Michigan State Employees' Retirement System
A Pension Trust Fund of the State of Michigan

Comprehensive Annual Financial Report for the Fiscal Year Ended September 30, 2007

M S E R S

Prepared by:
Financial Services
for
Office of Retirement Services
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INTRODUCTORY SECTION

Certificate of Achievement

Certificate of
Achievement
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Presented to

Michigan State Employees'
Retirement System

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
September 30, 2006

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.

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Public Pension Standards

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Presented to

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In recognition of meeting professional standards for
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Presented by the Public Pension Coordinating Council, a confederation of

National Association of State Retirement Administrators (NASRA)
National Conference on Public Employee Retirement Systems (NCPERS)
National Council on Teacher Retirement (NCTR)

Alan H. Winkle
Program Administrator

INTRODUCTORY SECTION

Letter of Transmittal

State Employees' Retirement System
P.O. Box 30171
Lansing, Michigan 48909
Telephone 517-322-5103
Outside Lansing 1-800-381-5111

STATE OF MICHIGAN

JENNIFER M. GRANHOLM, Governor

DEPARTMENT OF MANAGEMENT AND BUDGET

December 14, 2007

The Honorable Jennifer M. Granholm
Governor, State of Michigan,

Members of the Legislature
State of Michigan,

Retirement Board Members
and
Members, Retirees and Beneficiaries

Ladies and Gentlemen:

We are pleased to present the comprehensive annual financial report of the Michigan State Employees' Retirement System (System) for fiscal year 2007.

INTRODUCTION TO REPORT

The System was established by legislation under Public Act 240 of 1943 (the Michigan State Employees' Retirement Act) and is administered by the Office of Retirement Services (ORS). The number of active and retired members and beneficiaries of the System and a list of participating employers is presented in Note 1 of the financial statements in the Financial Section of this report. The purpose of the System is to provide benefits for all State Employees. The services performed by the staff provide benefits to members.

Responsibility

Responsibility for both the accuracy of the data and the completeness and fairness of the presentation, including all disclosures, rests with the leadership team of the System. To the best of our knowledge and belief, the enclosed data is accurate in all material respects and is reported in a manner designed to present fairly the financial position and results of operations of the System.

Internal Control Structure

The leadership team of the System is responsible for maintaining adequate internal accounting controls designed to provide reasonable assurance that transactions are executed in accordance with management's general or specific authorization, and are recorded as necessary to maintain accountability for assets and to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America. The internal

Letter Of Transmittal (Continued)

control structure is designed to provide reasonable assurance regarding the safekeeping of assets and reliability of all financial records.

Independent Auditors

Andrews Hooper & Pavlik P.L.C., independent auditors, conducted an annual audit of the System. The independent auditor's report on the System's financial statements is included in the Financial Section of this report.

Statute requires an annual actuarial valuation be conducted. The purpose of the valuation is to evaluate the mortality, service, compensation and other financial experience of the System and to recommend employer-funding rates for the subsequent year. This annual actuarial valuation was completed by Gabriel Roeder Smith & Company for the fiscal year ended September 30, 2006. Actuarial certification and supporting statistics are included in the Actuarial Section of this report.

Management's Discussion and Analysis (MD&A)

Generally Accepted Accounting Principles (GAAP) requires that management provide a narrative introduction, overview, and analysis to accompany the Basic Financial Statements in the form of MD&A. This letter of transmittal is intended to complement MD&A and should be read in conjunction with it. The MD&A can be found immediately following the Independent Auditor's Report.

PROFILE OF THE GOVERNMENT

The System was established by Public Act 240 of 1943 and is administered by a nine-member board under the direction of the Executive Secretary. Public Act 216 of 1974 eliminated the requirement for member contributions and provided for financing by legislative appropriation and investment earnings.

Effective March 31, 1997, Public Act 487 of 1996 closed the plan to new applicants. All new employees become members of the State's defined contribution plan. The public act also allows for returning employees and members who left state employment on or before March 31, 1997, to elect the defined benefit plan instead of the defined contribution plan.

ECONOMIC CONDITIONS AND OUTLOOK

Despite challenging economic times, the System continues to show strong performance.

Investments

The State Treasurer is the investment fiduciary and custodian of all investments of the System pursuant to State law. The primary investment objective is to maximize the rate of return on the total investment portfolio, consistent with a high degree of prudence and sufficient diversity to eliminate inordinate risks and to meet the actuarial assumption for the investment return rate. The investment activity for the year produced a total rate of return on the portfolio of 17.2%. For the last five years, the System has experienced an annualized rate of return of 14.0%. A summary of asset allocation and rates of return can be found in the Investment Section of this report.

Accounting System

Transactions of the System are reported on the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when incurred. Participants' benefits are recorded when payable by law. We believe the accounting and administrative internal controls established by the System provide reasonable assurance the System is carrying out its responsibilities in safeguarding its assets, in maintaining the reliability of financial records for preparing the financial statements, and in maintaining accountability for its assets.

Letter Of Transmittal (Continued)

Funding

Funds are derived from the excess of additions to plan net assets over deductions from plan net assets. Funds are accumulated by the System in order to meet future benefit obligations to retirees and beneficiaries. The percentage computed by dividing the actuarial value of assets by the actuarial accrued liability is referred to as the "funded ratio." This ratio provides an indication of the funding status of the System and generally, the greater this percentage, the stronger the System. Effective in fiscal year 2001, the System used the valuation from the previous fiscal year for this report. This approach is consistent with Governmental Accounting Standards Board (GASB) Statement No. 25. Consistent with this approach, the most recent actuarial valuation was performed as of September 30, 2006. The actuarial value of the assets and actuarial accrued liability of the System were $10.9 billion and $12.8 billion, respectively, resulting in a funded ratio of 85.1% on September 30, 2006. A historical perspective of funding levels for the System is presented on the Schedule of Funding Progress in the Required Supplementary Information in the Financial Section of this report.

Postemployment Benefits

In fiscal year 2007, the System implemented Governmental Accounting Standards Board (GASB) Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans.* A GASB No. 43 compliant actuarial valuation was completed as of September 30, 2006, to determine the actuarial accrued liability if the postemployment benefits were to be pre-funded. If these benefits were pre-funded, the actuarial accrued liability for these benefits would be approximately $12.5 billion. Only members of the defined benefit plan were included when calculating the actuarial accrued liability. Statement No. 43 does not require retroactive application of the reporting changes. Therefore, in this year of transition, only one valuation year is presented and is included in the required supplementary information of this report.

MAJOR GOALS ACCOMPLISHED

The Michigan Department of Management and Budget (DMB), Office of Retirement Services (ORS) is a customer focused organization that serves its members and employees today and prepares them for tomorrow. Progress in fiscal year 2007 has allowed us to do so better than ever before – we are providing better and faster service to customers, we reengineered our processes, and have nearly completed our "Vision ORS" technology project. Below are some of the highlights.

Focus on our Customer

Preretirement meetings — We offered 26 meetings to those nearing retirement eligibility, with 1,583 in attendance. Those who attended one of these meetings could schedule a personalized telephone appointment to address any specific questions or concerns they might have before retiring.

Customer contact — Most of our customers still view the telephone as their primary means of communicating; this year our representatives answered 225,611 calls. A growing number of customers have found email correspondence better meets their busy lifestyles as demonstrated by the 19,099 pieces of correspondence we responded to this year. Our staff also provided face-to-face interaction with 8,206 individuals who visited our office.

Pension payroll system — We deployed a new system that permits daily payroll runs; customers no longer have to wait for a monthly run to receive a refund, adjustment, or first pension payment. It also relieves bottlenecks in workload processing caused by trying to meet monthly deadlines.

Customer self-service — This project will allow active members and retirees to access account information and perform transactions via a secure website. In order to get to this point, subject matter experts gathered requirements to create bid documents for vendors. The planning sessions dove deep into the inner workings of our retirement administration system to finalize exactly what we wanted our members to do online and how they would go about doing it.

Letter Of Transmittal (Continued)

Continuously Improve Processes

Reengineering — To ensure we are making the most of our new technology tools, we reengineered 77 processes within the organization. This effort identified efficiencies, and found many ways to improve the speed and quality of services to our customers. We have expanded this reengineering to other administrations within the State's Department of Management and Budget.

File imaging — ORS is reaching "paperless" status: nearly all of our old paper files have now been scanned into electronic images. In 2007, we imaged 63,643 member files, 551,808 paper documents, and 254,630 microfiche documents so that staff can quickly access the files with a few clicks of a mouse rather than waiting for a paper file to be delivered. By dismantling and eliminating the need for our paper files prior to the office renovation we will save $7,040 in fiscal year 2007.

Promote a Positive Work Environment

Strategic planning — ORS engaged an all-inclusive approach to strategic planning. The entire staff participated in a group session to identify business issues of importance. Volunteer work groups also worked together to craft the seven strategic goals that will direct ORS for the next three-five years.

All-Staff meetings — ORS hosted two meetings to honor the hard work and dedication of its staff and to deliver direct, relevant business news. The first meeting included our annual presentation of the ORS Excellence Awards to celebrate staff nominated for awards in the categories of Customer Service, Every Day Hero, Innovator, Leadership, and Living the Values. The second meeting focused heavily on upcoming technology and customer service tools that will allow staff to do their jobs with greater ease.

Optimize Technology

Forms, letters, and bar-coding project — When a customer requests a form, the system will pre-populate certain form fields so the customer only needs to provide the information not already contained in our system. Adding barcodes to the forms streamlines the process and creates an automatic workflow for staff. The project also includes a process that electronically collects all correspondence and forms requests each day, and uses a secure website to send documents to the State's central printing and mail facility, increasing the efficiency and security of our print and mail process.

In fiscal year 2007 we reviewed, updated, and tested 160 forms, creating greater efficiencies and offering better customer service. We are nearing final implementation stages.

Server replacement — A major project to replace existing servers with new hardware and upgrade some of the middleware software versions is complete. This upgrade was accomplished with support from several different areas in the business and provides enhanced functionality and additional performance improvements.

Of special significance is the introduction of a separate set of servers that mirror our production servers and will serve as our disaster recovery site. The separate servers are located in a different building from our production servers and will be used for technical testing. The servers will always be ready to take over if there should be an emergency.

Workforce management software — Software implemented in our customer service center uses historical activity data to forecast future customer demands. Monitoring the workload volumes for a variety of time intervals assists with scheduling staff for phone and nonphone activities to provide better customer service.

Letter Of Transmittal (Continued)

Invest in Employee Development

Customer Service Center training — Staff created and executed contact center training for new employees. Trainees attended formal classroom sessions and were tested on the information presented. Topics included an overview of the retirement systems, software programs, and telephone etiquette. Subject matter experts shared valuable knowledge on insurance, service credit, eligibility, and preretirement topics. Trainees also observed contact center staff during customer calls.

Workforce development staff — The development staff created a series of six training videos to help staff stay on top of new software and program features and techniques. The training videos utilized software that allowed us to connect with our audience by creating interactive video tutorials that were posted online and offered free of charge to all staff in DMB.

Competency Based Training reviews — Senior leadership met individually with every employee and their direct supervisor to ensure each employee is given the opportunity to do what they do best on a daily basis. In addition employees are able to share their personal progress and challenges from the past year, and speak out about any suggestions they have for ways our organization could best utilize their skills.

AWARDS AND ACKNOWLEDGEMENTS

ORS received the following recognitions:

- Certificate of Achievement for Excellence in Financial Reporting for our *Fiscal Year 2006 Comprehensive Annual Financial Report.* Awarded by the Government Finance Officers Association of the United States and Canada.

- Public Pension Standards 2007 Award for meeting standards for public retirement system management and administration. Awarded by the Public Pension Coordinating Council.

- Blue Pencil-Gold Screen Award for two online video tutorials produced in-house on the topics of earning and purchasing service credit. Awarded by the National Association of Government Communicators in the Shoestring Budget category.

- 2007 Outstanding Program Award for our reorganization and reengineering efforts as we transitioned to become a process-based organization. Awarded by the National Association of State Chief Administrators.

- Innovator Award for our introduction of a phone appointment process that provides high-quality counseling services with less travel time and cost. Awarded by the State of Michigan Department of Management and Budget.

Acknowledgements

The preparation of this report was accomplished with the dedication and cooperation of many people. It is intended to provide complete and reliable information as a basis for making management decisions, as a means of determining compliance with legal provisions, and as a means for determining responsible stewardship of the funds of the System.

We would, therefore, like to express our appreciation for the assistance given by staff, the advisors and the many people who contributed to its preparation. We believe their combined efforts have produced a report that will enable employers

Letter Of Transmittal (Continued)

and plan members to better evaluate and understand the Michigan State Employees' Retirement System. Their cooperation contributes significantly to the success of the System.

Sincerely,

Lisa Webb Sharpe, Director
Department of Management and Budget

Phillip J. Stoddard, Director
Office of Retirement Services

INTRODUCTORY SECTION

Administrative Organization

Retirement Board Members *

Douglas Drake, Chair
Retiree Member
Term Expires July 31, 2007

H. David Dekker
Employee Member
Term Expires July 31, 2008

Calvin Frappier
Retiree Member
Term Expires July 31, 2009

George M. Elworth
Representing Attorney General
Ex officio

Craig Murray
Representing Deputy Auditor General
Ex officio

John Schoonmaker, Vice Chair
Representing Commissioner of
Finance & Insurance Services
Ex officio

D. Daniel McLellan
Representing State Personnel Director
Ex officio

Vernon Johnson
Representing State Treasurer
Ex officio

Harry Posner
Employee Member
Term Expires July 31, 2009

* Statute provides that board members may continue to serve after their term expires until they are either replaced or reappointed.

Administrative Organization

Department of Management and Budget
Office of Retirement Services
P.O. Box 30171
Lansing, Michigan 48909-7671
517-322-5103
1-800-381-5111

Advisors and Consultants

Actuaries
Gabriel Roeder Smith & Co.
Alan Sonnanstine
Southfield, Michigan

Auditors
Thomas H. McTavish, C.P.A.
Auditor General
State of Michigan

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

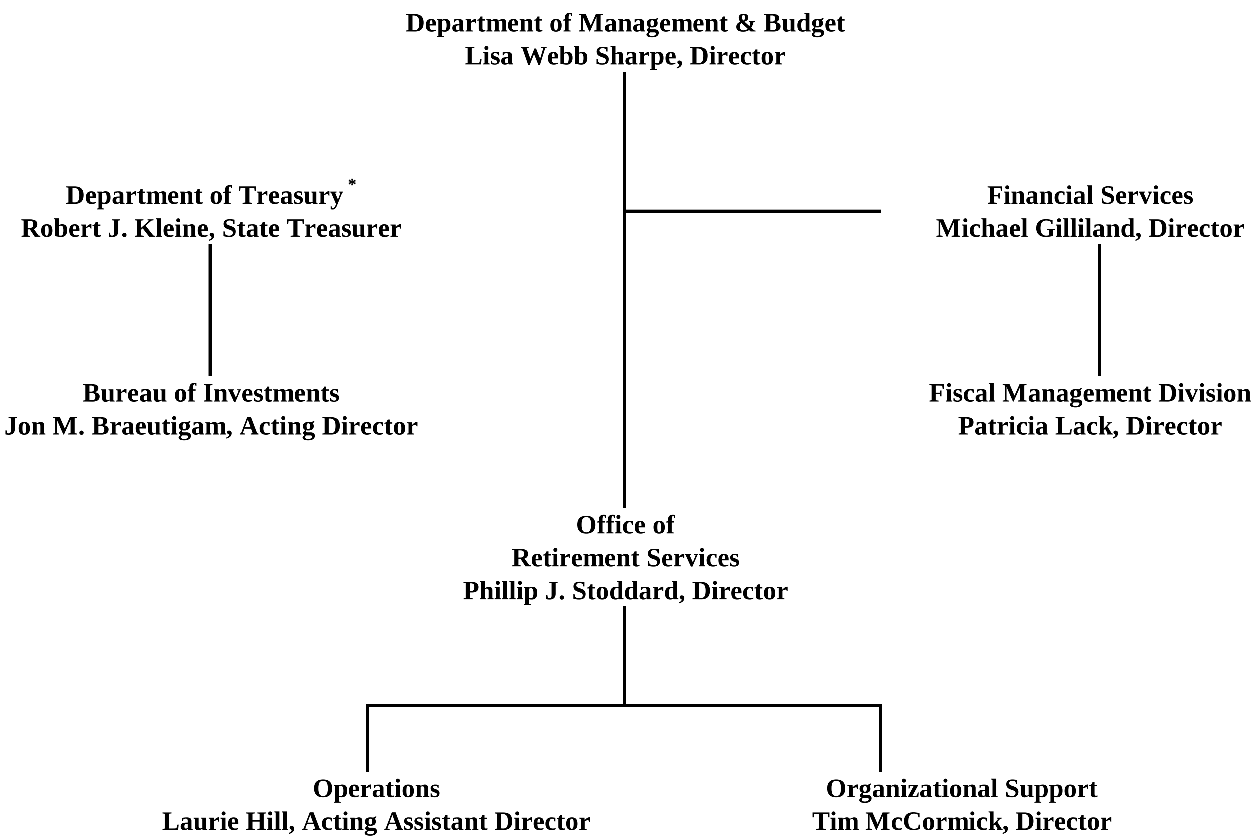
Investment Manager and Custodian
Robert J. Kleine
State Treasurer
State of Michigan

Legal Advisor
Mike Cox
Attorney General
State of Michigan

Investment Performance Measurement
State Street Corporation
State Street Analytics
Boston, MA

Administrative Organization (Continued)

Organization Chart



*** The investments of the System are managed by the Michigan Department of Treasury. Information on the investments and the fiduciary, Michigan Department of Treasury, can be found in the Investment Section, Introduction. In addition, see the Investment Section, Schedule of Investment Fees and Schedule of Investment Commissions, for information regarding the investment fees and commissions paid as well as investment professionals utilized by the System.**

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FINANCIAL SECTION

Independent Auditor’s Report
Management’s Discussion and Analysis
Basic Financial Statements
Notes to Basic Financial Statements
Required Supplementary Information
Notes to Required Supplementary Information
Supporting Schedules

Financial Section

Independent Auditor's Report

ANDREWS HOOPER & PAVLIK P.L.C.
Certified Public Accountants

Ms. Lisa Webb Sharpe, Director, Department of Management and Budget
Mr. Phillip Stoddard, Director, Office of Retirement Services
Mr. Thomas H. McTavish, CPA, Auditor General, Office of the Auditor General
Michigan State Employees' Retirement System Board

We have audited the accompanying statements of pension plan and postemployment healthcare plan net assets of the Michigan State Employees' Retirement System, as of September 30, 2007 and 2006, and the related statements of changes in pension plan and postemployment healthcare plan net assets for the years then ended. These financial statements are the responsibility of the management of the Michigan State Employees' Retirement System. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial status of the Michigan State Employees' Retirement System, as of September 30, 2007 and 2006, and the changes in its financial status for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 14, 2007 on our consideration of the Michigan State Employees' Retirement System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in conjunction with this report in considering the results of our audit.

