FINANCIAL SECTION

A Commitment to Accountability

We are committed to promoting fiscally sound policies, in our business practices and also to our members and participants. As trustee and fiduciary of the MERS Plan, the Board has the duty to operate on behalf of municipalities for the exclusive benefit of retirees, beneficiaries and participants.

FINANCIAL SECTION

AHP
CPAs & ADVISORS

ANDREWS HOOPER PAVLIK PLC
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Independent Auditors' Report

Retirement Board
Municipal Employees' Retirement System of Michigan

Report on the Financial Statements

We have audited the accompanying financial statements of the Municipal Employees' Retirement System of Michigan, which comprise the statement of plan net position as of December 31, 2012, and the related statement of changes in plan net position for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net position of the Municipal Employees' Retirement System of Michigan as of December 31, 2012, and the changes in plan net position for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Other Matters

Report on Summarized Comparative Financial Information

We have previously audited the Municipal Employees' Retirement System of Michigan's 2011 financial statements, and we expressed an unmodified opinion on those audited financial statements in our report dated June 29, 2012. In our opinion, the summarized comparative information presented herein as of and for the year ended December 31, 2011 is consistent, in all material respects, with the audited financial statements from which it has been derived.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis, Schedule of Funding Progress, and Schedule of Employer Contributions be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The Schedule of Administrative Expenses; Schedule of Investment Expenses; Schedule of Payments to Consultants and Services; and the Introductory, Investment, Actuarial, and Statistical Sections are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The Schedule of Administrative Expenses, Schedule of Investment Expenses, and Schedule of Payments to Consultants and Services are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Schedule of Administrative Expenses, Schedule of Investment Expenses, and Schedule of Payments to Consultants and Services are fairly stated in all material respects in relation to the basic financial statements as a whole.

The Introductory, Investment, Actuarial and Statistical sections have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on them.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated May 8, 2013, on our consideration of the Municipal Employees' Retirement System of Michigan's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Municipal Employees' Retirement System of Michigan's internal control over financial reporting.

Andrews Hooper Pavlik PLC

Okemos, Michigan
May 8, 2013

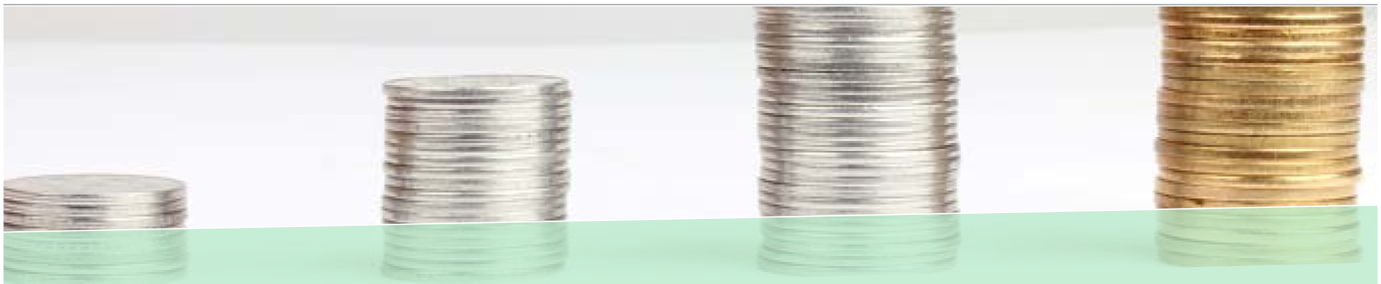
MANAGEMENT'S DISCUSSION AND ANALYSIS

This narrative overview and analysis of MERS financial condition for fiscal year ended December 31, 2012, is presented in conjunction with the Chief Executive Officer's and Chief Financial Officer's Letter of Transmittal. The Financial Section is comprised of the Independent Auditor's Report, Management's Discussion and Analysis, two basic financial statements with explanatory notes, two required supplementary schedules with explanatory notes and three supplementary expense schedules.

FINANCIAL HIGHLIGHTS

The following financial highlights occurred during the fiscal year ended December 31, 2012:

- Total net position for the Defined Benefit Plan, Defined Contribution Plan, Health Care Savings Program, Retiree Health Funding Vehicle, 457 Program, and Investment Services Program increased by 17% during 2012. MERS finished the year with $7.7 billion in net position, $1.1 billion higher than the previous year.
- Investment returns saw a gain of 11.39%. The 10 year return of 8.06% remains on target with MERS expected investment rate of return of 8%.
- MERS' most recent actuarial valuation dated December 31, 2011 showed 491 of MERS 706 municipalities, funded 70% or better with 107 municipalities being over 100% funded. The average funding ratio of all 706 MERS municipalities was 81% at the latest valuation date based on the actuarial value of assets.
- Administrative expenses increased slightly by 2% in 2012 to $26 million in a year when MERS grew significantly and brought in 131 new municipal programs. This increase is significantly lower than previous years' administrative expense increases reflecting stronger cost control measures implemented in 2012.
- Investment expenses totaled $18 million. This is a 6% decrease from 2011 primarily due to lower investment manager fees.
- Total annual retirement benefits paid to retirees and beneficiaries increased $63 million to a total of $599 million.



Basic Financial Statements

This discussion and analysis is intended to serve as an introduction to MERS financial reporting which has the following components:

1. Statement of Plan Net Position.
2. Statement of Changes in Plan Net Position.
3. Notes to Basic Financial Statements.

The "Statement of Plan Net Position" and "Statement of Changes in Plan Net Position" provide the current financial condition of each of the MERS products.

The "Comparison Statement of Plan Net Position" and "Comparison Statement of Changes in Plan Net Position" presented in the Management's Discussion and Analysis provides a comparative summary of the financial condition of the System as a whole with the prior year results.

Required Supplemental Information

1. Schedule of Funding Progress.
2. Schedule of Employer Contributions.
3. Notes to the Schedules of Required Supplementary Information.

The "Schedule of Funding Progress" shows the progress MERS has made in accumulating sufficient assets to pay future retirement benefits when due. The schedule sets forth the actuarially funded status of the Defined Benefit Plan with historical trends in funding.

The "Schedule of Employer Contributions" shows the current annual employer contributions and the historical trend of employer contributions. From a long-term investment perspective, these schedules provide a better understanding of the changes over time in the funded status of the Plan.

Supplementary Expense Schedules

1. Schedule of Administrative Expenses.
2. Schedule of Investment Expenses.
3. Schedule of Payments to Consultants.

The expense schedules summarize all expenses associated with administering the Defined Benefit Plan.

Comparison Statement of Plan Net Position (Dollars in Thousands)

	As of Dec. 31, 2012	As of Dec. 31, 2011	Increase (Decrease) Amount	Increase (Decrease) Percent
Assets				
Cash and Short-Term Investments	$47,926	$104,658	$(56,732)	(54%)
Receivables	945,682	346,165	599,517	173
Interfund Receivables	305	276	29	11
Loans	3,932	3,816	116	3
Investments, at fair value	7,634,304	6,533,652	1,100,652	17
Invested Securities Lending Collateral	618,756	771,418	(152,662)	(20)
Other Assets/Prepaids	285	223	62	28
Net Capital Assets	8,508	7,300	1,208	17
Total Assets	**9,259,698**	**7,767,508**	**1,492,190**	**19**
Liabilities				
Purchase of Investments	893,464	370,788	522,676	141
Securities Lending Collateral	620,739	776,696	(155,957)	(20)
Administrative and Investment Costs	10,197	6,250	3,947	63
Interfund Payables	305	276	29	11
Total Liabilities	**1,524,705**	**1,154,010**	**370,695**	**32**
Net Position-Restricted for Pension and Health Benefits and Investment Accounts Held for Others	**$7,734,993**	**$6,613,498**	**$1,121,495**	**17%**

Comparison Statement of Changes in Plan Net Position (Dollars in Thousands)

	Year ended Dec. 31, 2012	Year ended Dec. 31, 2011	Increase (Decrease) Amount	Increase (Decrease) Percent
Additions				
Contributions	$996,946	$451,524	$545,422	121%
Investment Net Income Investing Activities	746,132	136,531	609,601	446
Investment Net Income-Securities Lending	3,759	2,900	859	30
Miscellaneous Income	94	446	(352)	(79)
Total Additions	**1,746,931**	**591,401**	**1,155,530**	**195**
Deductions				
Benefits	598,752	536,168	62,584	12
Special Expenses and Fees	71	444	(373)	(84)
Transfers and Forfeitures	760	150	610	407
Administrative Expense	25,853	25,289	564	2
Total Deductions	**625,436**	**562,051**	**63,385**	**11**
Net Increase (Decrease)	1,121,495	29,350	1,092,145	3721
Net Position-Restricted for Pension and Health Benefits and Investment Accounts Held for Others Balance Beginning of Year	6,613,498	6,584,148	29,350	0
Balance End of Year	**$7,734,993**	**$6,613,498**	**$1,121,495**	**17%**

Analysis of Plan Net Position

The plan net position increased by $1.1 billion over the previous fiscal year primarily due to investment returns of $750 million and new municipalities joining MERS contributing $477 million in assets, including $467 million in new assets added when the City of Flint and Hurley Hospital joined MERS. MERS is a voluntary statewide program with new municipalities joining every year.

The overall employer and employee contributions increase of $545 million in 2012 was chiefly due to new municipalities joining the retirement system. Some municipalities also had fluctuations due to changes in required actuarial contribution rates resulting from salary adjustments, plan modifications, and the number of employees. Regular employee contributions are increasing as a percentage of pay relative to employer contributions.

