caliber and dedication.

If you have any questions regarding this report or other retirement questions, please contact us at (800) 767-6377, or send us a letter addressed to MERS, 1134 Municipal Way, Lansing, MI 48917.

In closing, I wish to thank the Board members and outstanding staff for continuing to maintain their high level of commitment and service to the retirement system's participants. The members of this retirement system should be very proud of the excellence and dedication presented to you in order that we all may have the necessary funds available to provide for retirement. "Our present is your future" is still a key and vital vision statement.

Sincerely,



Dale M. Walker, Chairman
MERS Board of Trustees

MERS RETIREMENT BOARD
2005



Back row (left to right): Bruce Johnson, Sue Stahl, John Ogden, Harold Hailey, Dennis Murphy. Seated (left to right): Dale Walker, Larry Opelt, Sally Dreves, Ray Klosowski.

Chairperson-Officer Member
Mr. Dale Walker, Chairperson
City of Cadillac

Retiree Member - Chairperson ProTem
Mr. Larry Opelt
Adrian, MI

Employee Member
Ms. Sally Dreves
Grand Traverse County

Officer Member
Mr. Harold Hailey
Ingham County

Public Member
Mr. Bruce Johnson
Holland, MI

Employee Member
Mr. Raymond Klosowski
Isabella County

Public Member
Mr. Dennis Murphy
Novi, MI

Officer Member
Mr. John Ogden
City of Port Huron

Employee Member
Ms. Sue Stahl
City of Bad Axe

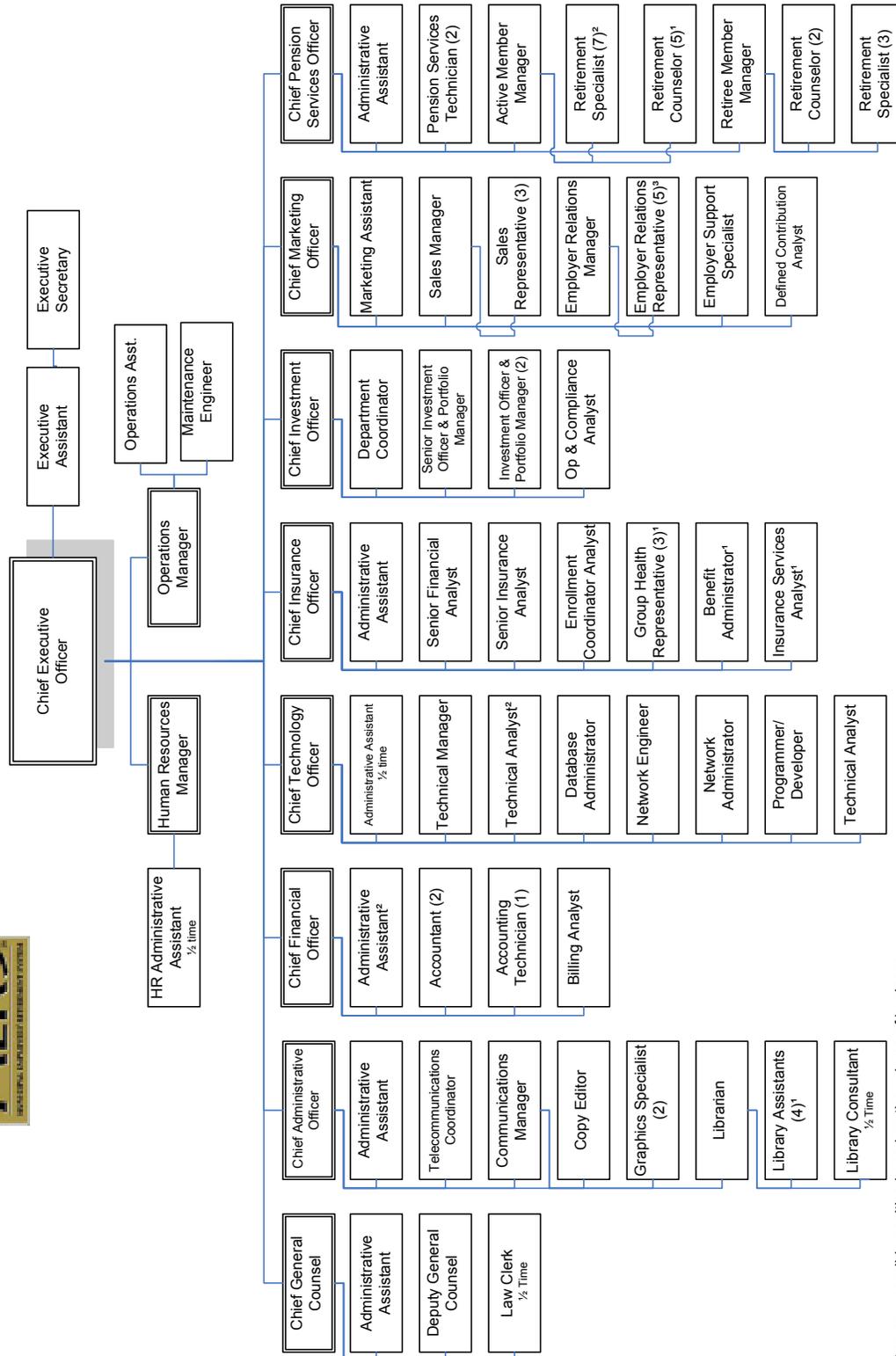
ADMINISTRATIVE ORGANIZATION



Officers: (Standing left to right): Jeb Burns, Chief Investments Officer; Luke Huelskamp, Chief Financial Officer; Kathy House, Chief Marketing Officer; William SaintAmour, Chief Administrative Officer; Michael Moquin, Chief General Counsel.
(Seated left to right): Debra Peake, Chief Pension Services Officer; Anne M. Wagner, Chief Executive Officer; Carrie Lombardo, Chief Insurance Officer.
(Not pictured) Tama Allen, Chief Technology Officer.



ORGANIZATIONAL CHART - 2005



¹One new possible position based on the volume of business.
 ²One new proposed position.
 ³Two new possible positions based on the volume of business.