4295 Okemos Road, Suite 200 • Okemos, Michigan 48864 • 517.706.0800 fax 517.706.0011 • www.ahpplc.com

Independent Auditor's Report (Continued)

The Management's Discussion and Analysis (MD&A) is not a required part of the basic financial statements but is supplemental information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this required supplemental information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The Introductory, Investment, Actuarial, and Statistical Sections and the required supplementary information and supporting schedules listed in the table of contents are presented for the purposes of additional analysis and are not a required part of the basic financial statements. The Introductory, Investment, Actuarial, and Statistical Sections and the required supplementary information and supporting schedules are the responsibility of the Michigan State Employees' Retirement System's management. The Schedules of Funding Progress and Employer Contributions and related notes and the supporting schedules have been subjected to the auditing procedures applied in our audits of the basic financial statements, and in our opinion, are fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole. The 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 express no opinion on them.

Andrews Hooper & Pavlik P.L.C.

Okemos, Michigan
December 14, 2007

FINANCIAL SECTION

Management's Discussion and Analysis

Our discussion and analysis of the Michigan State Employees' Retirement System's (System) financial performance provides an overview of the System's financial activities for the fiscal year ended September 30, 2007. Please read it in conjunction with the transmittal letter in the Introductory Section on page 6 and the basic financial statements, which follow this discussion.

FINANCIAL HIGHLIGHTS

- System assets exceeded liabilities at the close of fiscal year 2007 by $12.1 billion (reported as *net assets*). Net assets are held in trust to meet future benefit payments.

- The System's funding objective is to meet long-term benefit obligations through contributions and investment income. As of September 30, 2006, the funded ratio was approximately 85.1% for pension benefits, and the funded ratio for other postemployment benefits was zero.

- Revenues for the year were $2,387.0 million, which is comprised primarily of contributions of $541.7 million and investment gains of $1,803.1 million.

- Expenses increased in the current year from $1,134.5 million to $1,206.5 million or 6.3%. Most of this increase represented an increase in pension benefits paid.

THE STATEMENT OF PLAN NET ASSETS AND THE STATEMENT OF CHANGES IN PLAN NET ASSETS

This Comprehensive Annual Financial Report (CAFR) consists of two financial statements; *The Statements of Pension Plan and Other Postemployment Plan Net Assets* (page 22) and *The Statements of Changes in Pension Plan and Other Postemployment Plan Net Assets* (page 23). These financial statements report information about the System, as a whole, and about its financial condition that should help answer the question: Is the System, as a whole, better off or worse off as a result of this year's activities? These statements include all assets and liabilities using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, all revenues and expenses are taken into account regardless of when cash is received or paid.

The Statement of Pension Plan and Other Postemployment Plan Net Assets presents all of the System's assets and liabilities, with the difference between the two reported as net assets. Over time, increases and decreases in net assets measure whether the System's financial position is improving or deteriorating. *The Statement of Changes in Pension Plan and Other Postemployment Plan Net Assets* presents how the System's net assets changed during the most recent fiscal year. These two financial statements should be reviewed along with the Schedules of Funding Progress (page 43) and Schedules of Employer Contributions (page 44) to determine whether the System is becoming financially stronger or weaker and to understand changes over time in the funded status of the System.

Management's Discussion and Analysis (Continued)

FINANCIAL ANALYSIS

System total assets as of September 30, 2007, were $14.7 billion and were mostly comprised of cash, investments, and contributions due from employers. Total assets increased $2.0 billion or 16.2% between fiscal years 2006 and 2007 primarily due to an increase of invested assets, and increased $1.9 billion or 17.7% between fiscal years 2005 and 2006 primarily for the same reason.

Total liabilities as of September 30, 2007, were $2.6 billion and were mostly comprised of warrants outstanding, accounts payable, and obligations under securities lending. Total liabilities increased $864.6 million or 50.8% between fiscal years 2006 and 2007, and increased $1.1 billion or 198.6% between fiscal years 2005 and 2006, primarily due to an increase in obligations under securities lending.

System assets exceeded its liabilities at the close of fiscal year 2007 by $12.1 billion. In fiscal year 2007, net assets for the Health Advance Funding SubAccount were transferred to the unrestricted assets in accordance with Executive Order 2007-3 and the subaccount was closed. Net assets held in trust for pension and OPEB benefits increased $1.2 billion or 11.2% between fiscal years 2006 and 2007, and increased $761.0 million or 7.5% between fiscal years 2005 and 2006, primarily due to investment earnings and contributions for the year exceeding total deductions of the System.

Net Assets
(in thousands)

	2007	Increase (Decrease)	2006	Increase (Decrease)	2005
Assets					
Cash	$ 27,322	156.6 %	$ 10,647	(50.4) %	$ 21,464
Receivables	93,055	(20.8)	117,440	(6.8)	125,976
Investments	14,577,093	16.4	12,524,335	18.1	10,604,278
Total Assets	14,697,470	16.2	12,652,422	17.7	10,751,718
Liabilities					
Warrants outstanding	2,324	34.5	1,728	3.7	1,666
Accounts payable and other accrued liabilities	1,429	(13.3)	1,649	5.4	1,564
Obligations under securities lending	2,563,249	50.9	1,699,065	199.7	566,873
Total Liabilities	2,567,002	50.8	1,702,442	198.6	570,103
Net Assets - Health Advance Funding SubAccount	-	(100.0)	41,304	21.8	33,905
Net Assets - Pension and OPEB Benefits	12,130,468	11.2	10,908,676	7.5	10,147,710
Total Net Assets	$ 12,130,468	10.8 %	$ 10,949,980	7.5 %	$ 10,181,615

Management's Discussion and Analysis (Continued)

REVENUES - ADDITIONS TO PLAN NET ASSETS

The reserves needed to finance retirement and health benefits are accumulated through the collection of employer contributions and through earnings on investments. Contributions and net investment income/(losses) for fiscal year 2007 totaled $2.4 billion.

Total additions for fiscal year 2007 increased $484.1 million from those of fiscal year 2006 primarily due to an increase in investment earnings. Total additions increased $109.5 million between fiscal years 2005 and 2006 primarily for the same reasons. Total employer contributions decreased between fiscal years 2006 and 2007 by $117.1 million or (18.7)% due to contribution rates falling in April and again in August to achieve the savings required by Executive Order 2007-3. This compares to an increase in total employer contributions between fiscal years 2005 and 2006 by $46.6 million or 8.0%. Member contributions increased between fiscal years 2006 and 2007 by $10.5 million or 50.1%, while member contributions between fiscal years 2005 and 2006 decreased by $20.1 million or (49.0)%. The System is non-contributory; however, members may purchase service credit. The increase in member contributions for fiscal year 2007 occurred because there was an increase in individuals purchasing service credit, compared to a decrease in member contributions and a decline in service credit purchases between fiscal years 2005 and 2006. Net investment income increased between fiscal years 2006 and 2007 by $548.8 million. Net investment income increased between fiscal years 2005 and 2006 by $82.9 million. The Investment Section of this report reviews the results of investment activity for 2007.

EXPENSES - DEDUCTIONS FROM PLAN NET ASSETS

The primary expenses of the System include the payment of pension benefits to members and beneficiaries, payment for health, dental and vision benefits, refunds of contributions to former members, and the cost of administering the System. Total deductions for fiscal year 2007 were $1.2 billion, an increase of 6.3% over fiscal year 2006 expenses. The increase was due primarily to an increase in retirees which in turn caused an increase in payments for pension benefits. Total deductions for fiscal year 2006 were $1.1 billion, an increase of 5.6% over fiscal year 2005 expenses.

Payments for health care benefits to members and beneficiaries increased by $1.4 million or 0.4% from $362.6 million to $364.0 million during the fiscal year. This compares to a increase of $39.8 million or 12.3% from $322.8 million to $362.6 million between fiscal years 2005 and 2006. The payment of pension benefits increased by $28.8 million or 3.8% between fiscal years 2006 and 2007 and by $20.3 million or 2.7% between fiscal years 2005 and 2006. In fiscal years 2006 and 2007, pension benefit expenses increased due to an increase in benefit payments to retirees and an increase of 906 retirees and 179 retirees, respectively. Refunds and transfers to other Plans or Systems decreased by $27 thousand or (10.5)% between fiscal years 2006 and 2007. This compares to a decrease of $50 thousand or (16.3)% between fiscal years 2005 and 2006. The notes to the financial statements describe these transfers in more detail. Administrative expenses increased by $487 thousand or 10.5% between fiscal years 2006 and 2007, primarily due to an increase in technological support. Administrative expenses increased by $330 thousand or 7.7% between fiscal years 2005 and 2006, primarily for the same reasons.

Additions and deductions for fiscal year 2007 include the one-time transfer of $41.3 million out of the health plan's Health Advance Funding SubAccount to the pension plan. This transaction is described in more detail in the notes to the financial statements.

Management's Discussion and Analysis (Continued)

Changes in Plan Net Assets
(in thousands)

	2007	Increase (Decrease)	2006	Increase (Decrease)	2005
Member contributions	$ 31,457	50.1 %	$ 20,963	(49.0) %	$ 41,097
Employer contributions	510,233	(18.7)	627,379	8.0	580,738
Net investment income	1,803,088	43.8	1,254,277	7.1	1,171,402
Transfers from other systems	106	(13.8)	123	2.5	120
Transfers from pension/OPEB plan	41,304	N/A	-	0.0	-
Miscellaneous income	766	622.6	106	5200.0	2
Total Additions	2,386,954	25.4	1,902,848	6.1	1,793,359
Pension benefits	795,842	3.8	767,001	2.7	746,673
Health care benefits	363,975	0.4	362,597	12.3	322,834
Refunds of member contributions	222	(12.6)	254	(13.0)	292
Transfers to other systems	8	166.7	3	(80.0)	15
Transfers to pension/OPEB plan	41,304	N/A	-	0.0	-
Administrative expenses	5,115	10.5	4,628	7.7	4,298
Total Deductions	1,206,466	6.3	1,134,483	5.6	1,074,112
Net Increase	1,180,488	53.6	768,365	6.8	719,247
Net Assets - Beginning of the year	10,949,980	7.5	10,181,615	7.6	9,462,368
Net Assets - End of Year	$ 12,130,468	10.8 %	$ 10,949,980	7.5 %	$10,181,615

RETIREMENT SYSTEM AS A WHOLE

The System's combined net assets experienced an increase for the fifth consecutive year. This increase is a result of a moderate national economic upturn that resulted in improved investment income earnings. Management believes, and actuarial studies concur, that the System is in a financial position to meet its current obligations. We believe the current financial position has improved, in part, due to a prudent investment program, cost controls, and strategic planning.

CONTACTING SYSTEM FINANCIAL MANAGEMENT

This financial report is designed to provide the Retirement Board, our membership, taxpayers, investors, and creditors with a general overview of the System's finances and to demonstrate the System's accountability for the money it receives. If you have any questions about this report or need additional financial information, contact the Office of Retirement Services, P.O. Box 30171, Lansing, MI 48909-7671.

Statements of Pension Plan and Other Postemployment Plan Net Assets

As of September 30, 2007 and 2006

	September 30, 2007			September 30, 2006		
	Pension Plan	OPEB Plan	Total	Pension Plan	OPEB Plan	Total
Assets:						
Equity in common cash	$ 27,259,395	$ 62,056	$ 27,321,451	$ 10,588,129	$ 58,758	$ 10,646,887
Receivables:						
Amounts due from employer	30,168,875	68,680	30,237,555	48,763,667	270,610	49,034,277
Amounts due from employer long term	62,057,975		62,057,975	68,101,263		68,101,263
Interest and dividends	758,034	1,726	759,760	303,054	1,682	304,736
Total receivables	92,984,884	70,406	93,055,290	117,167,984	272,292	117,440,276
Investments:						
Short term investment pools	183,233,342	417,134	183,650,476	231,794,399	1,286,326	233,080,725
Fixed income pools	1,988,414,292	4,526,656	1,992,940,948	1,753,282,015	9,729,712	1,763,011,727
Domestic equity pools	5,688,380,454	12,949,685	5,701,330,139	5,221,599,744	28,976,891	5,250,576,635
Real estate pool	1,163,702,848	2,649,187	1,166,352,035	941,152,425	5,222,857	946,375,282
Alternative investment pools	1,579,357,778	3,595,432	1,582,953,210	1,296,337,558	7,193,931	1,303,531,489
International equities pools	1,383,468,408	3,149,487	1,386,617,895	1,321,361,318	7,332,799	1,328,694,117
Cash Collateral on loaned securities	2,557,426,371	5,822,020	2,563,248,391	1,689,687,834	9,376,800	1,699,064,634
Total investments	14,543,983,493	33,109,601	14,577,093,094	12,455,215,293	69,119,316	12,524,334,609
Total assets	14,664,227,772	33,242,063	14,697,469,835	12,582,971,406	69,450,366	12,652,421,772
Liabilities:						
Warrants outstanding	2,319,076	5,279	2,324,355	1,718,213	9,535	1,727,748
Accounts payable and other accrued liabilities	1,425,674	3,246	1,428,920	1,640,132	9,102	1,649,234
Obligations under securities lending	2,557,426,371	5,822,020	2,563,248,391	1,689,687,834	9,376,800	1,699,064,634
Total liabilities	2,561,171,121	5,830,545	2,567,001,666	1,693,046,179	9,395,437	1,702,441,616
Net Assets - Health Advance Funding SubAccount					41,304,031	41,304,031
Net Assets - Pension and OPEB Benefits	12,103,056,651	27,411,518	12,130,468,169	10,889,925,227	18,750,898	10,908,676,125
Net Assets Held in Trust for Pension and OPEB Benefits*	$ 12,103,056,651	$ 27,411,518	$ 12,130,468,169	$ 10,889,925,227	$ 60,054,929	$ 10,949,980,156

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

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

Statements of Changes in Pension Plan and Other Postemployment Plan Net Assets

For Fiscal Years Ended September 30, 2007 and 2006

	September 30, 2007			September 30, 2006		
	Pension Plan	OPEB Plan	Total	Pension Plan	OPEB Plan	Total
Additions:						
Contributions:						
Member contributions	$ 19,696,132	$ 11,760,544	$ 31,456,676	$ 9,434,310	$ 11,528,041	$ 20,962,351
Employer contributions	150,858,506	359,375,055	510,233,561	270,705,017	356,674,243	627,379,260
Total contributions	170,554,638	371,135,599	541,690,237	280,139,327	368,202,284	648,341,611
Investment income (loss):						
Net appreciation (depreciation) in fair value of investments	1,564,590,781		1,564,590,781	1,012,259,360		1,012,259,360
Interest, dividends, and other	248,765,760	1,500,072	250,265,832	248,408,079	5,660,782	254,068,861
Investment expenses:						
Real estate operating expenses	(276,483)		(276,483)	(94,039)		(94,039)
Other investment expenses	(16,198,290)		(16,198,290)	(13,449,226)		(13,449,226)
Securities lending activities:						
Securities lending income	116,786,647		116,786,647	39,745,998		39,745,998
Securities lending expenses	(112,080,389)		(112,080,389)	(38,253,881)		(38,253,881)
Net investment income (loss)	1,801,588,026	1,500,072	1,803,088,098	1,248,616,291	5,660,782	1,254,277,073
Transfers from other systems	105,572		105,572	123,059		123,059
Transfers from pension/OPEB plan	41,304,031		41,304,031			
Miscellaneous income	765,996		765,996	106,169		106,169
Total additions	2,014,318,263	372,635,671	2,386,953,934	1,528,984,846	373,863,066	1,902,847,912
Deductions:						
Benefits paid to plan members and beneficiaries:						
Retirement benefits	795,842,013		795,842,013	767,000,706		767,000,706
Health benefits		329,714,449	329,714,449		328,528,595	328,528,595
Dental/vision benefits		34,260,602	34,260,602		34,069,090	34,069,090
Refunds of member contributions	222,039		222,039	253,886		253,886
Transfers to other systems	7,561		7,561	2,647		2,647
Transfers to pension/OPEB plan		41,304,031	41,304,031			-
Administrative expenses	5,115,226		5,115,226	4,628,043		4,628,043
Total deductions	801,186,839	405,279,082	1,206,465,921	771,885,282	362,597,685	1,134,482,967
Net Increase (Decrease)	1,213,131,424	(32,643,411)	1,180,488,013	757,099,564	11,265,381	768,364,945
Net Assets Held in Trust for Pension and OPEB Benefits:						
Beginning of Year	10,889,925,227	60,054,929	10,949,980,156	10,132,825,663	48,789,548	10,181,615,211
End of Year*	$ 12,103,056,651	$ 27,411,518	$ 12,130,468,169	$ 10,889,925,227	$ 60,054,929	$ 10,949,980,156

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

Notes to Basic Financial Statements

NOTE 1 - PLAN DESCRIPTION

ORGANIZATION

The Michigan State Employees' Retirement System (System) is a single-employer, state-wide, defined benefit public employee retirement plan governed by the State of Michigan (State) and created under Public Act 240 of 1943, as amended. Section 2 of this act establishes the board's authority to promulgate or amend the provisions of the System. The System's pension plan was established by the State to provide retirement, survivor and disability benefits to the State's government employees. In addition, the System's health plan provides all retirees with the option of receiving health, dental and vision coverage under the Michigan State Employees' Retirement Act. The System is a qualified pension trust fund under section 401(a) of the Internal Revenue Code. By statute, employees of the following employers are also covered by this plan: American Legion, American Veterans, Veterans of Foreign Wars, Disabled American Veterans, Mackinac Island State Park, Marine Corps League, Michigan Bar Association, Military Order of the Purple Heart (through December of 2006), Business Enterprise Program, Third Circuit Court, Recorders Court and 36th District Court. Michigan judges and elected officials, legislators, National Guard and state police officers are covered by separate retirement plans. Although the System reports information for several small employers, the State is legally responsible for almost all contractually required contributions to the System. This level of responsibility is ongoing and is unlikely to change significantly in the foreseeable future. Therefore, the reporting requirements for a single employer plan have been adopted.