MERS had capital assets, net of accumulated depreciation, of approximately $8.5 million, mostly comprised of software and computer servers needed to run the System's pension administration and financial programs.

MERS has no long-term liabilities. The bulk of MERS liabilities at year-end are related to investment purchases that did not settle until early in 2013, accrued administrative and investment expenses, and securities' lending collateral.

Investment Activities

The performance of the Total Market Fund was favorable when compared to the benchmark over the past 10 years. The gross return of 11.39% was above the 8% actuarial return assumption target for the year. For both the five- and 10-year periods, the gross returns were 2.84% and 8.06% respectively, which compared unfavorably to the actuarial return assumption for the five-year return and favorably for the 10-year return. Net investment gains (net appreciation in fair value, less investment administrative expenses, plus securities lending income) were $750 million for the year. A further detailed analysis of investment returns is in the Investments Section.

MERS investments are managed to control the extent of downside risk that assets are exposed to while maximizing long-term gain potential. This positions the System to limit the impact of adverse market conditions. Portfolio diversification by asset class and style is an important element of investment risk control.

Investment activity is governed by the "prudent person rule." The "prudent person rule" establishes a standard for all fiduciaries that includes anyone who has authority with respect to the System. The "prudent person rule" states that fiduciaries shall discharge their duties solely in the interest of the System's participants and beneficiaries with a degree of diligence, care, and skill that a prudent person would ordinarily exercise under similar circumstances.

The "prudent person rule" permits the Board to establish an investment policy based on certain investment criteria, and allows for the delegation of investment authority to professional investment managers. Investment constraints are outlined, including the appropriate degree of risk. Investment managers are hired to execute the investment policy. They have full discretion for investment decisions within statutory authority, Board policy, and their respective guidelines. A list of investment managers under contract with MERS as of December 31, 2012, is in the Investments Section. A summary of the total System's assets is on page 65.

Funding Status

A pension plan is well funded when it has sufficient assets invested to meet all expected future obligations to participants. The greater the level of funding – the larger the ratio of assets to actuarial accrued liability. While the plan is not totally funded, annual contributions are being made at an actuarially determined rate to reach full funding. There is no single all encompassing test for measuring a retirement system's funding progress and current funded status. However, some common indicators that a retirement system has achieved progress in funding its obligations include: observing the changes over time of the ratio of valuation assets to actuarial accrued liabilities, and the pattern of the unfunded actuarial accrued liability as a percentage of active payroll. These ratios and numbers are in the Required Supplementary Information.

The MERS Retirement Board has adopted a funding methodology for the System to achieve the following major objectives:

- Develop level required contribution rates as a percentage of payrolls
- Finance benefits earned by present employees on a current basis along with paying the current portion of the unfunded accrued liability
- Accumulate assets to enhance benefit security
- Produce investment earnings and interest on accumulated assets to help meet future benefit costs
- Estimate the long-term actuarial cost of proposed amendments for the System's provisions
- Assist in maintaining the System's long-term financial viability

The actuarial method for calculating the accrued liability for all plans is entry age normal with the objective of maintaining employer contributions approximately level as a percentage of member payroll. A detailed discussion of the funding method is in the Actuarial Section.

MERS is an agent multiple-employer retirement system that pools assets of the participating employers for investment purposes, but maintains separate trusts for each individual employer. Each municipality is responsible for its own plan liabilities; a municipality cannot borrow from another municipality's account to pay for pension expenses. A measure of a municipality's funding progress is the ratio of its actuarial assets to actuarial accrued liabilities.

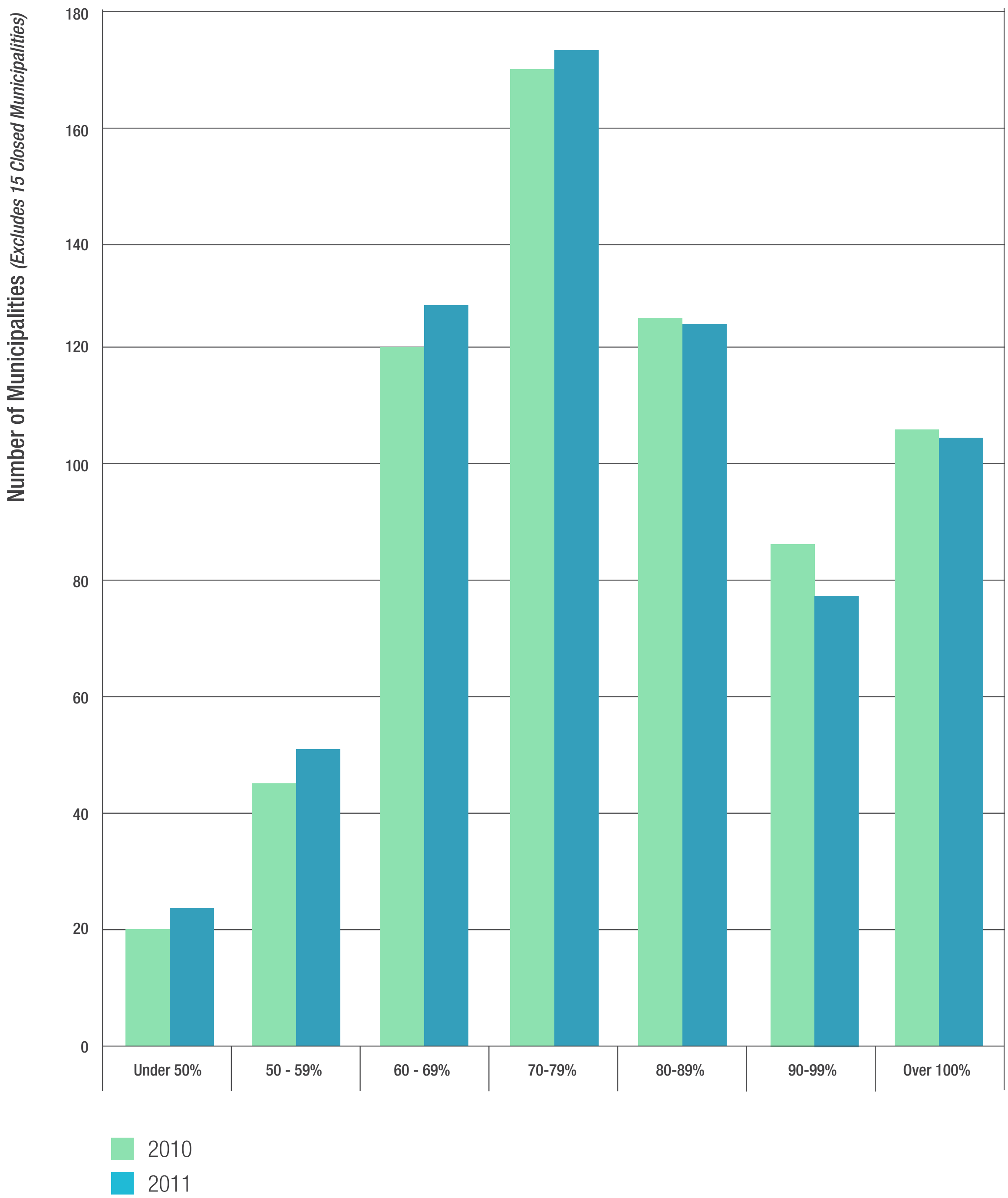
The most recent MERS actuarial valuation is as of December 31, 2011. On that date, the average funding ratio of all 706 individual MERS municipalities was 81%[1].

Funded Level	Number of Municipalities	Percentage of all Defined Benefit and Hybrid Plans
100% or higher	107 municipalities	15%
80% or higher	313 municipalities	44%
70% or higher	491 municipalities	70%
60% or lower	84 municipalities	12%
50% or lower	27 municipalities	4%

As a trend, the average funding ratio was 83% in 2010, and 82% in 2009. MERS partners with our local governments to determine the best retirement fit for each municipality, to offer cost-reducing strategies, and to provide fiscal best practices.

[1]Historically, MERS has reported the combined funding ratio of the System. This ratio is calculated using the grand totals of all assets and liabilities of each MERS individual plan added together. For December 31, 2011, that ratio is 72.6%. The comparable ratio for 2010 was 74.5%. Calculating this ratio provides less meaningful comparative value to an agent multiple-employer plan.