Outside Professional Services

Professional Consultants

Actuary

Gabriel, Roeder, Smith & Company

Auditor

Andrews, Hooper & Pavlik, PLC

Defined Contribution Third-Party

Administrator

International City/ County Management
Association Retirement Corporation
(ICMA-RC)

Investment Custodian

The Northern Trust Company

Legal Counsel

Ice Miller
John Eggersten, P.C.
Loomis, Ewert, Parsley, Davis & Gotting
Miller, Canfield, Paddock & Stone, PLC

Legislative Consultants

Karoub Associates
Matt Wesaw

Medical Advisor

Associated Physicians
Consulting Physicians

Security Lending Agent

The Northern Trust Company

***Systems Implementation and
Maintenance***

Gabriel, Roeder, Smith & Company
Oracle/ PeopleSoft

Investment Managers

Domestic Equity

Ariel Capital Management
Barclays Global Investors
Kennedy Capital Management
Trust Company of the West
Wasatch Advisors
Wellington Management Company
LSV Asset Management
Delaware Investment Advisors

International Equity

Acadian Asset Management
Barclays Global Investors
Mondrian Investment Advisors

Fixed Income

Barclays Global Investors
Evergreen Investments
Reams Asset Management
Western Asset Management

Real Estate

Urdang Investment Management
Townsend Group Consultants
Guggenheim Structures Real Estate Fund
Hancock Timber Resources
J.P. Morgan Investment Management
KBS Realty Advisors
Prudential Property Management
SSR Realty Advisors
UBS Realty Investors, LLC
LaSalle Investment Management
CB Richard Ellis Investors
FIA Timber Partners
Starwood Capital Group

Private Equity

Credit Suisse First Boston
Mesirow Capital Partners
Barclays Global Investors
Money Management Group

“From harvest to finished product, timber is a six billion dollar industry in Michigan. Sawlog production is in excess of 500 million board feet annually. Farm woodlots in southern Michigan produce nearly 15 percent of the total cut of sawlogs, and are an extremely important source of hardwood timber due. Hardwoods comprise about 80 percent of the total sawlog harvest in the state.”

Norman F. Smith

“Trees of Michigan and the Upper Great Lakes”

Publisher: Samuel Speigel, Thunder Bay Press