The System's financial statements are included as a pension trust fund in the combined financial statements of the State.

The System is administered by the Office of Retirement Services, within the Michigan Department of Management and Budget. The Department Director appoints the Office Director who serves as Executive Secretary to the System's Board, with whom the general oversight of the System resides. The State Treasurer serves as the investment officer and custodian for the System.

MEMBERSHIP

At September 30, 2007 and 2006, the System's membership consisted of the following:

Retirees and beneficiaries currently receiving benefits:	**2007**	**2006**
Regular benefits	36,963	36,271
Survivor benefits	6,308	6,121
Disability benefits	3,615	3,588
Total	46,886	45,980
Current employees:		
Vested	29,991	31,161
Non-vested	873	1,414
Total	30,864	32,575
Inactive employees entitled to benefits and not yet receiving them	6,663	7,217
Total all members	84,413	85,772

Notes to Basic Financial Statements (Continued)

Enrollment in the health plan is voluntary. The number of participants is as follows:

Health, Dental, and Vision Plan	**2007**	**2006***
Eligible participants	46,886	45,980
Participants receiving benefits:		
Health	42,161	41,513
Dental	42,101	41,422
Vision	42,215	41,529

*Restated based on more complete information provided by the actuary.

At September 30, 2003, the System recognized 116 participants in the Defined Contribution (DC) Plan who elected to retire under the Early Out Retirement program. This program provided a .25% incentive for those DC members who qualified, which will be provided by the System. These 116 participants have not been included in the pension membership schedule on the previous page.

BENEFIT PROVISIONS - PENSION

Introduction

Benefit provisions of the defined benefit pension plan are established by State statute, which may be amended. Public Act 240 of 1943, as amended, establishes eligibility and benefit provisions for the defined benefit pension plan. Retirement benefits are determined by final average compensation and years of service. Members are eligible to receive a monthly benefit when they meet certain age and service requirements. The System also provides duty disability, non-duty disability and survivor benefits.

A member who has separated from employment may request a refund of his or her member contribution account. The System is currently non-contributory. A refund may cancel a former member's rights to future benefits. However, former members who return to employment and who previously received a refund of their contributions may reinstate their service through repayment of the refund upon satisfaction of certain requirements.

Effective March 31, 1997, Public Act 487 of 1996 closed the plan to new entrants. All new employees become members of the defined contribution plan. The Public Act allows returning employees and members who left State employment on or before March 31, 1997, to elect the defined benefit plan instead of the defined contribution plan.

Regular Retirement

The retirement benefit is based on a member's years of credited service (employment) and final average compensation. The normal benefit equals 1.5% of a member's final average compensation multiplied by the years and partial year of credited service and is payable monthly over the member's lifetime.

Final average compensation is the average of a member's monthly pay during 36 consecutive months of credited service. The 36 consecutive month period producing the highest monthly average is used. For most members, this is the last three years of employment.

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

1. age 60 with 10 or more years of credited service; or
2. age 55 with 30 or more years of credited service; or
3. age 55 with at least 15 but less than 30 years of credited service. The benefit allowance is permanently reduced 0.5% for each month from the member's age on the effective date of retirement to the date the member will attain age 60.

Employees in covered positions are eligible for supplemental benefits and may retire after attaining:

1. age 51 with 25 or more years in a covered position; or
2. age 56 with 10 or more years in a covered position.

Notes to Basic Financial Statements (Continued)

In either case, the three years immediately preceding retirement must have been in a covered position. Employees in covered positions are responsible for the custody and supervision of inmates.

Employees of closing Department of Community Health facilities are eligible for retirement under one of the following conditions:

1. age 51 with 25 years of service, the last 5 of which were rendered in the closing facility;
2. age 56 with 10 years of service, the last 5 of which were rendered in the closing facility; or
3. 25 years of service at the closing facility regardless of age.

Employees of the State Accident Fund, Michigan Biologic Products, or Liquor Control Commission who were terminated as the result of privatization may retire if the member's age and length of service was equal to or greater than 70 on the date of transfer or termination.

Conservation Officers (CO) with a hire date on or before April 1, 1991, are eligible to retire after 25 years of service, 20 of which must have been rendered as a CO. COs hired after April 1, 1991, and before March 31, 1997, must have 23 years of service as a CO to be eligible for a full retirement with only 25 years of service. In either case, 2 years immediately preceding retirement must be as a CO.

Deferred Retirement

Any member with 10 or more years of credited service who terminates employment but has not reached the age of retirement is a deferred member and is entitled to receive a monthly pension upon reaching age 60, provided the member's accumulated contributions have not been refunded. Deferred retirement is available after 5 years of service for State employees occupying unclassified positions in the executive and legislative branches and certain Department of Community Health employees subject to reduction in force lay-offs by reason of deinstitutionalization.

Non-Duty Disability Benefit

A member with 10 or more years of credited service who becomes totally and permanently disabled not due to performing duties as a State employee is eligible for a non-duty disability pension. The non-duty disability benefit is computed in the same manner as an age and service allowance based upon service and salary at the time of disability.

Duty Disability Benefit

A member who becomes totally and permanently disabled from performing duties as a State employee as a direct result of State employment and who has not met the age and service requirement for a regular pension, is eligible for a duty disability pension. Public Act 109 of 2004 amended the State Employees' Retirement Act to change the calculation of the pension benefit and increase the minimum annual payment. If the member is under age 60, the duty disability allowance is now a minimum of $6,000 payable annually. At age 60 the benefit is recomputed under service retirement.

Survivor Benefit

Upon the death of a member who was vested, the surviving spouse shall receive a benefit calculated as if the member had retired the day before the date of death and selected a survivor pension. Certain designated beneficiaries can be named to receive a survivor benefit. Public Act 109 of 2004 amended the State Employees' Retirement Act to change the calculation of Duty Death benefits and redefines eligibility for deceased member's survivors. The new minimum duty-related death benefit has been increased to $6,000.

Pension Payment Options

When applying for retirement, an employee may name a person other than his or her spouse as a beneficiary if the spouse waives this right. If a beneficiary is named, the employee must choose whether the beneficiary will receive 100%, 75% or 50% of the retiree's pension benefit after the retiree's death. The decision is irrevocable. A description of the options follows.

Notes to Basic Financial Statements (Continued)

Regular Pension — The pension benefit is computed with no beneficiary rights. If the retiree made contributions while an employee and has not received the total accumulated contributions before death, a refund of the balance of the contributions is made to the beneficiary of record. If the retiree did not make any contributions, there will not be payments to beneficiaries.

100% Survivor Pension — Under this option, after the retiree's death, the beneficiary will receive 100% of the pension for the remainder of the beneficiary's lifetime. If this option is elected, the normal retirement benefit is reduced by a factor based upon the ages of the retiree and of the beneficiary. If the beneficiary predeceases the retiree, the pension "pops-up" to the regular pension amount; another beneficiary cannot be named.

75% Survivor Pension - Under this option, after the retiree's death, the beneficiary will receive 75% of the pension for the remainder of the beneficiary's lifetime. If this option is elected, the normal retirement benefit is reduced by a factor based upon the ages of the retiree and of the beneficiary. If the beneficiary predeceases the retiree, the pension "pops-up" to the regular pension amount; another beneficiary cannot be named.

50% Survivor Pension — Under this option, after the retiree's death, the beneficiary will receive 50% of the pension for the remainder of the beneficiary's lifetime. If this option is elected, the normal retirement benefit is reduced by a factor based upon the ages of the retiree and of the beneficiary. The reduction factor is lower than the factor used in the 100% or 75% option previously described. If the beneficiary predeceases the retiree, the pension "pops-up" to the regular pension amount; another beneficiary cannot be named.

Equated Pension — An equated pension may be chosen by any member under age 65 except a disability retiree and an early supplemental retiree. Equated pensions provide an additional amount until age 65 and may be combined with Regular, 100%, 75% or 50% option. At age 65 the monthly amount is permanently reduced. The initial and reduced amounts are based on an estimate of social security benefits at age 65, provided by the Social Security Administration Office. In order to calculate this benefit, members choosing this option must provide ORS with an estimate from the Social Security Administration Office. The actual amount received from social security may vary from the estimate.

Post Retirement Adjustments

One-time upward benefit adjustments were made in 1972, 1974, 1976, 1977 and 1987. Beginning October 1, 1988, a 3% non-compounding increase, up to a maximum of $25 monthly, is paid each October to recipients who have been retired 12 full months. Beginning in 1983, eligible benefit recipients share in a distribution of investment income earned in excess of 8% annually. This distribution is known as the supplemental payment. The supplemental payment is offset by one year's cumulative increases received after the implementation of the annual 3% increase in benefits. These adjustment payments were not issued during fiscal years 1991 through 1994. Members who retired on or after October 1, 1987, are not eligible for the supplemental payment.

Contributions

Member Contributions — Members currently participate in the System on a non-contributory basis. Under certain circumstances, members may contribute to the System for the purchase of creditable service, such as military service or maternity leave, or a universal buy-in. If a member terminates the System employment before a retirement benefit is payable, the member's contribution and interest on deposit may be refunded. If the member dies before being vested, the member's contribution and interest are refunded to the designated beneficiaries.

Employer Contributions — The statute requires the employer to contribute to finance the benefits of plan members. These employer contributions are determined annually by the System's actuary and are based upon level-dollar value funding principles so the contribution rates do not have to increase over time.

Transfers to Defined Contribution Plan

During fiscal year 1998, the Michigan State Employees' Retirement Act provided members an opportunity to transfer to the Defined Contribution Plan. This was a one-time opportunity and the decision is irrevocable. The transfer must have been completed by September 30, 1998. With the passage of the legislation permitting the transfer, the System also became a closed system. All new employees are members of the Defined Contribution Plan.

Notes to Basic Financial Statements (Continued)

Early Out Retirement

In February 2002, former Governor John Engler proposed an early out retirement for qualified State employees. Approximately 2,850 State Employees retired by the end of the fiscal year 2002 and an additional 5,160 State employees retired in fiscal year 2003 under this program. Among those members who qualify are Tier 1 (defined benefit) participants and those former members who made an election under section 50 of Public Act 240 of 1943, as amended, to terminate membership in Tier 1 and transfer to become a qualified participant in Tier 2 (defined contribution). Upon their retirement, qualified Tier 2 participants shall receive a retirement allowance equal to the member's number of years of service and fraction of a year of credited service multiplied by .25% of his or her final compensation. For purposes of this section, such individuals shall be considered members of Tier 1 for the limited purpose of receiving a retirement allowance calculated under this section and paid by the System. This allowance will be paid from employer contributions to the System.

Banked Leave Time

Public Act 33 of 2004 amended the State Employees' Retirement Act to include Banked Leave Time (BLT) for members. BLT is an extension of the State's current annual leave program, which banks a predetermined number of hours per pay period. However, the BLT program will not have an effect on a member's Final Average Compensation calculation.

BENEFIT PROVISIONS – OTHER POSTEMPLOYMENT

Introduction

Benefit provisions of the postemployment healthcare plan are established by State statute, which may be amended. Public Act 240 of 1943, as amended, establishes eligibility and benefit provisions for the health plan. Members are eligible to receive health, prescription drug, dental and vision coverage on the first day they start receiving pension benefits. There is no provision for ad hoc or automatic increases. The State Employees' Retirement Act requires joint authorization by DMB and the Civil Service Commission to make changes to retiree medical benefit plans.

The employer funds health benefits on a pay-as-you-go basis. Retirees with this coverage contribute 5%, 10%, and 10% of the monthly premium amount for the health (including prescription coverage), dental and vision coverage, respectively. The employer's payroll contribution rate to provide this benefit was 12.20% and 12.50% for fiscal years 2007 and 2006, respectively.

Retirees are provided with life insurance coverage equal to 25% of the active life insurance coverage, $1,000 for spouse and $1,000 for each dependent under age 23. Premiums are fully paid by the State.

The number of participants and other relevant financial information are as follows:

	2007	2006*
Health, Dental and Vision Plan:		
Eligible Participants	46,886	45,980
Participants receiving benefits:		
Health	42,161	41,513
Dental	42,101	41,422
Vision	42,215	41,529
Expenses for the year	$ 363,975,051	$ 362,597,685
Employer payroll contribution rate	12.20%	12.50%

*Participant data was restated based on more complete information provided by the actuary.

Notes to Basic Financial Statements (Continued)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting and Presentation

The System's financial statements are prepared using the accrual basis of accounting. Contributions from the State are recognized as revenue when due and payable. Benefits and refunds are recognized when due and payable in accordance with the terms of the System.

Reserves

Public Act 240 of 1943, as amended, created the employees' savings reserve, pension reserve, employer's accumulation reserve, income account and expense account, and health insurance reserve. The financial transactions of the System are recorded in these accounts as required by Public Act 240 of 1943, as amended.

Reserve for Employee Contributions — Members no longer contribute to this reserve except to purchase eligible service credit or repay previously refunded contributions. This reserve represents active member contributions and interest less amounts transferred to the Pension Reserve for regular and disability retirement, amounts refunded to terminated members and unclaimed amounts transferred to the income account. At September 30, 2007, and 2006, the balance in this account was $216.6 million and $210.0 million, respectively.

Reserve for Employer Contributions — All employer contributions are credited to this reserve. Interest from the income account is credited annually. Amounts are transferred annually from this reserve to the Pension Reserve to fund that reserve. At September 30, 2007, and 2006, the balance in this account was $1.8 billion and $1.7 billion, respectively.

Reserve for Retired Benefit Payments — This represents the reserves for payment of future retirement benefits to current retirees. At retirement, a member's accumulated contributions plus interest are transferred into this reserve from the Reserve for Employee Contributions. Monthly benefits, which are paid to the retiree, reduce the reserve. At the end of each fiscal year, an amount determined by an annual actuarial valuation is transferred from the Reserve for Employer Contributions to this reserve to bring the reserve into balance with the actuarial present value of retirement allowances. At September 30, 2007, and 2006, the balance in this account was $7.0 billion.

Reserve for Undistributed Investment Income — The income account is credited with all investment earnings. Interest is transferred annually to the reserves. Administrative expenses are paid from the expense account. The legislature appropriates the funds necessary to defray and cover the administrative expenses of the System. At September 30, 2007, and 2006, the net balance of these accounts was $3.1 billion and $2.0 billion, respectively.

Reserve for Health (OPEB) Related Benefits — This reserve is credited with employee and employer contributions for retirees' health (including prescription coverage), dental, and vision benefits. The required contribution is based on pay-as-you-go funding. It represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liability (or funding excess) over a period not to exceed thirty years. Interest is allocated based on the beginning balance of the reserve. Premiums for health, dental, and vision benefits are paid from this fund. At September 30, 2007, and 2006, the unrestricted balance in this reserve was $27.4 million and $18.8 million, respectively.

Section 204 of Public Act 431 of 1984, as amended, provides management the ability to administer selected risk management related programs for insurance or related services. At September 30, 2007, and 2006, the net balance of the Reserve for Health (OPEB) Related Benefits was $27.4 million and $60.1 million, respectively. If expenses had exceeded revenues, the State Sponsored Group Insurance Fund, which bears the risk of such losses, would have returned sufficient revenue to make the Reserve whole.

Health Advance Funding SubAccount — This funding subaccount was created by Public Act 93 of 2002 as a means to begin pre-funding, on an actuarial basis, health benefits for participants in the System. Any amounts received in the Health Advance Funding SubAccount (HAFS) and accumulated earnings on those amounts shall not be expended until the actuarial accrued liability for health benefits is at least 100% funded. However, the System may transfer an amount from the HAFS to the employer's accumulation fund (Reserve for Employer Contributions) under certain conditions

Notes to Basic Financial Statements (Continued)

described in the enabling legislation. At September 30, 2006, the balance of this subaccount was $41.3 million. In fiscal year 2007, due to Executive Order 2007-3, the 2006 balance was transferred in accordance with the provisions set forth in the State Employees' Retirement Act and the subaccount was closed.

Reporting Entity

The System is a pension trust fund of the State. As such, the System is considered part of the State and is included in the State's Comprehensive Annual Financial Report as a pension trust fund. The System and its Board are not financially accountable for any other entities or other organizations. Accordingly, the System is the only entity included in this financial report.

Benefit Protection

Public Act 100 of 2002 was passed by the Michigan Legislature to protect pension benefits of public employees from alienation (being transferred). Alienation is attachment, garnishment, levy, execution, bankruptcy or other legal process except for divorce orders or eligible domestic relation orders. The statutes governing the System contained an "anti-alienation" clause to provide for this protection; however, many smaller public pension systems did not have the benefit of this protection. Therefore, Public Act 100 of 2002 was passed to establish legal protection of pension assets that encompasses all public employees.