Distribution of Funded Percentage of Actuarial Accrued Liability among the 706 participating municipalities as of December 31, 2011 and the 700 participating municipalities as of December 31, 2010



Statement of Plan Net Position as of December 31, 2012 (Dollars in Thousands)

	Defined Benefit	Defined Contribution	Health Care Savings Program
Assets			
Cash and Short-Term Investments	$45,094	$493	$335
Receivables			
Employer and Member Contributions	32,583		
Sale of Investments	826,559	10,325	8,104
Investment Income	16,085	201	158
Loans		3,887	
Interfund Receivables	305		
Other	61	10	
Total Receivables	875,593	14,423	8,262
Investments, at fair value			
Fixed Income	2,113,892	26,408	20,728
Equities	2,940,447	36,734	28,832
Private Equity	511,582	6,391	5,016
Commodities	363,501	4,541	3,564
Cash Equivalents	439,152	5,486	4,306
Mutual Funds		283,703	1,871
Real Estate	407,652	5,093	3,997
Total Investments	6,776,226	368,356	68,314
Invested Securities Lending Collateral	618,756		
Prepaid Expenses	214		
Capital Assets, at cost, net of accumulated depreciation	8,508		
Total Assets	**8,324,391**	**383,272**	**76,911**
Liabilities			
Purchase of Investments	824,524	10,299	8,084
Securities Lending Collateral	620,739		
Forfeitures and Reserves			30
Administrative and Investment Costs	6,674	5	
Interfund Payables		104	7
Total Liabilities	**1,451,937**	**10,408**	**8,121**
Net Position-Restricted for Pension and Health Benefits and Investment Accounts Held for Others	**$6,872,454**	**$372,864**	**$68,790**

The accompanying notes are an integral part of these Financial Statements

Retiree Health Funding Vehicle	Investment Services Program	457 Program	Total Year Ended Dec. 31, 2012	Total Year Ended Dec. 31, 2011
$1,841	$37	$127	$47,927	$104,658
			32,583	36,181
48,970	995	717	895,670	295,263
953	19	13	17,429	14,721
		45	3,932	3,816
			305	276
			71	157
49,923	1,014	775	949,990	350,414
125,254	2,545	1,834	2,290,661	2,140,682
174,230	3,540	2,551	3,186,334	2,707,333
30,313	616	445	554,363	629,612
21,538	438	316	393,898	314,806
26,021	529	381	475,875	125,922
		5,858	291,432	237,529
24,154	491	353	441,740	377,767
401,510	8,159	11,738	7,634,303	6,533,651
			618,756	771,418
			214	66
			8,508	7,301
453,274	9,210	12,640	9,259,698	7,767,508
48,849	993	715	893,464	370,788
			620,739	776,696
		3,488	3,518	-
			6,679	6,250
62	1	131	305	276
48,911	994	4,334	1,524,705	1,154,010
$404,363	$8,216	$8,306	$7,734,993	$6,613,498

Statement of Changes in Plan Net Position for the Year Ended December 31, 2012 (Dollars in Thousands)

	Defined Benefit	Defined Contribution	Health Care Savings Program
Additions			
Contributions and Transfers In			
Employer Contributions and Other	$783,292	$24,931	$10,742
Plan Member Contributions	73,133	17,169	
Total Contributions and Transfers In	856,425	42,100	10,742
Investment Income			
Net Appreciation/Depreciation in Fair Value	580,402	37,367	4,498
Interest Income	56,802	709	557
Dividend Income	44,237	553	434
	681,441	38,629	5,489
Less Investment Expense	16,702	120	116
Net Investment Income Before Securities Lending Activities	664,739	38,509	5,373
Security Lending Activities			
Security Lending Income	4,805	60	47
Security Lending Expenses			
Borrower Rebates	470	6	5
Management Fees	866	11	9
Total Securities Lending Expenses	1,336	17	14
Net Income from Security Lending Activities	3,469	43	33
Total Net Investment Income	668,208	38,552	5,406
Miscellaneous Income			
Total Additions	**1,524,728**	**80,652**	**16,148**
Deductions			
Benefits	565,235	18,532	1,787
Special Expenses and Fees	71		
Transfers and Forfeitures	460		300
Administrative Expenses	24,412	759	144
Total Deductions	590,178	19,291	2,231
Net Increase/Decrease	934,550	61,361	13,917
Net Position-Restricted for Pension and Health Benefits and Investment Accounts Held for Others			
Balance Beginning of Fiscal Period	5,937,904	311,503	54,873
Balance End of Fiscal Period	**$6,872,454**	**$372,864**	**$68,790**

The accompanying notes are an integral part of these Financial Statements

Retiree Health Funding Vehicle	Investment Services Program	457 Program	Total Year Ended Dec. 31, 2012	Total Year Ended Dec. 31, 2011
$78,809	$700		$898,474	$376,358
		$8,170	98,472	75,166
78,809	700	8,170	996,946	451,524
31,568	689	88	654,612	64,330
3,365	68	49	61,550	53,475
2,621	53	38	47,936	37,890
37,554	810	175	764,098	155,695
990	23	15	17,966	19,164
36,564	787	160	746,132	136,531
285	6	4	5,207	4,151
28	1		510	526
51	1	1	939	725
79	2	1	1,449	1,251
206	4	3	3,758	2,900
36,770	791	163	749,890	139,431
			95	446
115,579	1,491	8,333	1,746,931	591,401
13,071	106	21	598,752	536,169
			71	444
			760	149
521	11	6	25,853	25,289
13,592	117	27	625,436	562,051
101,987	1,374	8,306	1,121,495	29,350
302,376	6,842	-	6,613,498	6,584,148
$404,363	$8,216	$8,306	$7,734,993	$6,613,498

NOTES TO BASIC FINANCIAL STATEMENTS

Year ended December 31, 2012

1. Reporting Entity and Plan Description

The Municipal Employees' Retirement System (MERS) of Michigan is an agent multiple-employer, statewide public employee pension plan that has helped provide retirement plans for municipal employees for more than 65 years. MERS was established by the Michigan Legislature under Public Act 135 of 1945 to provide pooled retirement plans specifically for Michigan municipalities on a voluntary basis. This Act was repealed and replaced by successor Municipal Employees' Retirement Act of 1984 (PA 427), as last amended by 2004 PA 490, embodied in the MERS Plan Document (as revised). MERS was established to provide a pooled program for retirement, survivor and disability benefits on a voluntary basis to the State of Michigan's local government employees.

On August 15, 1996, pursuant to 1996 PA 220, MERS became independent from the State of Michigan. Prior to that time, MERS was a component unit of the State and operated within the Department of Management and Budget. Since 1996, MERS is solely administered by a nine-member Retirement Board. It consists of the following members, each of whom, except for the retiree member and the Retirement Board appointees, shall be from a different county at the time of election:

- Two members, appointed by the Retirement Board, who have knowledge or experience in retirement systems, administration of retirement systems, investment management or advisory services
- One member, a retiree of the System, is appointed by the Retirement Board
- Three members of the System, officers of a participating municipality or of a participating court, who are elected as officer Board members by the delegates at the MERS Annual Meeting
- Three employee members of the System, who are not officers of a participating municipality or of a participating court, who are elected as employee Board members by the delegates at the MERS Annual Meeting

The regular term of office for members of the Retirement Board is three years. Members of the Retirement Board serve without compensation with respect to their duties, but are reimbursed by the System for their actual and necessary expenses incurred in the performance of their duties.

The MERS Retirement Board establishes the benefit plans and provisions that are available for adoption. The local municipality's governing body adopts all benefits of the plan. The various plans are discussed in the Actuarial Section. Pursuant to Article 9, Section 24 of the Constitution of the State of Michigan: "The accrued financial benefits of each pension plan and retirement system of the state and its political subdivisions shall be a contractual obligation thereof which shall not be diminished or impaired thereby. Financial benefits arising on account of service rendered in each fiscal year shall be funded during that year and such funding shall not be used for financing unfunded accrued liabilities."

Employee contribution rates vary depending on the benefit plan adopted by the local government. If an employee leaves employment or dies before becoming eligible for retirement benefits, accumulated employee contributions (plus interest) are refunded to the employee or designated beneficiary upon application.

The MERS programs have been determined to be a governmental plan that is a tax-qualified trust under Internal Revenue Code (the Code) Section 401(a), and tax exempt under Section 501(a). The Internal Revenue Service issued the most recent Letter of Favorable Determination for MERS on April 26, 2012. This updated approval is part of the Internal Revenue Service's Cycle C program for governmental plan Letters of Favorable Determination. The benefits of tax-qualified status include the preferential deferred taxability of contributions, accumulated earnings, pensions, rollovers, annual compensation limits, and benefit limitations.

Under the Code, the major portion of a retiree's pension becomes taxable upon periodic distribution. Pursuant to IRC Section 72(d), any "after tax contributions" are recovered tax-free over the life expectancy of the retiree (or beneficiary, if applicable).

The IRC Section 401(a) (17) limits the amount of compensation an active employee can receive for pension benefit calculation purposes and, correspondingly, limits the amount of employer and employee contributions. Compensation in excess of the 401(a) (17) limit ($250,000 for 2012 and $255,000 for 2013) will not be credited by MERS. Contributions in excess of the Internal Revenue Service limit will not be collected or accepted, nor figure into final average compensation for benefit purposes.

In addition, IRC Section 415 (b) (1) (A) imposes certain limitations on pension benefit payments from the MERS qualified trust. Any amounts that exceed the limitations shall be paid from a Qualified Excess Benefit Arrangement (QEBA), as authorized by IRC Section 415(m) and Michigan Compiled Law 38.1686. The QEBA shall be a separate plan, and is annually cash funded by the affected participating municipality or court. The Retirement Board established the MERS QEBA in 2003 solely for the purpose of providing retirees and beneficiaries, that portion of the retirement allowance exceeding the Section 415 limits, and otherwise not payable by the trust under the terms of the MERS qualified plan. The Internal Revenue Service approval of the QEBA was pursuant to Private Letter Ruling issued December 15, 2003. Retirees and beneficiaries do not have an election, directly or indirectly, to defer compensation to the QEBA.

The MERS Defined Contribution Plan became operative July 8, 1997, under Section 401(a) of the Internal Revenue Code. On this date, the MERS Plan Document of 1996 was first determined by the Internal Revenue Service Letter of Favorable Determination to meet qualifications as a "governmental plan" trust under Code Section 401(a), and tax exempt under Section 501(a). MERS has contracted with a third party administrator for recordkeeping and administrative functions. The plan is available to all MERS participating municipalities and may be adopted on a division-by-division basis. Plan provisions and requirements are specified in the MERS Plan Document. MERS Defined Contribution Plan provides employees with an account they manage. At retirement, benefits are based solely on the amount contributed by the employee and employer, and the performance of investments. The plan has several strategic investment categories designed to help employees meet their retirement goals. All participants have access to MERS streamlined investment menu that allows for simple and strategic investing.