Fair Value of Investments

Plan investments are reported at fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Corporate bonds not traded on a national or international exchange are based on equivalent values of comparable securities with similar yield and risk. Real estate debt is valued on the basis of future principal and interest payments, and is discounted at prevailing interest rates for similar instruments. The fair value of real estate investments is based on independent appraisals. Other investments not having an established market are recorded at estimated fair value.

Investment Income

Dividend and interest income are recognized on the accrual basis. Fair value changes are recorded as investment income or loss. Purchases and sales of investments are recorded as of the trade date (the date upon which the transaction is initiated), except for purchase and sale of mortgages, real estate, and alternative investments, which are recorded as of the settlement date (the date upon which the transaction is ultimately completed). The effect of recording such transactions as of the settlement date does not materially affect the financial statements.

Cost of Administering the System

Each year a restricted general fund appropriation is requested to fund the on-going business operations of the System. These administrative costs are ultimately funded by the System through the regular transfer of funds from the System to the State's general fund based on either a direct cost or allocation basis depending on the nature of the expense. Costs of administering the System are financed by undistributed investment income of the System.

Property and Equipment

Office space is leased from the State on a year-to-year basis. Office equipment is capitalized if the value exceeds $5,000. These assets are recorded at cost and are reported net of depreciation in the Statement of Pension and Other Postemployment Plan Net Assets. Such assets are depreciated on a straight-line basis over 10 years. As of September 30 1998, all capitalized equipment was fully depreciated. No additional equipment has been capitalized for the System since that date.

Related Party Transactions

Leases and Services — The System leases operating space and purchases certain administrative, data processing, legal and investment services from the State. The space and services are not otherwise available by competitive bid.

Notes to Basic Financial Statements (Continued)

The following summarizes costs incurred by the System for such services.

	2007	2006
Building Rentals	$ 142,235	$ 108,835
Technological Support	1,628,043	1,444,293
Attorney General	285,541	238,446
Investment Services	2,162,349	2,020,711
Personnel Services	1,598,604	1,566,340

Commitment and Contingency – The State has signed a contract with a vendor for technological support through 2007. As of September 30, 2007, the System's portion of this commitment is approximately $299,000.

Cash — On September 30, 2007, and 2006, the System had $27.3 million and $10.7 million, respectively in a common cash investment pool maintained for various State operating funds. The participating funds in the common cash pool earn interest at various rates depending upon prevailing short-term interest rates. Earnings from these activities amounted to $1.1 million and $0.6 million for the years ended September 30, 2007, and 2006, respectively.

Excess Benefits

Internal Revenue Service (IRS) Code Section 415 requires that, for individuals who receive retirement benefits in excess of established limits, these benefits be recorded and reported outside of the pension plan in order to keep the qualified status of the plan. This includes coordination of benefit issues whereby a retiree participates in more than one qualified plan. In fiscal years 2006 and 2007, the System provided excess benefits to one retiree.

Reclassification of Prior Year Amounts

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

NOTE 3 – CONTRIBUTIONS AND FUNDED STATUS

Contributions

Members currently participate in the System on a non-contributory basis. Under certain circumstances, members may contribute to the System for the purchase of creditable service such as military service or maternity leave. Effective August 1, 1998, the retirement act was amended to permit a "universal buy-in." With a universal buy-in, a member may elect to purchase no more than 5 years of service credit (less other service credit purchased). The State is required by Public Act 240 of 1943, as amended, to contribute amounts necessary to finance the coverage of members and retiree health benefits. Contribution provisions are specified by State statute and may be amended only by action of the State Legislature.

Periodic employer contributions to the System are determined on an actuarial basis using the entry age normal actuarial cost method. Under this method, the actuarial present value of the projected benefits of each individual included in the actuarial valuation is allocated on a level basis over the service of the individual between entry age and assumed exit age. The portion of this cost allocated to the current valuation year is called the normal cost. The remainder is called the actuarial accrued liability. Normal cost is funded on a current basis. For retirement benefits, the unfunded (overfunded) actuarial accrued liability is amortized over a 29-year period for the 2007 fiscal year and a 30-year period for the 2006 fiscal year. For health benefits, the unfunded (overfunded) actuarial accrued liability is amortized over a maximum period of 30 years. Because this is the first year of OPEB reporting, comparative data is not yet available. GASB Statement No. 43 does not require retroactive presentation.

Actual employer contributions for retirement benefits were $150.9 million and $270.7 million for fiscal years 2007 and 2006, respectively, representing 14.7% of annual covered payroll for the year ended September 30, 2006. The fiscal year 2007 annual covered payroll is not yet available. Required employer contributions based on previous year actuarial valuations for pensions included:

Notes to Basic Financial Statements (Continued)

1. $153.0 million and $154.4 million for fiscal years 2007 and 2006, respectively, for the normal cost of pensions representing 8.3% and 8.2% (before reconciliation) of annual covered payroll for fiscal years 2006 and 2005, respectively.
2. $163.1 million and $212.3 million for fiscal years 2007 and 2006, respectively, for amortization of unfunded actuarial accrued liability representing 8.8% and 11.3% (before reconciliation) of annual covered payroll for fiscal years 2006 and 2005, respectively.

Actual employer contributions for other postemployment benefits were $359.4 million and $356.7 million for fiscal years 2007 and 2006, respectively, representing 12.5% of annual covered payroll for the year ended September 30, 2006. The fiscal year 2007 annual covered payroll is not yet available. During fiscal year 2006, no transfers were made from the Health Advance Funding SubAccount. During fiscal year 2007, in order to comply with Executive Order 2007-3, the subaccount's balance of $41.3 million was transferred to the Reserve for Employer Contributions and the subaccount was closed. Required employer contributions based on previous year actuarial valuations for OPEB included:

1. $407.1 million for fiscal year 2007 for the normal cost of OPEB representing 14.3% (before reconciliation) of annual covered payroll for fiscal year 2006.
2. $491.6 million for fiscal year 2007 for amortization of unfunded actuarial accrued liability representing 17.3% (before reconciliation) of annual covered payroll for fiscal year 2006.

The System is required to reconcile with actuarial requirements annually. Any funding excess or deficiency for pension benefits is smoothed over 5 years. One fifth (20%) of the funding excess or deficiency is included in the subsequent years' contribution, and is not recognized as a payable or receivable in the accounting records.

In March 2001, the Internal Revenue Service issued a private letter ruling allowing the System's members to purchase service credit and repay refunds using tax-deferred (pre-tax) dollars. The program was implemented and payments began in fiscal year 2002.

The program allows members to purchase service credit and repay refunds on a tax-deferred basis. Members sign an irrevocable agreement that identifies the contract duration, monthly payment, total contract amount and years of service credit being purchased. The duration of the contract can range from 1 to 20 years. The amounts are withheld from the members' paycheck and are treated as employer pick-up contributions pursuant to Internal Revenue Code Section 414(h). At September 30, 2007, and September 30, 2006, there were 6,522 and 6,959 agreements, respectively. Agreement amounts that will not be collected within 12 months are discounted using the assumed actuarial rate of return of 8%. The average length remaining of a contract was approximately 14 years for 2007 and 2006. The short-term receivable was $11.6 million and the discounted long-term receivable was $62.1 million at September 30, 2007. At September 30, 2006, the short-term receivable was $12.8 million and the discounted long-term receivable was $68.1 million.

In March of 2007, the Governor signed Executive Order 2007-3 as a means to reduce expenditures due to an anticipated revenue shortfall for the State for fiscal year 2007. In conjunction with this Executive Order, Public Act 16 of 2007 was voted into law by the legislature to allow a one-time change in the way the System is funded for fiscal year 2007. This change allows for an interest only payment on the unfunded actuarially accrued liability (UAAL) for fiscal year 2007, deferring the remaining payments for this fiscal year. Executive Order 2007-3 authorized a reduction in contributions to the System through rate reductions to take advantage of investment gains over the past few years while still meeting the minimum contribution requirements for this fiscal year. Through these two measures, the savings to the State totaled approximately $145 million in savings to offset an equal amount of pension obligation payments that State agencies would otherwise have to pay.

Funded Status

Participating employers are required to contribute at an actuarially determined rate for both pension benefits and OPEB. For fiscal year 2006, the actuarial accrued liability (AAL) for pension benefits was $12.8 billion, and the actuarial value of assets was $10.9 billion, resulting in an unfunded actuarial accrued liability (UAAL) of $1.9 billion and a funded ratio of 85.1%. The covered payroll (annual payroll of active employees covered by the plan) was $1.8 billion, and the ratio of the UAAL to the covered payroll was 103.3%.

Notes to Basic Financial Statements (Continued)

For fiscal year 2006, the actuarial accrued liability (AAL) for OPEB benefits was $13.5 billion, and the actuarial value of assets was zero, resulting in an unfunded actuarial accrued liability (UAAL) of $13.5 billion and a funded ratio of 0.0%. The covered payroll (annual payroll of active employees covered by the plan) was $2.8 billion, and the ratio of the UAAL to the covered payroll was 474.0%.

Actuarial Valuations and Assumptions

Actuarial valuations for both the pension and OPEB plans involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions (ARC) are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedules of funding progress, presented as required supplementary information following the notes to the financial statements, presents multi-year trend information about whether the actuarial value of plan assets for both pension and OPEB plans is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

The accompanying schedules of employer contributions present trend information about the amounts contributed to the plan by employers in comparison to the ARC, an amount that is actuarially determined in accordance with the parameters of GASB Statement No. 25 for pension contributions and GASB Statement No. 43 for health contributions.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

The information presented in the required supplementary schedules was determined as part of the actuarial valuations at the dates indicated. Additional information as of the latest actuarial valuation follows:

Valuation Date	9/30/2006
Actuarial Cost Method	Entry Age, Normal
Amortization Method - pension	Level Dollar, Closed
Amortization Method - OPEB	Level Percent of Payroll, Closed
Remaining Amortization Period	30 years (1)
Asset Valuation Method	5-Year Smoothed Market (2)
Actuarial Assumptions:	
Wage Inflation Rate	3.5%
Investment Rate of Return - pension	8.0%
Investment Rate of Return - OPEB	4.0%
Projected Salary Increases	3.5-14.4%
Cost-of-Living Adjustments	3% Annual Non-Compounded with Maximum Annual Increase of $300 for those eligible
Health Care Cost Trend Rate	10.0% Year 1 graded to 3.5% Year 12

(1) Based on the provisions of GASB Statement No. 25, when the actuarial accrued liability for a defined benefit pension plan is underfunded or overfunded, the difference should be amortized over a period not to exceed thirty years for the fiscal periods beginning on or after June 15, 2006.

(2) The actuarial value of assets was written up to the market value as of September 30, 2006. Beginning October 1, 2006, a 5-year smoothed market value will again be developed.

Notes to Basic Financial Statements (Continued)

NOTE 4 – INVESTMENTS

Investment Authority

Under Public Act 380 of 1965, as amended, the authority for the purchase and the sale of investments resides with the State Treasurer. Investments are made subject to the Michigan Public Pension Investment Act, Public Act 314 of 1965, as amended. The Michigan Public Pension Investment Act authorizes, with certain restrictions, the investment of pension fund assets in stocks, corporate and government bonds and notes, mortgages, real estate, and certain short-term and alternative investments. Investments must be made for the exclusive purposes of providing benefits to active members, retired members and beneficiaries, and for defraying the expenses of investing the assets.

Under Public Act 314 of 1965, as amended, the State Treasurer may invest up to 5% of the System's assets in small businesses having more than one-half of its assets or employees in Michigan as described in section 20(a) of the Act and up to 20% of the System's assets in investments not otherwise qualified under the Act as described in section 20(d). Alternative investments include limited partnerships and distributions from these partnerships in the form of bonds, preferred stock, common stock, and direct investments.

Derivatives

The State Treasurer employs the use of derivatives in the investment of the pension trust funds.

Derivatives are used in managing pension trust fund portfolios, but uses do not include speculation or leverage of investments. Less than 12.0% of the total pension trust fund's portfolio has been invested from time to time in futures contracts, collateralized mortgages, swap agreements and option contracts. State investment statutes limit total derivative exposure to 15.0% of a fund's total asset value, and restrict uses to replication of returns and hedging of assets. Swap agreements represent the largest category of derivatives used, and they represented 6.6% of market value of total pooled assets on September 30, 2007 and 9.0% of market value of total pooled assets on September 30, 2006. Futures contracts represent the second largest category of derivatives used, and they represented 0.2% of market value of total pooled assets on September 30, 2007, and 0.0% of market value of total pooled assets on September 30, 2006. Option contracts represent the third largest category of derivatives used, and they represented 0.0% of market value of total pooled assets on September 30, 2007, and 0.6% of market value of total pooled assets on September 30, 2006.

To enhance management flexibility, the State Treasurer has traded futures contracts tied to Bond indices and Standard and Poor's indices. The bond futures are combined with the rest of the fixed income investments to manage interest rate risk. Standard and Poor's futures contracts are combined with short-term investments or with underlying stock to replicate or enhance the return of the Standard and Poor's indices.

To capitalize on shorter-term windows of investment opportunities, the State Treasurer has traded option contracts. Options allow more flexibility in achieving investment goals without disturbing the return/risk profiles of the longer-term strategies of the underlying investments.

To diversify the pension fund's portfolio, the State Treasurer has entered into swap agreements with investment grade counterparties, which are tied to stock market indices in the United States and twenty-two foreign countries. The notional amounts of the swap agreements at September 30, 2007, and 2006, were $611.3 million and $711.6 million, respectively. Approximately one half of the notional amount tied to foreign stock market indices is hedged against foreign currency fluctuations. The swap agreements provide that the System will pay quarterly, over the term of the swap agreements, interest indexed to the three month London Inter Bank Offer Rate (LIBOR), adjusted for an interest rate spread, on the notional amount stated in the agreements. At the maturity of the swap agreements, the pension fund will either receive the increase in the value of the equity indices from the level at the inception of the agreements, or pay the decrease in the value of the indices. Swap agreement maturity dates range from October 2007 to September 2010. U.S. domestic LIBOR based floating rate notes and other investments earning short-term interest are held to correspond with the notional amount of the swap agreements. The State Treasurer maintains custody and control of these dedicated notes and short-term investments.

The value of these synthetic equity structures is a combination of the value of the swap agreements and the value of the notes and short-term investments. The book value represents the cost of the notes and short-term investments. The

Notes to Basic Financial Statements (Continued)

current value represents the current value of the notes and short-term investments and the change in value of the underlying indices from the inception of the swap agreements. The current value is used as a representation of the fair value based on the intention to hold all swap agreements until maturity. For fiscal years ending September 30, 2007, and 2006, international and domestic equity investment programs involving swaps, received realized gains and earned interest income of $244.2 million and $157.6 million, respectively.

The unrealized gain of $189.1 million at September 30, 2007, and $267.4 million at September 30, 2006, primarily reflects the increases in international stock indices and changes in currency exchange rates. The combined swap structure generally realizes gains and losses on a rolling three-year basis.

The respective September 30, 2007, and 2006 swap values are as follows:

	Notional Value	Current Value
9/30/2007 (dollars in millions)	$ 611.3	$ 799.5
9/30/2006 (dollars in millions)	711.6	978.6

The September 30, 2006, amounts shown above reflect both the total International Equity Pool swap exposure, and the smaller swap exposure to the Standard and Poor's Small Cap Index Pool. Swap contracts in the Standard and Poor's Small Cap Index Pool matured during the year ending September 30, 2007. Therefore, the September 30, 2007, amounts shown above include only swaps from the International Equity Pool.

Security Lending

State statutes allow the System to participate in securities lending transactions, and the System has, by way of Security Lending Authorization Agreement, authorized the agent bank to lend the System's securities to broker-dealers and banks pursuant to a form of loan agreement.

During the fiscal year, the agent bank lent, at the direction of the System, the System's securities and received cash (United States and foreign currency), securities issued or guaranteed by the United States government, sovereign debt rated A or better, convertible bonds and irrevocable bank letters of credit as collateral. The agent bank did not have the ability to pledge or sell collateral securities delivered absent a borrower default. Borrowers are required to deliver collateral for each loan equal to (i) in case of loaned securities denominated in United States dollars or whose primary trading market is located in the United States or sovereign debt issued by foreign governments, 102% of the market value of the loaned securities; and (ii) in the case of loaned securities not denominated in United States dollars or whose primary trading market is not located in the United States, 105% of the market value of the loaned securities.

The System did not impose any restrictions during the fiscal year on the amount of the loans that the agent bank made on its behalf and the agent bank indemnified the System by agreeing to purchase replacement securities, or return cash collateral in the event borrower failed to return the loaned security or pay distributions thereon. There were no such failures by any borrowers during the fiscal year. Moreover, there were no losses during the fiscal year resulting from a default of the borrowers or the agent bank.

During the fiscal year, the System and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested in a collateral account dedicated to the System. As of September 30, 2007, such account had an average weighted maturity to next reset of 25 days and an average weighted maturity of 710 days. Because the loans were terminable at will, their duration did not generally match the duration of the investments made with cash collateral. On September 30, 2007, the System had no credit risk exposure to borrowers. The cash collateral held for securities on loan for the System as of September 30, 2007, were $2,563,248,391. The carrying amount, which is the fair market value, of securities on loan for the System as of September 30, 2007, was $2,498,701,438.

Gross income from security lending for the fiscal year was $116,786,647. Expenses associated with this income were the borrower's rebate of $111,191,625 and fees paid to the agent of $888,764.

Notes to Basic Financial Statements (Continued)

Risk

In accordance with GASB Statement No. 40, investments require certain disclosures regarding policies and practices, and the risks associated with them. The credit risk, (including custodial credit risk and concentration of credit risk), the interest rate risk, and the foreign currency risk are discussed in the following paragraphs. Amounts represent the pro rata share of the underlying investments as required by GASB No. 40. These are held in internal investment pools and reported as such in the financial statements.

Credit Risk - Credit risk is the risk that an issuer will not fulfill its obligations.

- Short-Term Fixed Income Investments - Prime commercial paper investments must be rated A-1 or P-1 at the time of purchase as rated by the two major rating services Standard and Poor's Corporation (S&P) and Moody's Investor Service (Moody's), respectively. Borrowers must have at least $400.0 million in commercial paper outstanding, and the State Treasurer may not invest in more than 10.0% of the borrowers outstanding debt. The investments are further limited to $200.0 million in any borrower, unless the borrower has a A-1+ rating, in which case the investment is not to exceed $300.0 million.

- Long-Term Fixed Income Investments – These investments must be investment grade or better at the time of purchase unless specific requirements are met as defined by PA 314 of 1965, as amended, and the State Treasurer's investment policy. Law defines investment grade as investments in the top four major grades, rated by two national rating services, S&P (AAA, AA, A, BBB) and Moody's (Aaa, Aa, A, Baa). At September 30, 2007, the System was in compliance with the policy in all material aspects.

Notes to Basic Financial Statements (Continued)

Rated Debt Investments
(in thousands)
For the Years Ended September 30, 2007 and 2006

	September 30, 2007				September 30, 2006			
		Rating				Rating		
Investment Type	**Fair Value**	**S&P**	**Fair Value**	**Moody's**	**Fair Value**	**S&P**	**Fair Value**	**Moody's**
Short Term	$ 535,747	A-1	$ 561,199	P-1	$ 528,860	A-1	$ 623,405	P-1
	-	A-2	-	P-2	18,187	A-2	25,467	P-2
	57,144	NR	31,692	NR	138,138	NR	36,313	NR
U.S. Agencies-Sponsored								
	682,120	AAA	682,120	Aaa	589,588	AAA	589,588	Aaa
	-	NR	-	NR	15,601	NR	15,601	NR
Corporate Bonds & Notes								
	157,056	AAA	145,255	Aaa	115,436	AAA	118,354	Aaa
	180,557	AA	198,449	Aa	161,719	AA	217,969	Aa
	320,704	A	309,731	A	292,721	A	194,487	A
	124,459	BBB	134,296	Baa	71,962	BBB	92,724	Baa
	3,466	BB	3,332	Ba	1,172	BB	4,327	Ba
	818	B	-	B	666	B	-	B
	-	CCC	354	Caa	-	CCC	-	Caa
	34,532	NR	30,175	NR	16,285	NR	32,100	NR
International *								
	63,948	AAA	63,948	Aaa	77,223	AAA	67,449	Aaa
	183,673	AA	303,833	Aa	172,046	AA	274,663	Aa
	88,237	A	19,410	A	226,744	A	108,510	A
	70,705	NR	19,372	NR	-	NR	25,391	NR
Equity*	-	AA	-	Aa	10,389	AA	67,106	Aa
	-	A	-		56,717	A	-	
Total	$ 2,503,166		$ 2,503,166		$ 2,493,454		$ 2,493,454	

* International and Equity Investment types consist of domestic floating rate note used as part of a Swap strategy

NR - not rated

Notes to Basic Financial Statements (Continued)

Custodial Credit Risk – Custodial credit risk for investments is the risk that, in the event of a failure of the counterparty, the State will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party.

- Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the government and are held by either:
- The counterparty or
- The counterparty's trust department or agent but not in the government name.

The State Treasurer does not have a policy for custodial risk. However, the State's custodial bank had a credit rating of AA at September 30, 2007. As of September 30, 2007, and 2006, the government securities with a market value of $4.8 million and $4.8 million, respectively, were exposed to custodial credit risk. These securities were held by the counterparty not in the name of the System.

Concentration of Credit Risk – Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer.

Other than obligations issued, assumed or guaranteed by the United States, its agencies or United States government sponsored enterprises, the System is prohibited by P.A. 314 of 1965, as amended, from investing in more than 5.0% of the outstanding obligations of any one issuer or investing more than 5.0% of a system's assets in the obligations of any one issuer.

At September 30, 2007, and 2006, there were no investments in any single issuer that accounted for more than 5.0% of the System's assets nor were there any investments totaling more than 5.0% of the obligations of any one issuer, other than U.S. Government Securities as described above.

Interest Rate Risk – Fixed Income Investments – Interest rate risk is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment.

The State Treasurer's policy states that cash equivalents are invested in short-term fixed income securities with an average weighted maturity of less than one year to provide liquidity and safety of principal from capital market and default risk. At September 30, 2007, and 2006, the fair value of the System's prime commercial paper was $591.7 million and $685.2 million with the weighted average maturity of 12 days and 41 days, respectively.

The State Treasurer does not have a policy regarding interest rate risk for long-term debt investments. However, the pension funds are invested with a long-term strategy. The goal is to balance higher returns while accepting minimum risk for the return. Analyzing the yield curve on individual securities as compared to U.S. Treasuries determines, in part, what is an acceptable risk for the return. Therefore, market conditions such as lower interest rates result in shorter duration and higher interest rates result in longer duration.

Notes to Basic Financial Statements (Continued)

Debt Securities
(in thousands)
As of September 30, 2007 and 2006

	2007		2006	
	Fair Value	**Effective Duration in Years**	**Fair Value**	**Effective Duration in Years**
Government				
U. S. Treasury	$ 105,677	4.8	$ 114,186	3.1
U. S. Agencies - Backed	314,192	5.7	247,269	5.7
U. S. Agencies - Sponsored	682,120	3.3	605,189	3.7
Corporate	821,591	4.9	659,961	4.4
International*				
U. S. Treasury	19,282	0.1	19,505	0.5
U. S. Agencies - Sponsored	-		9,727	0.1
Corporate	406,563	0.1	466,287	0.1
Equities*				
Corporate	-		67,106	0.6
Total	$ 2,349,425		$ 2,189,230	

*International and Equities contain U.S. Government and Corporate Debt Securities as a part of their derivative strategies. The interest rates reset on a quarterly basis for these securities.

Foreign Currency Risk – Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or deposit.

The System invests in various securities denominated in foreign currencies. These investments are limited to 20% of the total assets of the System with an additional limit of 5% of the outstanding foreign securities of any single issuer. No investment is allowed in a country that has been identified by the United States State Department as engaging in or sponsoring terrorism. These limits are set forth in P.A. 314 of 1965, as amended. The types of foreign investments include equities, fixed income, mutual funds, real estate, and limited partnerships. At September 30, 2007, and 2006, the total amount of foreign investment subject to foreign currency risk was $992.1 million and $629.6 million which amounted to 8.2% and 5.8% of total investments (exclusive of cash collateral on loaned securities) of the System, respectively.

Notes to Basic Financial Statements (Continued)

Foreign Currency Risk
(in thousands)
As of September 30, 2007

Region	Country	Currency	Alt. Invest. Market Value In U.S. $	Equity Market Value In U.S. $	Real Estate Market Value In U.S. $	International Equities Market Value In U.S. $	International Derivatives Market Value In U.S. $*
AMERICA							
	Canada	Dollar				$ 11,881	
	Mexico	Peso		$ 19,732			
EUROPE							
	European Union	Euro	$ 146,208	11,088		47,001	$ 40,069
	Switzerland	Franc		13,344		8,663	7,432
	Sweden	Krona				3,849	2,300
	Denmark	Krone		179		2,595	655
	Norway	Krone				3,080	431
	U.K.	Sterling	5,956	920		23,030	16,660
PACIFIC							
	Australia	Dollar				11,448	6,876
	China	Renminbi		2,518			
	Hong Kong	Dollar				4,130	6,480
	India	Rupee		116			
	Japan	Yen	1,002	33,303		27,700	10,209
	Singapore	Dollar				1,463	1,128
	South Korea	Won				4,320	5,710
VARIOUS					$ 105,057	405,552	
	Total		$ 153,166	$ 81,200	$ 105,057	$ 554,712	$ 97,950

*Note: International derivatives' market value exposure to foreign currency risk is the net amount of unrealized gains and unrealized losses. Maturity dates on these investments range from October 2007 through September 2010 with an average maturity of 1.2 years.

Notes to Basic Financial Statements (Continued)

Foreign Currency Risk
(in thousands)
As of September 30, 2006

Region	Country	Currency	Alt. Invest. Market Value In U.S. $	Equity Market Value In U.S. $	Real Estate Market Value In U.S. $	International Equities Market Value In U.S. $	International Derivatives Market Value In U.S. $*
AMERICA							
	Canada	Dollar		$ 3,939			
	Mexico	Peso		14,099			
EUROPE							
	European Union	Euro	$ 86,534	26,541		$ 6,287	$ 45,889
	Switzerland	Franc		8,392			10,071
	Sweden	Krona		1,814			2,117
	Denmark	Krone				111	1,567
	Norway	Krone		894		10	1,710
	U.K	Sterling	4,597	11,878		474	25,068
PACIFIC							
	Australia	Dollar		3,166			6,231
	Hong Kong	Dollar		626			4,234
	Japan	Yen	1,554	16,065		62	23,144
	Singapore	Dollar					970
	South Korea	Won		1,931			7,919
VARIOUS				127,559	$ 43,469	140,631	
	Total		$ 92,685	$ 216,904	$ 43,469	$ 147,575	$ 128,920

*Note: International derivatives' market value exposure to foreign currency risk is the net amount of unrealized gains and unrealized losses. Maturity dates on these investments range from October 2006 through November 2008 with an average maturity of 1.1 years.

Notes to Basic Financial Statements (Continued)

NOTE 5 - ACCOUNTING CHANGES

The GASB has issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which establishes uniform standards of financial reporting by state and local governmental entities for other post-employment benefit (OPEB) plans. The requirements of this statement are effective one year prior to the effective date of the related Statement (GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions)* for the employer or the largest employer in the plan. Because the State of Michigan is a phase 1 government (those with total annual revenues of $100 million or more), the System is required to implement Statement No. 43 in financial statements for periods beginning after December 15, 2005. The Statement was adopted in fiscal year 2007 and is reflected in this report.

The GASB has issued Statement No. 50, *Pension Disclosures*, which amends GASB Statements No. 25 and No. 27, and more closely aligns the financial reporting requirements for pensions with those for OPEB. This Statement is effective for periods beginning after June 15, 2007. Early implementation is encouraged. With the implementation of Statement No. 43 in fiscal year 2007, we have chosen to early implement Statement No. 50 as reflected in this report.

NOTE 6 - COMMITMENTS AND CONTINGENCIES

Under the Administrative Procedures Act, members may appeal a decision made by the Board. Once the administrative procedure has been exhausted, the decision may be appealed in Michigan's court system. Various cases that have exhausted the administrative procedures have been appealed in the court system. These cases are in the normal course of business and the System does not anticipate any material loss as a result of the contingent liabilities.

Required Supplementary Information

Schedules of Funding Progress

Expressing the net assets available for benefits as a percentage of the actuarial accrued liability provides one indication of the System's funding status. Analysis of this percentage over time indicates whether the System is becoming financially stronger or weaker. Generally, the greater this percentage, the stronger the System. Trends in unfunded actuarial accrued liability and annual covered payroll are both affected by inflation. Expressing the unfunded or overfunded actuarial accrued liability as a percentage of annual covered payroll approximately adjusts for the effects of inflation and aids analysis of progress made in accumulating sufficient assets to pay benefits when due. Generally, the smaller this percentage, the stronger the System.

Retirement Benefits ($ in millions)

Valuation Date Sept 30	Actuarial Value of Assets (a)	Actuarial Accrued Liability[1] (AAL) Entry Age (b)	Unfunded (Overfunded) Accrued Liability (UAAL) (b-a)	Funded Ratio AAL (a/b)	Covered Payroll (c)	UAAL as a % of Covered Payroll ((b-a)/c)
1997	$ 7,516	$ 8,213	$ 697	91.5 %	$ 2,273	30.7 %
1997 [1]	8,834	8,101	(733)	109.0	2,273	(32.2)
1998	9,109	8,374	(735)	108.8	2,108	(34.9)
1998 [1]	9,109	8,497	(612)	107.2	2,108	(29.0)
1999	9,648	9,029	(619)	106.9	2,214	(28.0)
2000	10,337	9,474	(863)	109.1	2,254	(38.3)
2001	10,633	9,878	(755)	107.6	2,231	(33.8)
2002	10,616	10,753	137	98.7	2,133	6.4
2003	10,441	11,761	1,320	88.8	1,860	71.0
2004 [2]	10,149	12,004	1,855	84.5	1,889	98.2
2005	9,897	12,400	2,503	79.8	1,880	133.1
2006	10,111	12,799	2,688	79.0	1,848	145.5
2006 [3]	10,890	12,799	1,909	85.1	1,848	103.3

(1) Revised actuarial assumptions and revised asset valuation method.

(2) Revised actuarial assumptions.

(3) Revised asset valuation method.

Other Postemployment Benefits[1] ($ in millions)

Valuation Date Sept 30	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Entry Age (b)	Unfunded (Overfunded) Accrued Liability (UAAL) (b-a)	Funded Ratio AAL (a/b)	Covered Payroll (c)	UAAL as a % of Covered Payroll ((b-a)/c)
2006	$ -	$ 13,499	$ 13,499	0.0 %	$ 2,848	474.0 %

(1) Includes members from both the defined benefit and defined contribution plans

Required Supplementary Information (Continued)

Schedules of Employer Contributions

Retirement Benefits

Fiscal Year Ended Sept. 30	Annual Required Contribution (ARC)	Actual Contribution	Percentage Contributed
1998	$ 126,396,181	$ 145,734,677	115.3 %
1999	111,415,984	121,119,857	108.7
2000	120,906,261	121,817,366	100.8
2001	102,989,963	112,299,808	109.0
2002	111,551,549	87,486,128 [1]	78.4
2003	184,214,419	79,291,845	43.0 [2]
2004	262,546,900	103,873,294 [3]	39.6
2005	308,208,544	256,433,052	83.2
2006	366,650,515	270,705,017	73.8
2007	316,138,419 [5]	150,858,506 [4]	47.7

Other Postemployment Benefits

Fiscal Year Ended Sept. 30	Annual Required Contribution (ARC)	Actual Contribution	Percentage Contributed
2007	$ 898,716,522	$ 359,375,055 [4]	40.0 %

[1] Employer contributions for fiscal year 2002 were transferred at year-end into the Health Advance Funding SubAccount established under Public Act 93 of 2002. PA 93 states in part that, "For each fiscal year that begins on or after October 1, 2001, if the actuarial valuation prepared … demonstrates that as of the beginning of the fiscal year, and after all credits and transfers required by this act for the previous fiscal year have been made … the annual level percent of payroll contribution rate … may be deposited into the Health Advance Funding SubAccount…" Pursuant to this legislation, a transfer was made into the subaccount in the amount of $87.5 million. The transfer effectively brought the contribution percentage to 0.0% for the fiscal year ended September 30, 2002.

[2] The ARC and percentage contributed are due to the $87.5 million transfer in fiscal year 2002 and an additional transfer of $17.4 million into the Health Advance Funding SubAccount in fiscal year 2003.

[3] In fiscal year 2004, $24.4 million was transferred from the Health Advance Funding SubAccount to the Pension Plan at the request of the State Budget Director and with the approval of the legislature. The purpose of this transfer was to reduce the contribution rates charged to State agencies for fiscal year 2003-2004 to help bring the general fund budget back into balance.

[4] In fiscal year 2007, $41.3 million was transferred from the Health Advance Funding SubAccount to the Reserve for Employer Contributions in accordance with the provisions set forth in the State Employees' Retirement Act to comply with Executive Order 2007-3 and the subaccount was closed.

[5] Pursuant to Public Act 22 of 2007, the System's assets were revalued to their actual market value as of September 30, 2006. The five-year smoothing will begin again in fiscal year 2008.

Notes to Required Supplementary Information

NOTE A - DESCRIPTION

Ten year historical trend information designed to provide information about the System's progress made in accumulating sufficient assets to pay benefits when due is presented in the preceding schedules. Other ten year historical trend information related to the System is presented in the Statistical and Actuarial Sections of the report. This information is presented to enable the reader to assess the progress made by the System in accumulating sufficient assets to pay pension and other postemployment benefits as they become due. Because this is the first year the System is reporting other postemployment benefits in accordance with GASB Statement No. 43, only one year of historical trend information is provided. In the transition year and until three actuarial valuations have been performed in accordance with the parameters, the required schedules of funding progress and employer contributions will include information for as many valuations as are available.

The comparability of trend information is affected by changes in actuarial assumptions, benefit provisions, actuarial funding methods, accounting policies, and other changes. Those changes usually affect trends in contribution requirements and in ratios that use the pension and other postemployment benefit obligations as a factor.

The Schedules of Funding Progress and Schedules of Employer Contributions are reported as historical trend information. The Schedules of Funding Progress are presented to measure the progress being made to accumulate sufficient assets to pay benefits when due. The Schedules of Employer Contributions are presented to show the responsibility of the Employer in meeting the actuarial requirements to maintain the System on a sound financial basis.