The MERS Hybrid Plan is an option for members that includes both a defined benefit and a defined contribution component. The defined benefit component (Part I) is employer funded, with benefit multipliers of 1.0, 1.25, and 1.5%. The defined contribution component (Part II) is a combination of employer and employee contributions that are invested in mutual funds selected by the individual participant.

MERS received a Private Letter Ruling dated January 13, 2004 allowing the establishment of an Internal Revenue Code Section 115 Integral Governmental Trust, giving MERS the ability to create two programs – the Health Care Savings Program and the Retiree Health Funding Vehicle.

The MERS Health Care Savings Program became operational in June 2004 and was made available to all municipalities in Michigan. The employer-sponsored program provides medical reimbursement accounts to participating employees. Medical expenses are reimbursed, as defined in Code Section 213, once employees terminate employment, are on medical leave for six months or longer, or are on disability from any public pension plan. There are four types of contributions that may be used in the program: 1) Basic Employer (tax-favored), 2) Mandatory Salary Reductions (tax-favored), 3) Mandatory Leave Conversions (tax-favored), and 4) Voluntary Employee Contributions (post-tax).

As a result of the Private Letter Ruling, Code Section 213, reimbursements are tax-exempt for the employee, their spouse, and/or Code Section 152 dependent(s). The Health Care Savings Program accounts are invested in the MERS Investment Menu, and earnings are tax exempt as a result of the MERS Private Letter Ruling. Plan provisions and requirements are specified in the MERS Health Care Savings Program and Retiree Health Funding Vehicle Plan Document and Trust.

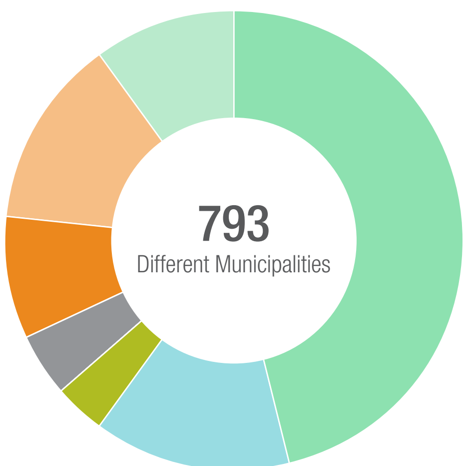
The MERS Retiree Health Funding Vehicle became operational in the fall of 2004 and was made available to all municipalities in Michigan. Participating municipalities can contribute monies to the Trust as desired and no contribution method in imposed. These funds constitute a health care fund, which enable municipalities to accumulate monies to provide or subsidize health benefits for retirees and beneficiaries as defined by Code Section 213. The Retiree Health Funding Vehicle accounts are invested in the MERS Core Investment Options and earnings are tax exempt as a result of the MERS Private Letter Ruling. Plan provisions and requirements are specified in the MERS Health Care Savings Program and Retiree Health Funding Vehicle Plan Document and Trust.

The MERS 457 Program was established as a deferred compensation plan and trust and became operational November 8, 2011. Its purpose is to provide benefits under the Plan to participants and beneficiaries upon retirement, termination, disability, or death, upon the terms and conditions, and subject to the limitations contained in the Plan. The Plan was created for the exclusive benefit of eligible participants and their beneficiaries of any employer electing to participate in the Plan. The Plan is intended to qualify under Code Section 457(b) and the Plan is intended to be tax-exempt under Code Section 501(a). All assets held in connection with the Plan, including all contributions and amounts of compensation deferred pursuant to the Plan, all property and rights acquired or purchased with such amounts and all income attributable to such amounts, property or rights shall be held in trust for the exclusive benefit of participants and their beneficiaries under the Plan. No part of the assets and income of the Plan shall be used for, or diverted to, purposes other than for the exclusive benefit of participants and their beneficiaries and for defraying reasonable expenses of the Plan.

The Investment Services Program is an investment trust fund that is available to all municipalities in Michigan to invest funds through the MERS portfolio while maintaining administrative functions at the municipal level. The program was established by the MERS Board in March 2006 and began operations in June 2006.

The Investment Services Program trust fund complies with all the requirements imposed by the Public Employee Retirement System Investment Act, 1965 Public Act 314. Participation in the Investment Services Program does not qualify as membership in MERS pension plans, and the participating employer does not have a vote at the MERS Annual Meeting.

MERS Participating Municipalities as of December 31, 2012



Defined Benefit	714
Defined Contribution	213
Hybrid	55
Investment Services Program	2
457 Supplemental Retirement Program	67
Tribal Government Retirement System	2
Retiree Health Funding Vehicle	132
Health Care Savings Program	202
Group Life and Disability	154

Note: There are 793 different municipalities that make up the 1,541 programs as many municipalities have more than one product.

Any “municipality” (a term defined by Section 2b (2) of the Retirement Act, Michigan Compiled Law 38.1502b (2)) within the state may elect to become a participating member of MERS by a majority vote of the municipality’s governing body, or by an affirmative vote of the qualified electors. Changes in retirement plan coverage are available to bargaining units after approval by a majority vote of the municipality’s governing body.

MERS Membership as of December 31, 2012

	Defined Benefit	Defined Contribution	Hybrid	Health Care Savings Program	457
Active	33,969	7,885	518	6,423	404
Deferred	7,738	NA	20	NA	NA
Retired	32,348	NA	8	NA	NA
Contributions not Vested	8,276	NA	375	NA	NA
Terminated	NA	2,325	NA	1,627	33
Product Totals	**82,331**	**10,210**	**921**	**8,050**	**437**

Total MERS Employment*	101,949
Total MERS Membership**	94,262

** Total Employment represents the total number of accounts within MERS, individuals may be represented multiple times across categories*

*** Total membership represents the number of unique individuals that have a liability in a program. At least one of the individual's employments fell into the following categories: Active Status, Retired Status, Terminated Status DB vested, Terminated Status DB not vested but has a contribution balance, Terminated Status Hybrid vested, Terminated Status Hybrid not vested but has a contribution balanace, Terminated Status DC with a contribution balance, or Terminated Status HCSP with a contribution balance.*

2. Summary of Significant Accounting Policies

Reporting Entity

The Retirement Board is responsible for the administration of the Retirement System, has fiduciary responsibility for the investment of assets, and oversees all funds included in these financial statements. The Retirement Board appoints the Chief Executive Officer who manages and administers the System under the supervision and direction of the Board.

MERS is an independent non-profit public corporation. MERS financial statements are not included in the financial statements of any other organization; it is the only entity included in this financial report.

Cost Allocation

The costs of administering the MERS Defined Benefit Plan are allocated to the municipalities along with investment gains and losses on a quarterly basis. The funding and accounting for each municipality is separate. The liabilities of each member municipality remain with that municipality, and the assets of one municipality cannot be used to pay the liabilities of another municipality. Additionally, the assets are combined for investment and administrative purposes, but maintained separately for accounting purposes.

The costs of administering the MERS Defined Contribution Plan, Health Care Savings Program, Retiree Health Funding Vehicle, and Investment Services Program are allocated out to the municipalities and members based on an administrative expense percentage for each municipality and member.

Basis of Accounting

The financial statements for MERS are prepared on the accrual basis in accordance with Generally Accepted Accounting Principles (GAAP) as applicable to government organizations. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period.

MERS Defined Benefit Plan employer and employee contributions are recognized when due pursuant to formal commitments, as well as statutory or contractual requirements. Benefits and refunds are recognized when due and payable in accordance with the terms of the Plan. Expenses and the associated liabilities for those expenses are also recorded using the accrual method when the liability is incurred.

The Defined Contribution Plan, 457 Program, Health Care Savings Program, Retiree Health Funding Vehicle and Investment Services Program financial statements are prepared using the modified accrual accounting method (which approximates the accrual basis of accounting) primarily for revenues which are recorded when funds are received and deposited. Expenses and the associated liabilities for those expenses are also recorded using the accrual method when the liability is incurred.

Plan investments are presented at fair value using the accrual method for those investments which are invested in the MERS portfolio. Investment purchases and sales and the associated investment payables and investment receivables, are recorded on their trade date. Investments invested outside of the MERS portfolio, (primarily mutual funds) are recorded at fair value.

GASB 27

The Governmental Accounting Standards Board (GASB) Statement No. 27, "Accounting for Pensions by State and Local Governmental Employers," requires certain changes in reporting pensions by employers.

The following section is required and pertains to MERS staff only:

Prior to separation from the State of Michigan on August 15, 1996, the pension liability for MERS staff remained the obligation of its official employer, the State of Michigan. Therefore, MERS has no pension liability for staff prior to August 15, 1996, when it began independent payroll processing separate and apart from the State of Michigan.

After separation from the State in 1996, the MERS Retirement Board (as an employer) elected to become a participating municipality in the MERS Defined Benefit Plan, and to provide pension benefits for MERS staff.

Vesting occurs after six years of credited service; normal retirement age is 60, although an employee may retire at age 55 with 30 years of credited service. The annual pension benefit is calculated by multiplying the employee's years of credited service by 2.25%, and then multiplying by the final average compensation based on the highest consecutive three years of compensation.

In 2012, MERS contributed 11.33% of compensation; employees contributed 2% of compensation.

The following pension information for GASB 27 applies to MERS staff only:

Schedule of Funding Progress

Actuarial Valuation December 31	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded (Over) AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a % of Covered Payroll ((b-a)/c)
2009	$9,202,748	$9,954,321	$751,573	92.45%	$8,198,952	9.17%
2010	11,347,345	11,893,235	545,890	95.41	9,113,922	5.99
2011	13,500,888	14,947,095	1,446,207	90.32	10,195,504	14.18

GASB 63

The Governmental Accounting Standards Board (GASB) Statement No. 63, "Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position," provides financial reporting guidance for deferred outflows and inflows of resources. It also amends the net asset reporting requirements of GASB Statement No. 34 and other pronouncement by incorporating deferred outflows and inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets. The requirements of this statement were effective for the periods beginning after December 15, 2011. MERS has implemented GASB Statement No. 63 for the fiscal year ended December 31, 2012.

Actuarial Accrued Liability from December 31, 2011 and December 31, 2010 Actuarial Valuations

	2011	2010
Active Members	$12,326,833	$9,930,102
Retirees and beneficiaries currently receiving benefits	2,218,957	1,558,188
Vested former members not yet receiving benefits	331,206	341,525
Nonvested terminated employees (pending refunds of accumulated member contributions)	70,099	63,420
Total Actuarial Accrued Liability	**14,947,095**	**11,893,235**
Net assets available for benefits at actuarial value ($11,196,484 and $9,757,623 at market value for December 31, 2011, and 2010, respectively)	13,500,888	11,347,345
Unfunded actuarial accrued liability	**$1,446,207**	**$545,890**

Three-Year Trend Information Schedule of Employer Contributions

Fiscal Year Ended	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
December 31, 2010	$994,080	100%	-
December 31, 2011	920,736	100	-
December 31, 2012	1,005,264	100	-

Post-Employment Benefits

The Government Accounting Standards Board (GASB) Statement No. 50, Pension Disclosures – an amendment of GASB Statements No. 25 and No. 27 – more closely aligns the financial reporting requirements for pensions with other post-employment benefits. This enhances information disclosed in the “Notes to Basic Financial Statements,” or presented as required supplementary information by pension plans and employers.

The MERS Retiree Health Funding Vehicle is designed to be an investment choice for municipalities rather than a plan for other post-employment benefits. The other post-employment benefit plan remains with the municipalities for their administration, and implementation of GASB Statement 50 will reside with them.

Fair Value of Investments

In accordance with GASB 25, plan investments are presented at fair value. Short-term investments are valued at cost plus accrued interest, 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 upon equivalent values of comparable securities with similar yield and risk. Independent appraisals are the basis for valuing the fair value of real estate. Other investments that do not have established markets are recorded at an estimated fair value. Real estate investments typically have a quarter lag in reporting, which is an industry standard.

Capital Assets

Office furniture, equipment, and software with a value of $5,000 or more are carried at cost, less accumulated depreciation. The capital assets are depreciated using the straight-line method over the estimated useful lives of the related assets varying from three- to eight-year spans. The table below is a schedule of the capital asset account balances as of December 31, 2011, and December 31, 2012.

Capital Assets	Office Furniture and Equipment	Software	Total Capital Assets
Balances December 31, 2011	$3,528,584	$19,742,401	$23,270,985
Additions	259,748	2,996,400	3,256,148
Deletions and Transfers	(646,128)	(4,038,669)	(4,684,797)
Balances December 31, 2012	**$3,142,204**	**$18,700,132**	**$21,842,336**
Accumulated Depreciation			
Balances December 31, 2011	$2,160,319	$13,810,159	$15,970,478
Depreciation Expense	539,029	1,509,192	2,048,221
Deletions and Transfers	(646,128)	(4,038,669)	(4,684,797)
Balances December 31, 2012	**$2,053,220**	**$11,280,682**	**$13,333,902**
Net Capital Assets December 31, 2012	**$1,088,984**	**$7,419,450**	**$8,508,434**

MERS occupies two buildings in Delta Township (west of Lansing) that it leases at fair market value rental rates from properties that are maintained in the MERS investment portfolio. These properties are actively managed by MERS Office of Investments staff. In 2012, MERS paid $687,600 in rent for the two buildings. At December 31, 2012, the two properties occupied by MERS staff had a value of $8.6 million.

Total Columns on Statements

The "Total" columns on the "Statement of Plan Net Position" and "Statement of Changes in Plan Net Position" are presented to facilitate financial analysis. Amounts in these columns do not present the plan net position and changes in plan net position in conformity with GAAP, nor is such data comparable to a consolidation. Transactions between the Defined Benefit Plan, Defined Contribution Plan, Health Care Savings Program, 457 Supplemental Retirement Program, Retiree Health Funding Vehicle, and Investment Services Program have not been eliminated from the "Total" columns.

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

3. Contributions and Reserves

Contributions

The Defined Benefit Plan contribution funding requirements are actuarially determined using the entry age normal actuarial cost method, and are based upon the benefit plan adopted by the municipality. Some municipalities fund their entire pension obligations solely from employer contributions. Most municipalities jointly fund pension obligations from employee and employer contributions. Monthly employee contributions are based upon a percentage of actual compensation as determined by the employer. Employer contributions are based upon projected compensation as determined by an annual actuarial valuation. Employee contributions are held in individual member accounts that are credited with interest annually. Pursuant to Board resolution adopted November 9, 2005, the interest rate for each year beginning in 2005 is the one-year T-bill rate as of December 31 each year for the ensuing December 31 employee interest calculation. It is also used for interest calculations the subsequent year for those employees requesting a refund of their contributions.

Contributions to the Defined Contribution Plan are reported directly to MERS by the participating municipalities, and are separate from contributions made to the MERS Defined Benefit Plan. Both employer contributions and employee voluntary and mandatory contributions are governed by the contribution limits under the Internal Revenue Code. Municipalities may elect to have mandatory employee contributions where the member pays a fixed dollar or percentage. If the municipality has a match contribution type, the member will elect the amount of contribution at the time of enrollment, and will not be allowed to make any changes. Municipalities may also choose to allow additional after-tax contributions through payroll deduction.

Participating municipalities may, upon adoption of a Defined Contribution resolution for new hires, offer current Defined Benefit employees an opportunity to opt into Defined Contribution. MERS transfers the actuarial present value of the employee's accrued benefit in the Defined Benefit Plan into the employee's Defined Contribution account (at a stipulated funded ratio that shall not exceed 100%). Employees direct their contributions to various investment options offered by the MERS Office of Investments, and may transfer their account balances between investment categories or make changes to the percentage allocation on a daily basis.

Defined Benefit Plan Reserves

Three reserves have been established pursuant to the MERS Plan Document. See "Schedule of Changes in Reserves" in the Statistical Section.

- Reserve for Employee Contributions

All additions to and deductions from this reserve are for the Defined Benefit Plan and Defined Benefit portion of the Hybrid Plan. Employee contributions and interest are credited to this reserve. Also credited are monies received from the purchase of service credit and monies received in repayment of previously refunded contributions. The reserve is reduced by amounts paid to employees who terminate employment and request refunds, and by amounts transferred into the "Reserve for Employer Contributions and Benefit Payments" upon an employee's retirement. Interest is credited to each employee's account, as provided in the Board's November 9, 2005 Resolution.

• **Reserve for Employer Contributions and Benefit Payments**

All additions to and deductions from this reserve are for the Defined Benefit Plan and Defined Benefit portion of the Hybrid Plan. All employer contributions are credited to this reserve. Net income is allocated to this reserve from the “Reserve for Expenses and Undistributed Investment Income.” At retirement, the employee’s accumulated contributions (if any and including interest) are transferred into this reserve from the “Reserve for Employee Contributions.” Monthly benefits paid to retirees reduce this reserve.

• **Reserve for Expenses and Undistributed Investment Income**

All additions to and deductions from this reserve are for the Defined Benefit Plan and Defined Benefit portion of the Hybrid Plan. All investment earnings and other monies received that are not dedicated to other areas are credited to this reserve. All administrative and investment expenses are paid from this reserve. Transfers from this reserve to the “Reserve for Employer Contributions and Benefit Payments” are at allocation rates determined by the Retirement Board.

Other Reserves

Each of the products outside of Defined Benefit Plan has its own reserve for additions and deductions to be recorded. MERS maintains separate employer account records for each municipality within the product.

A more detailed analysis of the reserves can be found in the Statistical Section.

4. Deposits and Investments

The Retirement Board has the fiduciary responsibility and authority to oversee the investment portfolio. Various professional investment managers are contracted to manage the System’s assets. All investment decisions are subject to statutory regulations imposed under the Michigan Public Employee Retirement System Investment Act, 1965 PA 314, as amended, and the investment policy guidelines established by the Retirement Board. Michigan law allows diverse investment in stocks, corporate and government bonds, mortgages, real estate, and other investments. The Act sets forth prudent standards and requires the assets of the Retirement System be invested solely in the interest of the participants and beneficiaries. Under Plan Document Section 55(6), and 1965 PA 314, and Section 401(a)(2) of the Internal Revenue Code, the investments shall be made for the exclusive purpose of providing benefits to the participants and their beneficiaries, and defraying reasonable expenses to the System.

The Retirement Board’s investment policy requires independent performance measurement of investment managers, and establishes total return objectives for the total portfolio and major categories of investments. As of December 31, 2012, all securities held met the required statutory provisions and Retirement Board policy. As of the same dates, no investments were in default or subject to bankruptcy proceedings that had not been previously recorded.