Supporting Schedules

Comparative Summary of Pension Plan Administrative Expenses For fiscal years ended September 30, 2007 and 2006

	2007	2006
Personnel Services:		
Staff Salaries	$ 1,089,972	$ 1,072,078
Retirement and Social Security	276,485	293,581
Other Fringe Benefits	232,147	200,681
Total	1,598,604	1,566,340
Professional Services:		
Accounting	275,740	225,506
Actuarial	133,900	94,887
Attorney General	285,541	238,446
Audit	41,301	36,651
Consulting	109,320	78,045
Medical	266,928	276,303
Total	1,112,730	949,838
Building and Equipment:		
Building Rentals	142,235	108,835
Equipment Purchase, Maintenance, and Rentals	10,365	9,449
Total	152,600	118,284
Miscellaneous:		
Travel and Board Meetings	2,571	5,175
Office Supplies	11,466	13,330
Postage, Telephone, and Other	543,767	453,003
Printing	65,445	77,780
Technological Support	1,628,043	1,444,293
Total	2,251,292	1,993,581
Total Administrative Expenses	$ 5,115,226	$ 4,628,043

Supporting Schedules (Continued)

Schedule of Investment Expenses
For fiscal years ended September 30, 2007 and 2006

	2007	2006
Real Estate Operating Expenses	$ 276,483	$ 94,039
Securities Lending Expenses	112,080,389	38,253,881
Other Investment Expenses*		
ORS-Investment Expense	2,162,349	2,020,711
Custody Fees	260,796	228,770
Management Fees-Real Estate	942,271	601,122
Management Fees-Alternative	12,121,821	10,408,922
Management Fees-International	480,159	-
Research Fees	230,894	189,701
Total Investment Expenses	$ 128,555,162	$ 51,797,146

* See Investment Section for fees paid to investment professionals

Schedule of Payments to Consultants
For fiscal years ended September 30, 2007 and 2006

	2007	2006
Independent Auditors	$ 41,301	$ 36,651
Consulting	109,320	78,045
Medical	266,928	276,303
Attorney General	285,541	238,446
Accounting	275,740	225,506
Actuary	133,900	94,887
Total Payment to Consultants	$ 1,112,730	$ 949,838

Supporting Schedules (Continued)

Detail of Changes in Plan Net Assets (Pension and Other Postemployment Benefits)
For the Year Ended September 30, 2007

	Employee Contributions	Employer Contributions	Retired Benefit Payments	Undistributed Investment Income	OPEB Related Benefits	Total
Additions:						
Contributions:						
Member contributions	$ 19,696,132				$ 11,760,544	$ 31,456,676
Employer contributions		$ 150,858,506			359,375,055	510,233,561
Total Contributions	19,696,132	150,858,506	-	-	371,135,599	541,690,237
Investment income (loss):						
Net appreciation (decreciation) in fair value of investments				$ 1,564,590,781		1,564,590,781
Interest, dividends, and other				248,765,760	1,500,072	250,265,832
Investment expenses:						
Real estate operating expenses				(276,483)		(276,483)
Other investment expenses				(16,198,290)		(16,198,290)
Securities lending activities:						
Securities lending income				116,786,647		116,786,647
Securities lending expenses				(112,080,389)		(112,080,389)
Net investment income (loss)	-	-	-	1,801,588,026	1,500,072	1,803,088,098
Transfer from other systems	105,572					105,572
Transfer from pension/OPEB plan		41,304,031				41,304,031
Miscellaneous income			$ 24,299	741,697		765,996
Total additions	19,801,704	192,162,537	24,299	1,802,329,723	372,635,671	2,386,953,934
Deductions:						
Benefits paid to plan members and beneficiaries:						
Retirement benefits			795,842,013			795,842,013
Health benefits					329,714,449	329,714,449
Dental/vision benefits					34,260,602	34,260,602
Refunds of member contributions	42,892	178,316	831			222,039
Transfers to other systems	7,561					7,561
Transfer to pension/OPEB plan					41,304,031	41,304,031
Administrative expenses				5,115,226		5,115,226
Total deductions	50,453	178,316	795,842,844	5,115,226	405,279,082	1,206,465,921
Net Increase (Decrease) Before Other Changes	19,751,251	191,984,221	(795,818,545)	1,797,214,497	(32,643,411)	1,180,488,013
Other Changes in Net Assets:						
Interest allocation	3,463,632	561,830,405	136,665,302	(701,959,339)		-
Transfers upon retirement	(16,594,635)		16,594,635			-
Transfers of employer shares		(625,759,073)	625,759,073			-
Total other changes in net assets	(13,131,003)	(63,928,668)	779,019,010	(701,959,339)	-	-
Net Increase (Decrease)	6,620,248	128,055,553	(16,799,535)	1,095,255,158	(32,643,411)	1,180,488,013
Net Assets Held in Trust for Pension and OPEB Benefits:						
Beginning of Year	209,993,380	1,708,316,274	6,981,576,036	1,990,039,537	60,054,929	10,949,980,156
End of Year	$ 216,613,628	$ 1,836,371,827	$ 6,964,776,501	$ 3,085,294,695	$ 27,411,518	$ 12,130,468,169

Supporting Schedules (Continued)

Detail of Changes in Plan Net Assets (Pension and Other Postemployment Benefits)
For the Year Ended September 30, 2006

	Employee Contributions	Employer Contributions	Retired Benefit Payments	Undistributed Investment Income	OPEB Related Benefits*	Total
Additions:						
Contributions:						
Member contributions	$ 9,434,310				$ 11,528,041	$ 20,962,351
Employer contributions		$ 270,705,017			356,674,243	627,379,260
Total Contributions	9,434,310	270,705,017	-	-	368,202,284	648,341,611
Investment income (loss):						
Net appreciation (depreciation) in fair value of investments				$ 1,012,259,360		1,012,259,360
Interest, dividends, and other				248,408,079	5,660,782	254,068,861
Investment expenses:						
Real estate operating expenses				(94,039)		(94,039)
Other investment expenses				(13,449,226)		(13,449,226)
Securities lending activities:						
Securities lending income				39,745,998		39,745,998
Securities lending expenses				(38,253,881)		(38,253,881)
Net investment income (loss)	-	-	-	1,248,616,291	5,660,782	1,254,277,073
Transfer from other systems	123,059					123,059
Miscellaneous income				106,169		106,169
Total additions	9,557,369	270,705,017	-	1,248,722,460	373,863,066	1,902,847,912
Deductions:						
Benefits paid to plan members and beneficiaries:						
Retirement benefits			$ 767,000,706			767,000,706
Health benefits					328,528,595	328,528,595
Dental/vision benefits					34,069,090	34,069,090
Refunds of member contributions	145,554	105,809	2,523			253,886
Transfers to other systems	2,647					2,647
Administrative expenses				4,628,043		4,628,043
Total deductions	148,201	105,809	767,003,229	4,628,043	362,597,685	1,134,482,967
Net Increase (Decrease) Before Other Changes	9,409,168	270,599,208	(767,003,229)	1,244,094,417	11,265,381	768,364,945
Other Changes in Net Assets:						
Interest allocation	2,966,829	550,252,642	129,324,726	(682,544,197)		-
Transfers upon retirement	(12,001,854)		12,001,854			-
Transfers of employer shares		(729,094,655)	729,094,655			-
Total other changes in net assets	(9,035,025)	(178,842,013)	870,421,235	(682,544,197)	-	-
Net Increase (Decrease)	374,143	91,757,195	103,418,006	561,550,220	11,265,381	768,364,945
Net Assets Held in Trust for Pension and OPEB Benefits:						
Beginning of Year	209,619,237	1,616,559,079	6,878,158,030	1,428,489,317	48,789,548	10,181,615,211
End of Year	$ 209,993,380	$ 1,708,316,274	$ 6,981,576,036	$ 1,990,039,537	$ 60,054,929	$ 10,949,980,156

*Includes Health Advance Funding SubAccount

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INVESTMENT SECTION

Prepared by Michigan Department of Treasury, Bureau of Investments
Jon M. Braeutigam, Acting Director

INVESTMENT SECTION

Report on Investment Activity

INTRODUCTION

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

The Investment Advisory Committee was created by Act 380 of the Public Acts of 1965. The three public members of the five-member committee are appointed by the Governor with the advice and consent of the Senate for three-year terms. The Director of the Department of Labor and Economic Growth and the Director of the Department of Management and Budget are ex-officio members. As of September 30, 2007, members of the Committee were as follows: David G. Sowerby, CFA (public member), Robert E. Swaney, CFA (public member), James B. Jacobs (public member), Keith W. Cooley (ex-officio member), and Lisa Webb Sharpe (ex-officio member). The public members serve without pay, but may be paid actual and necessary travel and other expenses.

INVESTMENT POLICY & GOALS

Investment policy states that the fiduciary will operate within standard investment practices of the prudent person and in accordance with Public Employee Retirement System Investment Act 314 of 1965. The fiduciary is authorized to invest in government obligations, corporate obligations, various short-term obligations, corporate (domestic and international) stocks, private equity interests, mutual funds, real estate interests, and other investments subject to specific parameters. Above all, pension fund assets are to be invested for the exclusive benefit of the members of the System, in a fiduciary capacity.

The System's Proxy Voting Policy sets forth directives on the following issues: Boards of Directors, corporate governance, social issues, corporate restructurings and defenses. All proxies are reviewed and voted in accordance with the System's policy.

The primary function of the System is to provide retirement, survivor and disability benefits to its members. The State Treasurer is the sole investment fiduciary and custodian of the System's investments pursuant to State law. The goals of the System are:

1. Achieve the optimal rate of return possible within prudent levels of risk.
2. Maintain sufficient liquidity to pay benefits.
3. Diversify assets to preserve capital and avoid large losses.
4. Meet or exceed the actuarial assumption over the long term.
5. Perform in the top half of the public plan universe over the long term.
6. Exceed individual asset class benchmarks over the long term.
7. Operate in a cost-effective manner.

The strategy for achieving these goals is carried out by investing the assets of the System according to a three-year asset allocation model. The System currently has seven different asset classes it invests in, which provides for a well-diversified portfolio.

Report on Investment Activity (Continued)

Asset Allocation
(Excludes Collateral on Loaned Securities)

Investment Category	As of 9/30/07 Actual %		Three-Year Target %
Domestic Equity - Active	29.4%		24.0%
Large Cap Core Pool		15.6%	
Large Cap Value Pool		5.0%	
Large Cap Growth Pool		5.5%	
Mid Cap Pool		2.3%	
Small Cap Pool		1.0%	
Domestic Equity - Passive	17.9%		16.0%
S&P 500 Index Pool		16.2%	
S&P MidCap Index Pool		1.7%	
International Equity	11.5%		11.0%
International Equity Pool - Passive		8.5%	
International Equity Pool - Active		3.0%	
Alternative Investments Pool	13.1%		15.0%
Real Estate Pool	9.7%		11.0%
Fixed Income	16.6%		21.0%
Government Bond Pool		8.0%	
Corporate Bond Pools		5.5%	
Fixed Income Bond Pools		2.6%	
Treasury Inflation Prot. Sec. Pool		0.5%	
Short Term Investment Pool	1.8%		2.0%
TOTAL	**100.0%**		**100.0%**

INVESTMENT AUTHORITY

Pursuant to State Law (Section 91 of Act No. 380 of the Public Acts of 1965, as amended), the State Treasurer, State of Michigan, is the investment fiduciary for the following four State sponsored retirement systems: Michigan Public School Employees' Retirement System, Michigan State Employees' Retirement System, Michigan State Police Retirement System, and Michigan Judges' Retirement System.

Act No. 314 of the Public Acts of 1965, as amended, authorizes the investment of assets of public employee retirement systems or plans created and established by the State or any political subdivision.

INVESTMENT RESULTS

Total Portfolio Results

For the fiscal year ended September 30, 2007, the total System's rate of return was 17.2% as compiled by State Street Analytics. Annualized rates of return for the three-year period ending September 30, 2007, were 14.3%; for the five-year period were 14.0%; and for the ten-year period were 8.2%.

Returns were calculated using a time-weighted rate of return in accordance with industry standards, unless a modification is described in the discussion of the reported return.

Report on Investment Activity (Continued)

Investment results were once again driven by double-digit returns from every major asset class except fixed income and short-term investments. Equity performance was strong much of the year in spite of soaring commodity and energy prices. International stocks turned in the best performance, led by emerging markets and the benefit of a declining dollar. Domestic equities were also strong, with mid cap stocks (S&P 400) turning in the best performance for the period, followed by larger companies (S&P 500) then small cap (S&P 600). Credit markets experienced turmoil in July and August due to problems associated with subprime mortgages and concerns with housing. However, a 50 basis point cut in the federal funds rate in mid September provided some stability to the credit markets as well as a positive lift to the equity markets. The Alternative Investments Division continued to benefit from an extraordinarily liquid credit environment that fueled strong mergers and acquisitions, for most of the year, and refinancing activity for its buyout sector. Robust commercial real estate markets allowed the Real Estate pool to experience strong gains from both sales and appraisals of property. Investment grade bonds generally had positive returns for the year. The yield curve shifted from being inverted to being positively sloped as ten to thirty year rates remained relatively unchanged while short-term to ten year rates declined.

For the fiscal year, the Dow Jones Industrial Average provided a total return of 21.7%, while the broader based S&P 500 returned 16.4%. The Lehman Brothers U.S. Government/Credit Bond Index appreciated 5.1%.

The U.S. economy grew at an estimated rate of 2.6% in fiscal year 2007 as measured by real gross domestic product. The first half was weak due to a significant rise in imports and a decline in inventories. The second half of the fiscal year picked up due to a narrowing of the trade deficit, a pick up in defense spending and a surge in commercial construction. Corporate earnings remained strong for most of the year, led by robust profits from energy companies and a rebound in technology, but earnings growth slowed for some sectors, namely housing and financials, late in the year. Strong demand sent commodity and energy prices climbing during most of the year, with oil moving close to $80 per barrel in September.

For the first time since June of 2003, Federal Reserve Chairman Ben Bernanke and the Federal Reserve decided unanimously to cut the federal funds rate from 5.25% to 4.75%. They expressed a general concern that tightening credit conditions and disruptions in the financial markets might have the potential to intensify the housing corrections and possibly restrain future economic growth.

The System remains well diversified, both across and within asset classes, and positioned to benefit from moderate economic growth.

Large Cap Core Pool

The objective of the pool of large company core stocks is to generate a rate of return from investment in common stocks and equity equivalents that exceeds that of the S&P 500 Index.

The pool invests primarily in equities and equity-related securities of U.S. companies with market capitalization generally greater than $5 billion that have passed several screens based on the stocks' valuation, risk attributes and tracking error relative to the overall index. The goal is to build a portfolio of stocks that will provide excess returns relative to the S&P 500 while providing minimal tracking error to the index. At times a portion of the pool may be invested in exchange traded funds (ETFs) and fixed-income short-term securities with maturities of less than one year.

The pool invests in equities and equity related securities that are listed on U.S. national securities exchanges, including American Depository Receipts (ADRs). It may also invest in stocks that are traded over-the-counter. The pool diversifies its investments by allocating its equities with consideration of the weightings of the S&P 500 Index.

Report on Investment Activity (Continued)

The following summarizes the weightings of the pool as of September 30, 2007:

Financials	20.5 %
Technology	17.2
Healthcare	12.9
Consumer Discretionary	11.5
Industrials	10.3
Consumer Staples	9.3
Energy	8.7
Utilities	3.2
Telecom	3.0
Materials	2.5
Short Term Investments	0.9
Total	**100.0 %**

The System's Large Cap Core pool was established in July of 2007, and therefore does not have performance for the entire 2007 fiscal year.

At the close of fiscal year 2007, the Large Cap Core pool represented 15.6% of total investments. The following summarizes the System's 19.3% ownership share of the Large Cap Core pool at September 30, 2007:

Large Cap Core Pool
(in thousands)

Short Term Pooled Investments	$ 5,352
Equities	1,882,027
Settlement Principal Payable	(3,450)
Accrued Dividends	2,316
Total	**$ 1,886,245**

Large Cap Value Pool

The objective of the pool of large company value stocks is to generate a rate of return from investment in common stocks and equity equivalents that exceeds that of the S&P Citigroup Value Index.

The pool invests primarily in equities and equity-related securities of U.S. companies with market capitalization generally greater than $5 billion that are significantly under-priced as measured by several valuation criteria, including price-to-earnings and price-to-book value ratios, as well as below fair value as determined by several quantitative and qualitative valuation models. The focus is on companies trading 25% or more below estimated fair value with experienced management and conservative accounting practices. At times a portion of the pool may be invested in fixed-income short-term securities with maturities of less than one year.

The pool invests in equities and equity related securities that are listed on U.S. national securities exchanges, including American Depository Receipts (ADRs). It may also invest in stocks that are traded over-the-counter. The pool diversifies its investments by allocating its equities among ten sectors with some consideration of the weightings of the S&P Citigroup Value Index.

Report on Investment Activity (Continued)

The following summarizes the weightings of the pool as of September 30, 2007:

Financials	33.0 %
Healthcare	17.8
Consumer Discretionary	9.5
Energy	9.3
Technology	8.1
Short Term Investments	6.6
Consumer Staples	5.9
Industrials	3.7
Telecomm. Services	3.2
Materials	2.2
Utilities	0.7
Total	**100.0** %

The System's Large Cap Value pool achieved a total rate of return of 13.7% for fiscal year 2007. This compared with 16.1% for the S&P 500 Citigroup Value Index.

At the close of fiscal year 2007, the Large Cap Value pool represented 5.0% of total investments. This compares to 12.9% for fiscal year 2006. The following summarizes the System's 19.0% ownership share of the Large Cap Value pool at September 30, 2007:

Large Cap Value Pool
(in thousands)

Short Term Pooled Investments	$	23,234
Equities		575,037
Accrued Dividends		447
Total	**$**	**598,718**

Large Cap Growth Pool

The primary investment objective is to generate a rate of return from investment in common stocks and equity equivalents that exceeds that of the S&P Citigroup Growth Index.

The pool invests primarily in equities and equity-related securities of U.S. companies with market capitalization generally greater than $3 billion and which offer above-average and sustainable growth in revenues, earnings, cash flow, identifiable catalysts, and reasonable valuations relative to their fundamentals. The focus is on companies with a strong presence in categories anticipated to be fast growing, with high rates of unit sales growth and seasoned management. At times a portion of the pool may be invested in fixed-income short-term securities with maturities of less than one year.

The pool invests in equities and equity related securities that are listed on U.S. national securities exchanges, including American Depository Receipts (ADRs). It may also invest in stocks that are traded over-the-counter. The pool diversifies its investments by allocating its equities with weightings that approximate the weightings of the S&P Citigroup Growth Index.

Report on Investment Activity (Continued)

The following summarizes the weightings of various sectors in the pool as of September 30, 2007:

Technology	22.9 %
Health Care	17.2
Energy	14.7
Consumer Staples	13.0
Industrials	11.1
Financials	8.7
Consumer Discretionary	8.3
Short Term Investments	3.4
Utilities	0.4
Materials	0.3
Total	**100.0** %

The Large Cap Growth pool's total rate of return was 19.8% for fiscal year 2007 versus 16.8% for the S&P 500 Citigroup Growth Index.