Cash Deposits

Custodial credit risk for cash deposits is the risk that, in the event of a failure of a depository financial institution, the system may not be able to recover it deposits. Balances on deposit are insured by the Federal Deposit Insurance Corporation (FDIC) up to specified limits. Balances in excess of FDIC limits are uninsured. MERS has not experienced any losses in its accounts and believes it is not exposed to a significant credit risk on its cash.

Credit Risk

Credit risk is the financial risk that an issuer or other counterparty will not fulfill its obligations to MERS. Credit risk exposure is dictated by each investment manager's agreement. Other criteria based on MERS Retirement Board's investment policy, includes that if a security is downgraded below investment grade after purchase, a review with a written explanation shall be forwarded to the Investments staff. Board policy also allows that when calculating the average rating of the portfolio, the manager may use the highest rating of the major rating agencies to calculate the average. Board policy, with regard to global fixed income securities, is that no more than 10% of the portfolio may be invested in corporate bonds or sovereign bonds rated below investment grade, as defined by Moody's and Standard & Poor's. Board policy for global fixed income securities is that the average weighted credit of the portfolio will be a minimum of A-. When calculating the average rating of the global portfolio, the manager may use the highest rating of the major agencies to calculate the average. Board policy with regard to global, non-investment grade fixed income securities includes criteria that credit quality must maintain a minimum of 10% of the portfolio in investment grade fixed income with at least two ratings of BBB-/Baa3 or higher (as assigned by Standard & Poor's or Moody's). Each portfolio is managed in accordance with investment guidelines that are specific as to permissible credit quality ranges, exposure levels within individual security quality rating tiers, and/or the average credit quality of the overall portfolio.

As of December 31, 2012, the domestic fixed income portfolio consisted of fixed income investments with respective quality ratings, excluding those obligations of the U.S. government. Investments issued by or explicitly guaranteed by the U.S. government are not considered to have credit risk.
The Plan's exposure to credit risk as of December 31, 2012, is presented on the following pages, by investment category as rated by Standard & Poor's, Moody's, and Fitch credit ratings.

Credit Ratings Summary - December 31, 2012

Quality Rating	Agencies	Asset Backed	Corporate Bonds	Foreign	LMTD Part Units
AAA/Aaa	$62,841,734	$3,670,444	$16,149,954	$0	$0
AA+/Aa1	63,900,916	81,938	33,322,724	411,959	0
AA/Aa2	5,473,160	2,481	17,363,369	0	0
AA-/Aa3	30,510,675	162,759	26,779,003	2,402,014	0
A+/A1	3,824,613	375,759	36,948,335	0	0
A/A2	18,077,629	1,030,730	86,932,848	3,502,937	0
A-/A3	40,960,888	0	116,917,963	7,443,741	0
BBB+/Baa1	16,287,641	643,330	89,052,461	11,484,630	0
BBB/Baa2	44,653,284	580,902	110,964,034	13,195,086	0
BBB-/Baa3	14,644,252	0	97,900,312	19,065,987	0
BB+/Ba1	5,437,789	0	58,834,650	9,970,860	0
BB/Ba2	12,924,003	180,759	32,929,857	11,434,588	0
BB-/Ba3	1,308,750	0	37,847,683	11,947,518	0
B+/B1	3,879,708	0	50,204,177	20,442,140	0
B/B2	993,755	0	28,557,986	7,443,741	0
B-/B3	903,232	0	23,657,757	3,915,080	0
CCC+/Caa1	0	0	8,673,261	0	0
CCC/Caa2	0	913,532	0	0	0
CCC-/Caa3	0	0	2,253,001	0	0
CC/Ca	0	288,491	775,258	0	0
C	0	0	0	0	0
D/C	0	928,134	530,000	0	0
NA	0	0	0	0	0
Cash with no ratings	0	0	982,642	713,098	0
NR*	1,671,976	567,782	30,715,865	5,138,676	335,554,308
Totals	**$328,294,005**	**$9,427,041**	**$908,293,141**	**$128,512,057**	**$335,554,308**

**The Not Rated classification includes $336 million in limited partnerships without credit ratings.*
Removing that classification leaves the overall portfolio at 2% Not Rated.

Reconciliation of Investments

Fixed income	$2,307,555,447
Total from page 39	2,274,647,243
Difference from Investments	32,908,204
Payables settling in 2013	(213,735,148)
Receivables settling in 2013	245,699,072
Foreign Exchanges settling in 2013	944,281
Small difference	(1)
Total	$32,908,204

Mortgage Backed Securities	Other	Short-Term Cash	U.S. Treasuries	Total	% of Portfolio
$22,188,814	$0	$0	$331,684,809	$436,535,755	19.19%
25,110,982	0	0	3,156,183	125,984,702	5.54
91,855,003	2,693,273	0	0	117,387,286	5.16
264,566	0	0	0	60,119,017	2.64
81,988	0	0	0	41,230,695	1.81
800,824	0	0	0	110,344,968	4.85
822,151	37,328	0	0	166,182,071	7.31
963,776	21,351	0	0	118,453,189	5.21
102,932	15,024	0	0	169,511,262	7.45
0	333,971	0	0	131,944,522	5.80
0	41,119	0	0	74,284,418	3.27
0	25,856	0	0	57,495,063	2.53
131,495	136,822	0	0	51,372,268	2.26
96,642	467,220	0	0	75,089,887	3.30
0	413,619	0	0	37,409,101	1.64
139,127	23,693	0	0	28,638,889	1.26
0	694,534	0	0	9,367,795	0.41
2,237,053	0	0	0	3,150,585	0.14
0	0	0	0	2,253,001	0.10
867,568	972,354	0	0	2,903,671	0.13
0	0	0	0	0	0.00
693,278	0	0	0	2,151,412	0.09
0	0	0	0	0	0.00
0	0	74,490,686	0	76,186,426	3.35
3,351,714	-349,065	0	0	376,651,256	16.56
$149,707,913	$5,527,099	$74,490,686	$334,840,992	$ 2,274,647,243	100%

Interest Rate Risk

Interest rate risk is the risk that an investment's value will change due to a change in the absolute level of interest rates. Interest rate risk is controlled through diversification of portfolio management styles. Duration is a measure of interest rate risk. The greater the duration of a bond or a portfolio of bonds, the greater its price volatility will be in response to a change in interest rates and vice-versa. Sensitivity to changing interest rates may derive from prepayment options embedded in an investment. The Board policy, in regard to interest rate risk, is that the effective duration of the domestic portfolio shall be (+/-) 20% of the Barclays Capital Aggregate Index or the Barclays Universal Bond Index. Board policy in regard to global non-investment grade fixed income securities is that the portfolio's duration is (+/-) 2 years of the benchmark duration. The benchmark for global non-investment grade fixed income securities is 1/3 Barclays Capital U.S. Treasury Inflation Protected Securities Index, 1/3 Citigroup High Yield Market Index, and 1/3 JP Morgan Emerging Markets Global Bond Index. As of December 31, 2012, the Plan's exposure to interest rate risk (as measured by the effective duration method summary) is listed on the following page by investment type.

Effective Duration – December 31, 2012

Investment Type	Market Value	Weighted Effective Duration
Agency	$47,264,200	6.09
Asset Backed	13,431,321	2.96
Cash Equivalent	2,053,604	6.28
CMBS	16,870,577	2.53
CMO	12,971,732	8.13
Convertible	177,157	8.35
Corporate	795,503,290	4.99
Euro	14,577,241	4.46
Foreign	250,785,138	6.62
Loans	2,721,457	2.76
Mortgage Pass-Through	108,757,567	1.59
Preferred Stock	2,660,319	9.44
Private Placement	1,955,440	7.41
Quasi Sovereign	52,675,747	6.06
Sovereign	72,429,152	6.06
Swaps	-860,326	4.09
Unclassified	679,205	-
US Treasury	343,145,411	4.04
Yankee (International bonds in U.S. dollars)	99,819,735	7.32
	$1,837,617,967	

Concentration of Credit Risk Debt Securities

Concentration of credit risk is the risk of loss attributed to the magnitude of an entity's exposure in a single issuer. The investment policy states securities representing debt and equity of any one company shall not exceed 5% of the fair value of the Plan's portfolio. MERS did not hold a single organization's securities that exceeded 5% of the Plan's investment portfolio other than those issued or explicitly guaranteed by the U.S. government as of December 31, 2012.

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. MERS currency risk exposure, or exchange rate risk, is primarily derived from its holdings in foreign currency denominated equities, and fixed income investments. MERS Retirement Board investment policy for the global non-investment grade fixed income portfolio, allows currency hedging to mitigate currency exposure.

Hedging the non-U.S. dollar currency exposure of the portfolio is permitted. The portfolio will be limited to the maximum net currency exposure of 25% at any given time.

MERS exposure to foreign currency risk in U.S. dollars as of December 31, 2012, is summarized on the following page.

Custodial Credit Risk

Custodial credit risk is the risk that deposits may not be recovered in the event of failure of a depository financial institution. As of December 31, 2012, the $523.8 million carrying amount of the Plan's cash and cash equivalents was comprised of $509.6 million of short-term investments, and $14.2 million in deposits. The $14.2 million bank balance of deposits was subject to custodial credit risk because it was uninsured and uncollateralized.

Foreign Currency Risk in U.S. Dollar Denominations – December 31, 2012

Currency	Equities	Fixed Income	Total
Argentine peso	$2,118,747		$2,118,747
Australian dollar	16,857,622	$32,567,044	49,424,666
Bahraini dinar	366,826		366,826
Bangladesh taka	2,170,930		2,170,930
Bermudian dollar	170,911		170,911
Brazilian real	26,750,628	10,180,318	36,930,946
Botswana pula	568,431		568,431
British pound sterling	54,784,669	4,442,617	59,227,286
Bulgarian lev	73,101		73,101
Canadian dollar	22,975,489	19,579,080	42,554,569
Chilean peso	70,096		70,096
Chinese renminbi	23,090,023		23,090,023
Colombian peso		2,409,650	2,409,650
Croatian kuna	1,989,703		1,989,703
Danish krone	6,975,665		6,975,665
Euro	62,402,133	58,878,875	121,281,008
Ghanaian cedi	21,810		21,810
Hong Kong dollar	27,909,210		27,909,210
Hungarian forint		6,732,911	6,732,911
Indonesian rupiah	132,111	729,809	861,920
Israeli new shekel	3,324,728		3,324,728
Japanese yen	63,022,784	10,959,864	73,982,648
Jordanian dinar	884,256		884,256
Kenyan shilling	3,048,258		3,048,258
Kuwaiti dinar	10,925,897		10,925,897
Malaysian ringgit	957,063	17,658,839	18,615,902
Mauritian rupee	899,794		899,794
Mexican peso	3,262,648	15,572,715	18,835,363
New Zealand dollar	93,539	16,334,848	16,428,387
Nigerian naira	12,410,252		12,410,252
Norwegian krone	6,625,742	10,314,039	16,939,781
Omani rial	3,121,987		3,121,987
Paklstani rupee	3,791,070		3,791,070
Philippine peso	60,375		60,375
Polish zloty	186,166	17,631,936	17,818,102
Qatari riyal	10,626,325		10,626,325
Romanian leu	1,256,179	561,632	1,817,811
Russian ruble	14,202,844	346,620	14,549,464
Singapore dollar	9,208,773		9,208,773
Sri Lankan rupee	1,748,063		1,748,063
South African rand	100,114	12,516,753	12,616,867
South Korean won	27,770,103	16,959,423	44,729,526
Swedish krona	2,423,927	9,621,639	12,045,566
Swiss franc	4,558,128		4,558,128
Taiwan dollar	4,550,598		4,550,598
Thai baht	2,963,511	10,045,903	13,009,414
Turkish lira	844,153		844,153
Tunisian dollar	679,955		679,955
United Arab Emirates dirham	7,793,579		7,793,579
Vietnamese dong	2,162,291		2,162,291
Total International Investment Securities	**$452,931,207**	**$274,044,515**	**$726,975,722**

Securities Lending

MERS' policy authorizes participation in a securities lending program administered by its global custodian, State Street Bank and Trust Company. MERS receives income as the owner of securities, as well as income from the lending of those securities. There are no dividends or coupon payments owing on the securities on loan. Securities lending earnings are credited to MERS and other participating clients on approximately the 15th day of the following month. The securities loans are open contracts and, therefore, could be terminated at any time by either party.

The borrower collateralizes the loan with either cash or securities at 102% of market value plus accrued interest on domestic securities, and 105% of market value plus accrued interest on international securities loaned. Due to the nature of the program's collateralization of U.S. fixed income securities loans at 102% plus accrued interest, MERS management believes that there is no credit risk per GASB 40 since the lender owes the borrower more than the borrower owes the lender. Cash collateral is invested for MERS in a dedicated short-term investment fund consisting of investment grade fixed income securities. The custodian provides for full indemnification to MERS for any losses that might occur in the event of borrower default resulting from negligence or intentional misconduct. Securities on loan are marked to market daily to ensure the adequacy of the collateral. There are no restrictions on the amount of securities that can be loaned at one time. Neither MERS nor the custodian has the ability to pledge or sell collateral securities delivered unless the borrower is in default.

MERS has never experienced a loss on securities lending transactions resulting from the default of a borrower or lending agent since it commenced lending securities in March 1995. As of December 31, 2012, the fair market value of fixed income securities invested in the cash collateral pool was below the original cost, resulting in a cumulative unrealized loss of $2 million that is reflected in the financial statements. Security lending produced a net income of $3.8 million in 2012, excluding unrealized gains and losses.

Collateral Held and Fair Value of Securities on Loan – December 31, 2012

Fair Value of Securities on Loan	Nature of Collateral	Collateral Held
$605,499,819	Cash	$620,739,058
-	Non-Cash	-
$605,499,819		**$620,739,058**

Securities Lending Collateral

	S & P Rating	Percentage	Amount
Short-Term Credit Ratings	A-1+/P-1 *	18.09%	$112,268,418
	A-1/P-1 *	59.82	371,349,382
Long-Term Credit Ratings	AAA	1.38	8,577,683
	AA	11.08	68,764,231
	A	5.96	37,016,532
	BBB+	0.00	0
	BBB	0.52	3,258,259
	BBB-	0.00	0
	BB+	0.00	0
	BB	0.00	0
	BB-	0.00	0
	Other	3.15	19,504,553
		100.00%	**$620,739,058**
Net accumulated depreciation in fair value			(1,983,356)
Invested Securities Lending Collateral			$618,755,702

** A short term obligation rated A-1/P-1 is rated in the highest category by both Standard & Poor's (S&P) and Moody's Investor Services. These Issuer's have a superior ability to repay short-term obligations. S&P will designate certain issues with a plus sign (+) to indicate that the obligor's capacity to meet its financial committtment is extremely strong.*

Derivatives

Derivative instruments are financial contracts whose value depends on the values of underlying assets, reference rates, or financial indexes. They include futures contracts, swap contracts, credit-linked notes (CLN) and forward foreign currency exchange. While the Board has no formal policy specific to derivatives, MERS holds investments in futures contracts, swap contracts, credit linked notes, and forward foreign currency exchange. MERS enters into these derivative contracts primarily to obtain exposure to different markets to enhance the performance, and reduce the volatility of the portfolio. It enters swaps and futures contracts to gain or hedge exposure to certain markets, and to manage interest rate risk and forward foreign exchange contracts primarily to hedge foreign currency exposure.

The following tables summarize the various contracts in the portfolio as of December 31, 2012. The notional value associated with these derivative instruments are generally not recorded on the financial statements; however, the amounts for the exposure (unrealized gains/losses) on these instruments are recorded. Interest rate risks associated with these investments are included in the table. MERS does not anticipate additional significant market risk from the swap arrangements.

Swap Contracts and Structured Notes - December 31, 2012

Name	Maturity Date	Position	Cost	Market Value	Counterparty
Dow Jones UBS Commodity Index	5/31/13	Long	$335,548,948	$327,192,563	Cargill Risk Management
CDX North American High Yield	6/20/17	Short	-	(177,989)	Bank of America
CMBX AAA	2/17/51	Short	(1,150,216)	(290,557)	Citigroup
CMBX North America Index	2/17/51	Short	(80,324)	(70,011)	Citigroup
Interest Rate Swap (USD)	12/9/19	Receive Floating	-	(321,770)	Citigroup
CLN Cablevision	2/13/18	Long	289,875	203,000	Deutchse Bank
CLN Brazil Inflation Linked	5/15/15	Long	1,205,962	1,195,894	JP Morgan
CLN Colombia	7/27/20	Long	635,468	740,829	Citigroup
CLN Colombia	7/24/24	Long	155,270	184,026	Citigroup
CLN Indonesia	5/15/18	Long	705,824	701,946	JP Morgan
CLN Russia	4/14/21	Long	338,896	364,001	Credit Suisse

Swap contracts are governed by International Swaps and Derivatives Association Master Agreements, MERS and counterparties. These agreements require collateral to be posted by either party when exposure exceeds the amount specified in the agreement (usually $250,000 to $5,000,000).

Foreign Currency Forward Contracts

Pending Receivable	$10,365,730
Pending Payable	(10,331,271)
Foreign Currency Forward Contract Asset (Liability)	**$34,459**

Futures and Options Contracts - December 31, 2012

Futures Contract	Expiration Date	Long/Short	Cost	Market Value
US 2-Yr Treasury Note	3/28/13	Long	$14,773,494	$14,771,406
US 5-Yr Treasury Note	3/28/13	Long	127,026,755	127,026,758
US 10-Yr Treasury Note	3/19/13	Long	40,876,360	40,763,844
US Long Treasury Bond	3/19/13	Long	53,289,468	52,657,500
S&500 E-Mini Futures	3/14/13	Long	76,254,214	76,685,400
MSCI Emerging Market Futures	3/14/13	Long	32,832,805	33,868,925
US Dollar Put / Japanese Yen Call Option	2/24/14	Long	217,000	13,837

MERS could be exposed to risk if the counterparties to the contracts are unable to meet the terms of the contracts. MERS and its investment managers seek to control this risk through counterparty credit evaluations and approvals, counterparty credit limits, and exposure monitoring procedures. MERS anticipates that counterparties will be able to satisfy their obligations under the contracts. Investments in limited partnerships and combined funds may include derivatives that are not shown in the derivatives' totals

Private Equity and Capital Calls

The MERS Board has approved $833,204,546 for investment in private equity securities. As of December 31, 2012, $777,713,801 was invested in private equity with $84,671,486 recallable return of capital, leaving $140,162,231 available for future investments.

5. Commitments and Contingencies

MERS maintains insurance for workers' compensation, owned and leased vehicles, blanket property, fiduciary, fidelity, and faithful performance to cover other risk of loss such as personal injury to employees or others, property damage, or other liability.