At the close of fiscal year 2007, the Large Cap Growth pool represented 5.5% of total investments. This compares to 13.1% for fiscal year 2006. The following summarizes the System's 19.4% ownership share of the Large Cap Growth pool at September 30, 2007:

Large Cap Growth Pool
(in thousands)

Short Term Pooled Investments	$	8,951
Equities		650,904
Accrued Dividends		242
Total	**$**	**660,097**

Mid Cap Pool

Nine Mid Cap managers were selected in 2005 and they were funded out of the Large Cap Value and Growth pools. The manager's investment styles range from value, growth and core and they select stocks with average market capitalizations greater than $1 billion but less than $5 billion. The investment objective of the Mid Cap manager pool is to generate a combined rate of return from investment in common stocks and equivalents that exceeds the S&P 400 Mid Cap Index.

The Mid Cap pool return for fiscal year 2007 was 22.6% versus the benchmark's 18.8%.

At the close of fiscal year 2007, the Mid Cap pool represented 2.3% of total investments. This compares to 2.1% for fiscal year 2006. The following summarizes the System's ownership share and composition of the Mid Cap pool at September 30, 2007:

Mid Cap Value and Core Pools
(in thousands)

	Artisan MidCap Value	Cramer Rosenthal McGlynn MidCap Value	Los Angeles Capital MidCap Core	Wellington Management MidCap Core
Total Investment	$44,969	$44,844	$28,316	$39,628
Ownership Percentage	19.9%	20.0%	19.9%	19.9%

Report on Investment Activity (Continued)

Mid Cap Growth Pools
(in thousands)

	Alliance MidCap Growth	Putnam MidCap Growth	Rainer MidCap Growth	UBS MidCap Growth	Wellington Management MidCap Growth
Total Investment	$30,192	$11,720	$28,892	$26,049	$26,755
Ownership Percentage	20.0%	20.2%	20.2%	20.2%	20.2%

Small Cap Pool

The primary investment objective is to generate a rate of return from investment in common stocks and equivalents that exceeds the S&P 600 Small Cap Index by selecting stocks with market capitalizations greater than $60 million but less than $3 billion.

In December of 2006, five new small cap managers were hired in the Small Cap pool, and in January of 2007, three managers were terminated for performance reasons. The current System's Small Cap pool is invested with one Growth, one Core, and five Value managers.

The Small Cap pool return for fiscal year 2007 was 17.7% versus the benchmark's 14.9%.

At the close of fiscal year 2007, the Small Cap pool represented 1.0% of total investments. This compares to 1.0% for fiscal year 2006. The following summarizes the System's ownership share and composition of the Small Cap Pool at September 30, 2007:

Small Cap Value Pool
(in thousands)

	Donald Smith Small Cap Value	Fisher Small Cap Value	GW Capital Small Cap Value	Northpointe Small Cap Value	Opus Capital Small Cap Value
Total Investment	$19,954	$22,765	$16,032	$16,915	$5,387
Ownership Percentage	20.6%	17.8%	20.6%	19.8%	20.6%

Small Cap Growth and Core Pool
(in thousands)

	Champlain Small Cap Core	Pier Capital Small Cap Growth
Total Investment	$17,421	$23,302
Ownership Percentage	20.6%	20.6%

Report on Investment Activity (Continued)

S&P 500 Index Pool

The objective of the enhanced S&P 500 Index pool is to closely match the return performance of its benchmark, the S&P 500 Index, and to use low risk strategies to offset transaction costs and add to performance when possible. The pool generally holds all 500 stocks that make up the Standard & Poor's 500 Index in proportion to their weighting in the index. The following summarizes the sector weightings of the pool as of September 30, 2007:

Financials	19.8 %
Information Technology	16.2
Health Care	11.7
Energy	11.7
Industrials	11.5
Consumer Staples	9.5
Consumer Discretionary	9.2
Telecomm. Services	3.7
Utilities	3.5
Materials	3.2
Total	**100.0** %

The S&P 500 Index pool return for the fiscal year was 16.5% versus the benchmark's 16.4%.

At the close of fiscal year 2007, the S&P 500 Index pool represented 16.2% of total investments. This compares to 16.5% for fiscal year 2006. The following summarizes the System's 19.3% ownership share of the S&P 500 Index pool at September 30, 2007:

S&P 500 Index Pool
(in thousands)

Short Term Pooled Investments	$	26,278
Equities		1,920,918
Futures Contracts		44
Accrued Dividends		2,195
Total	**$**	**1,949,435**

S&P MidCap Index Pool

The objective of the S&P MidCap Index pool is to closely match the return performance of its benchmark, the S&P MidCap, and use low risk strategies to offset transaction costs and add to performance when possible. The pool invests in equities of mid-size firms.

The S&P MidCap Index pool return for the fiscal year was 18.7% versus its benchmark's 18.8%.

At the close of fiscal year 2007, the S&P MidCap Index pool represented 1.7% of total investments. This compares to 2.1% for fiscal year 2006. The following summarizes the System's 19.3% ownership share of the S&P MidCap Index pool at September 30, 2007:

Report on Investment Activity (Continued)

S&P MidCap Index Pool
(in thousands)

Short Term Pooled Investments	$	2,873
Equities		201,637
Futures Contracts		(7)
Settlement Principal Payable		(943)
Accrued Dividends		135
Total	**$**	**203,695**

International Equity Pool - Passive

The objective of the International Equity Pool - Passive is to match the return performance of the S&P/Citigroup Broad Market Index (BMI) Europe and Pacific Composite (EPAC) adjusted for net dividends. Fifty percent of the benchmark is hedged to the U.S. Dollar and the other half is impacted by foreign currency exchange rate changes. The total passive international return for the fiscal year was 20.7% compared to the Citigroup BMI-EPAC return of 19.8%.

Core passive exposure to international equity returns is achieved primarily by investing in a combination of fixed income LIBOR notes, short-term fixed income investments, and equity swap agreements on foreign stock indices in developed markets. Interest on the dedicated notes and short-term fixed income investments is exchanged for international stock returns, and the total notional amount of the swap agreements is invested in the approximate proportions of the S&P/Citigroup Broad Market Index (BMI) Europe and Pacific Composite (EPAC) country weightings in related indices. Use of swap agreements for a core position began in 1993, an American Depository Receipts (ADR) and index-related security portfolio was added in June of 1999 to increase portfolio management flexibility, and a country fund portfolio with targeted capitalization was added in September of 2002 to improve exposure to the smallest companies in the BMI index.

The combination of notes, dedicated short-term investments and equity swap agreements was valued at $799.4 million on September 30, 2007. That valuation included a net unrealized gain of $189.1 million. The combined swap agreements, notes and short-term investments together continue to perform like a stock index fund that realizes all gains and losses on a rolling three year basis. During fiscal year 2007, the pool received realized gains of $223.5 million on swap equity exposures and dedicated short-term investments. During the same period, $16.7 million of interest income was earned from international equity swaps.

At the close of fiscal year 2007, the International Equity - Passive pool represented 8.5% of total investments. This compares to 10.5% for fiscal year 2006. The following summarizes the System's 19.4% ownership share of the International Equity Pool - Passive at September 30, 2007:

International Equity Pool - Passive
(in thousands)

Short Term Pooled Investments	$	203,973
Equities		208,438
Fixed Income Securities		425,844
Market Value of Equity Contracts		186,634
Accrued Dividends and Interest		3,013
Total	**$**	**1,027,902**

Report on Investment Activity (Continued)

International Equities Pool – Active

The investment objective is to generate a rate of return from investment in common stocks and equivalents that exceeds the S&P Citigroup Broad Market Index (BMI) World Ex-United States. That benchmark is impacted by foreign currency exchange rate changes.

In fiscal year 2005, the System invested in AllianceBernstein International Style Blend, a mix of Large Cap Growth and Value. During fiscal year 2006, investments were made in the following funds: The Wellington Trust Company International Research Equity Fund and the State Street Global Asset International Alpha Select Pool. Two international managers, SSgA Int'l Small Cap Alpha and GlobeFlex Int'l Small Cap, were selected and funded during April 2007, and added to the three managers already in the pool.

The International Equity Pool – Active return for the fiscal year was 26.6% versus the benchmark's 26.0%.

At the close of fiscal year 2007, the International Equity - Active pool represented 3.0% of total investments. This compares to 1.8% for fiscal year 2006. The following summarizes the System's ownership share and composition of the pool at September 30, 2007:

International Equity Pool - Active
(in thousands)

	AllianceBernstein International	Wellington International	SSGA International	Globeflex Int'l Small Cap	SSGA Int'l Small Cap
Total Investment	$112,528	$95,629	$111,642	$18,962	$19,955
Ownership Percentage	19.6%	20.0%	20.0%	19.4%	19.4%

Alternative Investments Pool

The Alternative Investments pool objective is to meet or exceed the benchmark for all private equity investments over long time periods. The benchmark is a blend of the S&P 500 Index plus 300 basis points and the 10 year yield plus 300 basis points using ending weights of equity and fixed income holdings within the portfolio.

Alternative Investments are investments in the private equity market, primarily through limited partnerships. The following summarizes the weightings of the pool as of September 30, 2007:

Buyout Funds	52.3	%
Special Situation Funds	16.8	
Venture Capital Funds	10.9	
Liquidation Portfolio	7.0	
Fund of Funds	6.4	
Hedge Funds	2.5	
Short Term Investments	2.3	
Mezzanine Funds	1.8	
Total	**100.0**	**%**

The Alternative Investments pool had a return of 30.7% for the fiscal year ended September 30, 2007, versus the benchmark of 19.2%.

T. Rowe Price managed the stock distributions of the Alternative Investments beginning in October 2006. The T. Rowe Price return for the fiscal year ending September 30, 2007 was 4.8%.

Report on Investment Activity (Continued)

At the close of fiscal year 2007, the Alternative Investments pool represented 13.1% of total investments and T. Rowe Price represented 0.04% of total investments. This compares to 12.0% for Alternative and 0.01% for Credit Suisse Asset Management for fiscal year 2006. The following summarizes the System's ownership share and composition of the Alternative Investments pool and T. Rowe Price at September 30, 2007:

Alternative Investments Pool
(in thousands)

	Alternative	T. Rowe Price
Short Term Pooled Investments	$ 36,855	$ 2,329
Equities	1,541,804	1,381
Settlement Proceeds Receivable	-	585
Total	**$ 1,578,659**	**$ 4,295**
Ownership Percentage	18.3%	16.8%

Real Estate Pool

The Real Estate pool seeks favorable returns primarily through rental income and appreciation of real estate investments. Real estate investments are typically held through various legal investment entities, such as limited partnerships or limited liability companies, established for the specific purpose of owning, leasing, managing, financing, or developing real estate and real estate related investments. Independent third parties regularly value the real estate investments to establish current market values.

The Real Estate pool diversifies its holdings by:

- Geography - The pool is diversified geographically with emphasis placed upon domestic (U.S.) real estate investments. The pool may also make foreign real estate investments, which are not expected to exceed 15% of the value of the pool.
- Property Size and Value - The pool diversifies its holdings so that it is not concentrated in a limited number of large real estate investments.
- Property Type - The pool is diversified by type of property as summarized in the table below.

Multi-Family Apartments	22.8	%
Commercial Office Buildings	22.3	
Hotels	19.4	
Retail Shopping Centers	14.4	
Industrial Warehouse Buildings	7.5	
Short Term Investments	5.7	
Senior Living	3.3	
Land	2.3	
For Sale Housing	2.3	
Total	**100.0**	**%**

The Real Estate pool generated a return of 20.5% for fiscal year 2007, while the benchmark return was 16.0%. The benchmark is the National Council of Real Estate Investment Fiduciaries Property Index less 130 basis points. During the year the pool benefited from continued strong flow of capital into the commercial real estate market from both domestic and foreign investors coupled with improvement in commercial real estate fundamentals, which resulted in the pool realizing strong appreciation and gains on asset sales.

Report on Investment Activity (Continued)

At the close of fiscal year 2007, the Real Estate pool represented 9.7% of total investments. This compares to 8.7% for fiscal year 2006. The following summarizes the System's 20.5% ownership share of the Real Estate pool at September 30, 2007:

Real Estate Pool
(in thousands)

Short Term Pooled Investments	$	66,021
Equities		1,100,330
Fixed Income Securities		1
Total	**$**	**1,166,352**

Government Bond Pool

The objectives are to maximize the rate of return consistent with sound portfolio management principles and to outperform the Lehman Brothers Government Index.

The Government Bond pool invests in a diversified portfolio of United States' government bonds including, but not limited to, treasuries, agencies, government sponsored enterprises and government guaranteed mortgages. To achieve above average returns, the pool emphasizes those sectors exhibiting the best risk/reward relationship relative to historical norms and the outlook for interest rates.

During the fiscal year, rates continued to be volatile. Ten-year treasuries started the year at 4.6%, rose to 5.3%, then declined and ended at 4.6%. The yield curve shifted from inverted to positively sloped. Ten to thirty-year rates remained relatively unchanged while short-term to ten-year rates declined.

For the fiscal year ending September 30, 2007, the Government Bond pool returned 5.9%, which compared favorably to the 5.6% return of the Lehman Brothers Government Index.

The following summarizes the security type breakdown of the pool as of September 30, 2007:

U.S. Agency	62.8	%
GNMA	20.5	
U.S. Guaranteed	11.9	
Short Term Investments/Accruals	4.8	
Total	**100.0**	**%**

At the close of fiscal year 2007, the Government Bond pool represented 8.0% of total investments. This compares to 8.4% for fiscal year 2006. The following summarizes the System's 19.3% ownership share of the Government Bond pool at September 30, 2007:

Government Bond Pool
(in thousands)

Short Term Pooled Investments	$	37,599
Fixed Income Securities		917,006
Accrued Dividends		8,896
Total	**$**	**963,501**

Report on Investment Activity (Continued)

Treasury Inflation Protected Securities Pool

A Treasury Inflation Protected Securities (TIPS) pool was established in January 2007. Transfer of TIPS holdings in the Government Bond pool provided the initial funding for the TIPS pool.

The TIPS pool return from inception to fiscal year end was 6.3%.

At the close of fiscal year 2007, the Treasury Inflation Protected Securities pool represented 0.5% of total investments. The following summarizes the System's 19.3% ownership share of the TIPS pool at September 30, 2007:

TIPS Pool
(in thousands)

Short Term Pooled Investments	$	831
Fixed Income Securities		54,137
Accrued Interest		261
Total	**$**	**55,229**

Corporate Bond Pool

The objectives are to maximize the rate of return consistent with sound portfolio management principles and to outperform the Lehman Brothers Credit Index.

The Corporate Bond pool invests in a diversified portfolio of investment grade corporate issues. Such issues are rated in the top four categories by nationally recognized rating agencies. Non-rated issues may be acceptable if they are determined to be of comparable quality. To achieve above average returns, the pool emphasizes those sectors exhibiting the best risk/reward ratio relative to historical norms and the outlook for interest rates.

For the fiscal year ending September 30, 2007, the Corporate Bond pool returned 5.3% compared to the 4.2% return of the Lehman Brothers Credit Index. The pool's performance improved as the year progressed due to the decline in rates later in the year.

The following summarizes the security type breakdown of the pool as of September 30, 2007:

Financials	23.7	%
Health Care	17.9	
Industrials	13.1	
Consumer Staples	11.9	
Consumer Discretionary	10.3	
Other	7.3	
Utilities	5.5	
Energy	2.7	
Materials	2.6	
Information Technology	2.6	
Short Term Investments/Accruals	2.4	
Total	**100.0**	**%**

At the close of fiscal year 2007, the Corporate Bond pool represented 5.5% of total investments. This compares to 6.0% for fiscal year 2006. The following summarizes the System's 19.2% ownership share of the Corporate Bond pool at September 30, 2007:

Report on Investment Activity (Continued)

Corporate Bond Pool
(in thousands)

Short Term Pooled Investments	$	7,812
Fixed Income Securities		647,683
Accrued Interest		7,873
Total	**$**	**663,368**

Fixed Income Core Pools

Five Fixed Income Core managers were selected in fiscal year 2006, beginning March 31, 2006. Their objective is to generate a rate of return exceeding the Lehman Aggregate Index net of fees.

Delaware Investments, Dodge & Cox, Dupont Capital Management, Pyramis Global Advisors, and Metropolitan West Asset Management were the firms hired.

The Fixed Income Core pools combined rate of return for the fiscal year was 5.3% versus the benchmark's 5.1%.

At the close of fiscal year 2007, the Fixed Income Core pools represented 1.4% of total investments. This compares to 1.0% for fiscal year 2006. The following summarizes the System's ownership share and composition of the five Fixed Income Core pools at September 30, 2007:

Fixed Income Core Pools
(in thousands)

	Delaware Fixed Income Core	Dodge & Cox Fixed Income Core	Dupont Fixed Income Core	Pyramis Fixed Income Core	Metro West Fixed Income Core
Total Investment	$21,257	$36,465	$25,914	$52,123	$36,756
Ownership Percentage	19.7%	19.7%	19.7%	19.7%	19.7%

Fixed Income Corporate Manager Pools

Four Fixed Income Corporate managers were selected and commenced management on September 15, 2006, with an objective of exceeding the return of the Lehman Credit Index net of fees.

The four managers hired were AllianceBernstein, Prudential Financial, Western Asset, and Taplin, Canida & Habacht.

The Fixed Income Corporate Manger pools combined rate of return for the fiscal year was 4.7% versus the benchmark's 4.2%.