In the normal course of business, MERS is involved in a number of disputes over benefits or other claims. MERS does not anticipate any material loss as a result of these claims. Furthermore, the cost of a successful benefit claim is ultimately the responsibility of the affected municipality – it becomes a funding obligation.

In 1998, MERS entered into a contractual agreement with a municipality and its bargaining units to pay for certain costs to settle a legal dispute. MERS recently determined the estimated present value of its liability under this agreement using actuarial principles. As a result of this analysis, MERS paid $4.0 million to the municipality's MERS retirement account on December 31, 2012 to fulfill its outstanding obligation.

6. Related Parties

Tegrit Group is a collection of companies that provide public and private sector sponsors with solutions to retirement planning needs including actuarial consulting, retirement plan services, and technology. MERS is the majority stockholder of Tegrit Group. This is an investment in the MERS Strategic Opportunity Fund held within the MERS Total Market Fund. Tegrit Administrators, a division of the Tegrit Group, is the record-keeper for the MERS Defined Contribution Plan, Defined Contribution portion of the Hybrid Plan, Retiree Health Funding Vehicle, Investment Services Program, 457 Program, and the Health Care Savings Program. MERS contracts with Tegrit Technology for building and maintaining its pension software. MERS paid Tegrit Group $4,952,518 in 2012 for these services.

Cobalt Community Research is a 501(c)(3) nonprofit, non-partisan coalition that helps local governments, schools and membership organizations measure, benchmark, and manage their efforts through shared data, high-quality affordable surveys, focus groups and meetings that use instant audience feedback technology. MERS facilitated the creation of Cobalt and MERS employees perform the regular work required to run Cobalt. Cobalt maintains separate financial reporting and is responsible for repaying MERS for all administrative costs including staff time. In 2012 Cobalt paid MERS $102,461 to cover the year's expenses.

7. Funded Status and Funding Progress

The MERS funded status is summarized on pages 19-21 in the Management's Discussion and Analysis. The following funded status of the MERS Defined Benefit Plan is computed by aggregating all individual assets and liabilities:

Schedule of Funding Progress – (Dollars in Millions)

Actuarial Valuation December 31	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded (Over) AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a % of Covered Payroll ((b-a)/c)
2011	$7,150.5	$9,844.4	$2,693.9	72.6%	$1,669.7	161.3%

The "Schedule of Funding Progress" that follows the "Notes to Basic Financial Statements" found on page 48 presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing relative to actuarial accrued liability.

Actuarial valuations are prepared annually as of December 31 for each participating municipality. To facilitate budgetary planning needs, employer contribution requirements are provided for each municipality's unique fiscal year that commences after the following calendar year end. For example, the contribution requirements for fiscal years that began in 2012 were determined by actuarial valuations as of December 31, 2010.

Approximately 78% of the participating municipalities have fiscal years that begin January 1 or July 1.

The annual required contributions shown in the required supplementary schedule represents the summation of each participating municipality's contribution requirements for its fiscal year commencing in the year stated. However, the calculations to determine the percentage contributed use the contributions recorded during MERS fiscal year.

The information presented in the required supplementary schedules was determined as part of the actuarial valuation at the dates indicated. Additional information as of the latest actuarial valuation is in the Actuarial Section.

Summary Information

Valuation Date	December 31, 2011
Actuarial Cost Method	Entry Age Normal
Amortization Method	Level Percent of Payroll, Open
Remaining Amortization Period	There are 27 years for positive unfunded liabilities, and 10 years for negative unfunded liabilities. The 27-year period will decline by one year in each of the following seven annual valuations. For closed divisions (new hires are not covered by MERS defined benefit plan or hybrid provisions in a linked division) of active municipalities, the amortization period for positive unfunded liabilities is decreased annually by 2 years until the period reaches 5 years.
Asset Valuation Method	A 10-year smoothed market asset valuation method was adopted December 31, 2005, with a prospective application. Prior to 2006, a 5-year smoothing method was used.
Actuarial Assumptions	Investment Rate of Return – 8%
Projected Salary Increases	A 4.5% for base inflation, plus 0.0% to 8.4% per year attributable to merit and longevity. For the 2010 through 2013 valuations, the base wage inflation assumption will be 1% instead of 4.5%.
Post-Retirement Benefit	A 2.5% annual post-retirement benefit adjustment – if adopted by individual municipalities.

REQUIRED SUPPLEMENTARY INFORMATION (UNAUDITED)

Schedule of Funding Progress – (Dollars in Millions)

Actuarial Valuation December 31	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded (Over) AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a % of Covered Payroll ((b-a)/c)
2006	$5,493.8	$7,187.7	$1,693.9	76.4%	$1,545.9	109.6%
2007	5,973.0	7,723.9	1,750.9	77.3%	1,581.6	110.7
2008	6,245.5	8,321.9	2,076.4	75.0%	1,624.9	127.8
2009	6,443.1	8,534.7	2,091.6	75.5%	1,636.5	127.8
2010	6,945.4	9,317.2	2,371.8	74.5%	1,684.0	140.8
2011	7,150.5	9,844.4	2,693.9	72.6%	1,669.7	161.3

Schedule of Employer Contributions – (Dollars in Millions)

Fiscal Year	Annual Required Contribution	Percentage Contributed
2007	$258	92%
2008	224	109
2009	229	113
2010	264	110
2011	266	111
2012	288	108

Schedule of Administrative Expenses for the Year Ended December 31, 2012

Administrative Expenses	
Personnel Services	
Salaries	$9,859,682
Social Security	721,309
Retirement	1,133,274
Insurance	1,898,420
Total Personnel Services	**13,612,685**
Professional Services	
Third Party Administrator	1,446,374
Actuarial Services	1,424,049
Audit Services	222,142
Commercial Banking	117,840
Computer Consultant/Maintenance	240,510
Consultants	1,618
Legal Services	172,344
Medical Services	57,250
Total Professional Services	**3,682,127**
Communication	
Advertising / Promotional Supplies	24,223
Annual Meeting	90,625
Board Travel and Meetings	47,199
Library and Records Storage	20,516
Postage / Shipping	183,634
Printing and Copying Services	107,661
Telephone / Communications	241,719
Travel and Meetings	392,855
Total Communication	**1,108,432**
Rentals	
Equipment Rental	82,091
Office Rental	687,600
Total Rentals	**769,691**
Miscellaneous	
Depreciation	2,048,221
Equipment Purchases	71,392
Insurance	262,215
Building / Equipment Maintenance	329,483
Office Supplies	92,741
Operating Expenses	5,174,068
Payroll Processing	19,847
Personnel Support	230,526
Professional Development & Tuition	264,325
Software Purchases and Maintenance	1,154,658
Subscriptions / Memberships	36,776
Service Fees	(3,003,593)
Total Miscellaneous	**6,680,659**
Total Administrative Expenses	**$25,853,594**

Note: See accompanying Independent Auditor's Report.

Schedule of Investment Expenses for the Year Ended December 31, 2012

Investment Expenses	
Personnel Services	
Salaries	$1,135,674
Social Security	71,974
Retirement	133,164
Insurance	152,490
Total Personnel Services	**1,493,302**
Professional Services	
Commercial Banking	1,055,791
Investment Managers	14,948,460
Investment Performance	102,000
Other Consultants	125,245
Total Professional Services	**16,231,496**
Communication	
Travel	69,761
Total Communication	**69,761**
Miscellaneous	
Memberships	10,749
Operating Expenses	19,171
Software Purchases/Maintenance	141,991
Total Miscellaneous	**171,911**
Total Investment Expenses	**$17,966,470**

Note: See accompanying Independent Auditor's Report.

Schedule of Payments for Consultants and Services

Firm	Nature of Service	Amount
Tegrit Financial Group, LLC	Software Development, Implementation and Support Services	$3,020,634
Tegrit Administrators, LLC	Third Party Administration	1,473,094
State Street Bank and Trust Company	Depository Trust Banking Services	1,238,524
Tegrit Actuarial Consulting, LLC	Actuarial Services	458,790
Andrews Hooper Pavlik PLC	Auditing Services	192,100
Epicor Software Corporation	Software Implementation and Configuration Services	127,293
Resources Global Professionals	IT Consulting Services	123,634
Logicalis	Telecom Integration and Support Services	68,432
Consulting Physicians	Medical Advisor	57,250
Ice Miller	Legal Counsel	51,229
Miller Canfield	Legal Counsel	50,240
Innovative Comm	Audio Visual Equipment Installation and Support Servives	46,499
Gallagher Benefit Services	Benefits Consultant	35,000
Elizabeth Schwartz	Legal Counsel	20,100
Michigan Legislative Consultants	Legislative Consultants	18,000
Presidio Networked Solutions	Software Consulting and Configuration Services	17,000
Karoub Associates	Legislative Consultants	12,000
Maner Costerisan	Software Support Services	11,978
Pro-Tech Cable	Cable Installation Services	11,355
HTC Global Services Inc	Software Implementation Services	6,150
Mark Jasonowicz, CPA, PLLC	Auditing Services	6,000
Summit Technology, Inc	Unix System Implementation and Configuration Services	2,813
Reinhart Boerner Van Deuren	Legal Counsel	513

Note: Fees paid to investment managers are included in the Investment Section. Payments to consultants are already included in the Administrative and Investments Expenses stated in the Statement of Changes in Plan Net Position.

Note: See accompanying Independent Auditor's Report.

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