At the close of fiscal year 2007, the Fixed Income Corporate Manager pools represented 1.2% of total investments. This compares to 0.9% for fiscal year 2006. The following summarizes the System's ownership share and composition of the four Fixed Income Corporate Manager pools at September 30, 2007:

Report on Investment Activity (Continued)

Fixed Income Corporate Manager Pools
(in thousands)

	Alliance Bernstein Corporate	Prudential Financial Corporate	Western Asset Corporate	Taplin, Canida & Habacht Corporate
Total Investment	$30,720	$46,485	$30,617	$30,505
Ownership Percentage	19.6%	19.6%	19.6%	19.6%

Short Term Investment Pool

The objective of the Short Term Investment pool is to closely match the return performance of its benchmark, the 30 day Treasury bill. The Short Term Investment pool return for the fiscal year was 5.5% versus the benchmark's 4.9%.

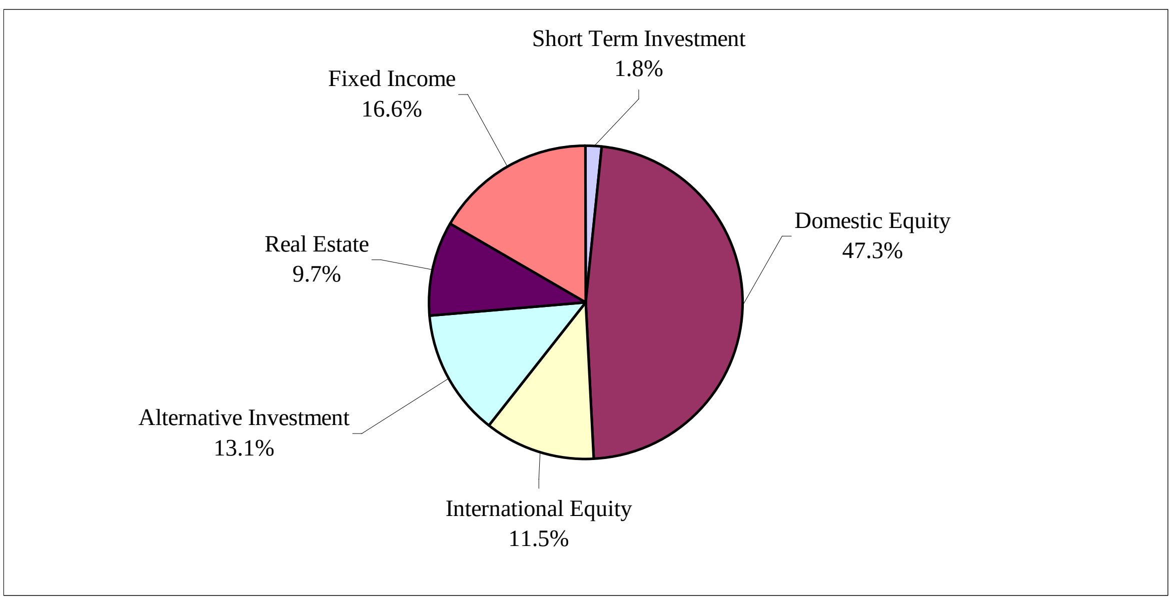
Potential areas of investment are:

- Obligations of the United States or its agencies.
- Bankers' acceptances, commercial accounts, certificates of deposit or depository receipts.
- Repurchase agreements for the purchase of securities issued by the US government or its agencies.
- Commercial paper rated at the time of purchase within the two highest classifications established by not less than two national rating services as determined by the State Treasurer.

As of September 30, 2007, the Short Term Investment pool was 100% invested in commercial paper because of its advantages in yield and flexibility in maturities.

At the close of fiscal year 2007, the Short Term Investment pool represented 1.8% of total investments. This compares to 2.2% for fiscal year 2006. The System's ownership of the Short Term Investment Pool at September 30, 2007 was $210,971,927 composed of fixed income securities and equity in common cash.

Asset Allocation – Security Type Only



Investment Results for the Period Ending September 30, 2007

Investment Category	Current Year	Annualized Rate of Return[1] 3 Years	5 Years	10 Years
Total Portfolio	17.2 %	14.3 %	14.0 %	8.2 %
Total Domestic Equity	16.7	13.1	15.6	6.8
S&P 1500 Index	16.6	13.4	15.8	7.0
Large Cap Value Pool	13.7	14.1		
Large Cap Growth Pool	19.8	11.7		
Mid Cap Pool	22.6			
Small Cap Pool	17.7	14.1		
S&P 500 Index Pool	16.5	13.2		
S&P MidCap Index Pool	18.7	15.8		
International Equity Pool - Passive	20.7	21.8	21.3	8.4
S&P Citigroup BMI - EPAC - 50/50	19.8	22.5	21.6	8.1
International Equity Pool - Active	26.6			
Alternative Investments Pool	30.7	26.2	19.9	13.3
Alternative Blended Benchmark[2]	19.2	16.1	18.6	10.0
T. Rowe Price (Stock Distributions)	4.8			
Real Estate Pool	20.5	17.9	13.5	12.1
NCREIF Property Blended Index[3]	16.0	16.9	13.8	12.2
Total Fixed Income	5.6	4.1	4.2	5.8
Lehman Brothers Government/Credit	5.1	3.7	4.2	6.0
Government Bond Pool	5.9	4.5		
Corporate Bond Pool	5.3	3.7		
Fixed Income Core Pool	5.3			
Fixed Income Managers Pool	4.7			
Short Term Investment Pool	5.5	4.2	3.0	4.1
30 Day Treasury Bill	4.9	3.9	2.8	3.5

[1] Calculations used a time-weighted rate of return based on the market rate of return in accordance with industry standards.

[2] As of 1/1/07, index is blend of S&P 500 plus 300 bps and 10 year yield plus 300 bps based on ending weights. History prior to 1/1/07 is S&P 500 plus 300 bps.

[3] As of 10/1/05, index is NCREIF less 130 bps. History prior to 10/1/05 reflects NCREIF less 75 bps.

Largest Assets Held

Largest Stock Holdings (By Market Value)[1]
September 30, 2007

Rank	Shares	Stocks	Market Value
1	1,498,876	Exxon Mobil Corporation	$ 138,735,930
2	3,244,371	General Electric Corporation	134,316,962
3	780,087	SPDR Trust	119,025,659
4	3,942,876	Microsoft Corporation	116,157,141
5	1,647,045	American International Group	111,422,616
6	2,211,466	Citigroup Incorporated	103,209,105
7	1,524,491	Johnson and Johnson	100,159,056
8	1,290,066	Procter and Gamble Corporation	90,743,262
9	899,998	Chevron Corporation	84,221,807
10	2,494,272	Cisco Systems Inc	82,585,335

Largest Bond Holdings (By Market Value)[1]
September 30, 2007

Rank	Par Amount	Description	Market Value
1	$ 48,359,885	General Electric Cap Corp 5.7275% FRN Due 2-15-2017	$ 47,269,660
2	38,578,200	Treasury Inflation Index Due 7-15-2014	42,041,717
3	38,744,500	Bank Nova Scotia 5.37% FRN Due 10-12-2007	38,747,522
4	39,027,844	Wachovia Corp 5.28125% FRN Due 4-23-2012	38,691,229
5	29,058,375	HSBC Finance Corp 5.46% FRN Due 10-22-2007	29,064,361
6	29,058,375	JP Morgan Chase & Co 5.7375% FRN Due 9-21-2012	28,944,699
7	20,340,863	American Honda Finance 5.25% FRN Due 1-22-2008	20,344,646
8	19,372,250	First Tennessee Bank 5.41% FRN Due 11-7-2008	19,410,336
9	19,372,250	American Honda Finance 5.74313% FRN Due 3-13-2008	19,388,135
10	19,372,250	HBOS PLC 5.70313% FRN Due 3-14-2008	19,380,309

[1] A complete list of holdings is available from the Michigan Department of Treasury.

The System's assets are commingled in various pooled accounts. Amounts, par value and number of shares represents the System's pro-rata share based on its ownership of the investment pools.

Schedule of Investment Fees

The State Treasurer is the investment fiduciary and custodian of the System's funds pursuant to State law. Outside advisors are utilized to augment the State Treasurer's internal staff. Only 30.5% of the total investment portfolio is managed by fully discretionary outside advisors. The Michigan Department of Treasury's cost of operations applicable to the retirement system for the fiscal year end amounted to $2,162 thousand or two and six tenths basis points (.026%) of the market value of the Assets under Management by the State Treasurer.

Act 380 of the Public Acts of 1965 created an Investment Advisory Committee (Committee) comprised of the directors of the Department of Labor and Economic Growth and the Department of Management and Budget, or their duly authorized representatives, and three public members appointed by the Governor with the advice and consent of the Senate. The public members serve without pay, but may be paid actual and necessary travel and other expenses. The Committee meets quarterly to review investments, goals and objectives and may submit recommendations to the State Treasurer. The Committee may also, by a majority vote, direct the State Treasurer to dispose of any holding, which in the Committee's judgment is not suitable for the fund involved, and may by unanimous vote direct the State Treasurer to make specific investments.

Schedule of Investment Fees

Investment Managers' Fees:

	Assets under Management (in thousands)	Fees (in thousands)	Basis Points[1]
State Treasurer	$ 8,366,974	$ 2,162	2.6
Outside Advisors for			
Fixed Income	310,842	377	12.1
Mid Cap Equity	281,364	1,412	50.2
Small Cap Equity	121,776	843	69.2
International Equity	556,111	1,032	18.6
Alternative	1,543,312	12,122	78.5
Real Estate	860,787	942	10.9
Total	$ 12,041,166	$ 18,890	

Other Investment Services Fees:

Assets in Custody	$ 11,830,194	$ 492
Securities on Loan	2,498,701	889

1 Outside Advisors Fees are netted against the income for Fixed Income, Small Cap Equity, Mid Cap Equity, and International Equity. For Alternative partnership agreements that define the management fees, the asset management fees range from 100 on remaining assets under management to 250 basis points of the committed capital. For Real Estate, the asset management fees range from 50 to 175 basis points. Alternative and Real Estate fees, in most cases, are netted against income.

Schedule of Investment Commissions

	Fiscal Year Ended September 30, 2007						
	Actual Commissions Paid [1]	Actual Number of Shares Traded [1]	Average Commission Per Share	Estimated Trade Costs Per Share	Estimated Research Costs Per Share	Estimated Trade Costs	Estimated Research Costs
Investment Brokerage Firms:							
Banc of America Securities LLC	$ 5,995	199,841	$ 0.03	$ 0.01	$ 0.02	$ 1,998	$ 3,997
Bear Stearns & Co Inc.	145,014	7,059,401	0.02	0.01	0.01	70,594	74,420
Broadcort Capital	24,549	818,295	0.03	0.01	0.02	8,183	16,366
Cantor Fitzgerald & Co.	47,887	1,918,533	0.02	0.01	0.01	19,185	28,702
Citigroup Global Markets Inc.	135,578	4,461,551	0.03	0.01	0.02	44,616	90,963
Cowen & Co., LLC	59,159	1,971,951	0.03	0.01	0.02	19,720	39,439
Credit Suisse Securities LLC	127,531	4,398,811	0.03	0.01	0.02	43,988	83,543
Deutsche Bank Securities Inc.	52,009	1,725,683	0.03	0.01	0.02	17,257	34,752
Goldman Sachs & Co.	101,955	3,398,046	0.03	0.01	0.02	33,980	67,975
The Griswold Co., Inc.	37,675	1,883,768	0.02	0.01	0.01	18,838	18,838
Investment Technology Group Inc.	40	3,314	0.01	0.01	-	33	7
ISI Capital LLC	28,586	924,736	0.03	0.01	0.02	9,247	19,339
J P Morgan Securities Inc.	59,187	1,962,065	0.03	0.01	0.02	19,621	39,566
Labranche Financial Services Inc. (MARA)	7,160	352,936	0.02	0.01	0.01	3,529	3,631
Lehman Brothers Inc.	80,266	2,674,297	0.03	0.01	0.02	26,743	53,523
Liquidnet Inc.	35	1,740	0.02	0.01	0.01	17	17
Merrill Lynch, Pierce, Fenner & Smith, Inc.	189,209	6,220,309	0.03	0.01	0.02	62,203	127,006
Mischler Financial Group, Inc.	6,123	204,111	0.03	0.01	0.02	2,041	4,082
Morgan Stanley Co Inc.	100,562	3,352,064	0.03	0.01	0.02	33,521	67,041
OTA LLC	10,374	345,798	0.03	0.01	0.02	3,458	6,916
Prudential Equity Group LLC	40,067	1,335,570	0.03	0.01	0.02	13,356	26,711
Punk, Ziegel & Co.	22,491	749,685	0.03	0.01	0.02	7,497	14,994
Sandford C. Bernstein & Co. LLC	87,882	2,929,380	0.03	0.01	0.02	29,294	58,588
Stanford Group Co.	15,463	492,961	0.03	0.01	0.02	4,930	10,533
State Street Brokerage Services	369,925	32,431,056	0.01	0.01	-	324,311	45,615
Thinkequity Partners LLC	646	17,348	0.04	0.01	0.03	173	473
Thomas Weisel Partners	7,366	193,903	0.04	0.01	0.03	1,939	5,427
UBS Securities LLC	84,502	2,816,738	0.03	0.01	0.02	28,167	56,335
Wachovia Capital Markets, LLC	50	1,657	0.03	0.01	0.02	17	33
Wayne Company	3,569	109,065	0.03	0.01	0.02	1,091	2,479
Weeden & Co.	16,234	1,623,383	0.01	0.01	-	16,234	-
Total	$ 1,867,089	86,577,996	$ 0.03 [2]	$ 0.01	$ 0.02	$ 865,781	$ 1,001,311

[1] Commissions are included in purchase and sale prices of investments. The commissions and shares represent the System's pro-rata share of commission and share transactions based on ownership in the investment pools.

[2] The average commission rate per share for all brokerage firms.

Investment Summary

Fiscal Year Ended September 30, 2007

	Market Value (a)	Percent of Total Market Value	Investment & Interest Income (b)	Percent of Investment & Interest Income
Fixed Income Pools	$ 1,992,940,948	16.6%	$ 102,917,375	5.7%
Domestic Equity Pools	5,701,330,139	47.3%	834,484,298	45.9%
Real Estate Pool	1,166,352,035	9.7%	193,332,964	10.6%
Alternative Investment Pools	1,582,953,210	13.1%	395,053,763	21.8%
International Equities Pools	1,386,617,895	11.5%	274,987,420	15.2%
Short Term Investment Pools	210,971,927	1.8%	14,080,793	0.8%
Total	$ 12,041,166,154	100.0%	$ 1,814,856,613	100.0%

(a) Market value excludes $2,563,248,391 in cash collateral for security lending for fiscal year 2007.

(b) Total Investment & Interest Income excludes net security lending income of $4,706,258.

Investment Summary

Fiscal Year Ended September 30, 2006

	Market Value (a)	Percent of Total Market Value	Investment & Interest Income (b)	Percent of Investment & Interest Income
Fixed Income Pools	$ 1,763,011,727	16.3%	$ 67,743,736	5.4%
Domestic Equity Pools	5,250,576,635	48.5%	514,539,082	40.6%
Real Estate Pool	946,375,282	8.7%	160,708,496	12.7%
Alternative Investment Pools	1,303,531,489	12.0%	293,537,817	23.2%
International Equities Pools	1,328,694,117	12.3%	217,158,043	17.1%
Short Term Investment Pools	243,727,612	2.2%	12,641,047	1.0%
Total	$ 10,835,916,862	100.0%	$ 1,266,328,221	100.0%

(a) Market value excludes $1,699,064,634 in cash collateral for security lending for fiscal year 2006.

(b) Total Investment & Interest Income excludes net security lending income of $1,492,117.

ACTUARIAL SECTION

Actuary's Certification

GRS
Gabriel Roeder Smith & Company
Consultants & Actuaries
One Towne Square
Suite 800
Southfield, MI 48076-3723
248.799.9000 phone
248.799.9020 fax
www.gabrielroeder.com

September 13, 2007

Ms. Lisa Webb Sharpe, Director
Department of Management and Budget
and
The Retirement Board
Michigan State Employees Retirement System
P.O. Box 30171
Lansing, Michigan 48909

Ladies and Gentlemen:

The basic financial objective of the Michigan State Employees Retirement System (SERS) is to establish and receive contributions which when combined with present assets and future investment return will be sufficient to meet the financial obligations of the system to present and future benefit recipients.

The financial objective is addressed within the actuarial valuation. The valuation process develops employer contributions that are sufficient to fund the plan's normal cost (i.e., the costs assigned by the valuation method to the year of service about to be rendered), as well as to fund any unfunded accrued liabilities over a reasonable period. The most recent valuation was completed based upon population data, asset data, and plan provisions as of September 30, 2006.

The Retirement System provides the actuary with data for the actuarial valuation. The actuary relies on the data after reviewing it for internal and year to year consistency. The actuary summarizes and tabulates population data in order to analyze long term trends. The plan's external auditor also audits the actuarial data annually.

Annual actuarial valuations are based upon assumptions regarding future activity in specific risk areas including the rate of investment return and payroll growth, eligibility for the various classes of benefits and longevity among retired lives. These assumptions are adopted by the Board and the Department after considering the advice of the actuary and other professionals. The assumptions and the methods comply with the requirements of GASB Statement No. 25. Each actuarial valuation takes into account all prior differences between actual and assumed experience in each risk area and adjusts the contribution rates as needed.

Ms. Lisa Webb Sharpe
September 13, 2007
Page 2

Our firm provided the following supporting schedules for use in the Comprehensive Annual Financial Report:

Financial Section

- Note 1 Table of System's Membership
- Schedule of Funding Progress
- Schedule of Employer Contributions (Annual Required Contribution)
- Note B - Summary of Actuarial Assumptions

Actuarial Section

- Summary of Actuarial Assumptions and Methods
- Percent of Eligible Active Members Retiring Within Next Year
- Separation from Active Employment Before Age and Service Retirement and Individual Pay Increase Assumptions
- Schedule of Active Member Valuation Data
- Schedule of Changes in the Retirement Rolls
- Prioritized Solvency Test
- Analysis of System Experience

Statistical Section

- Schedule of Retired Members by Type of Pension Benefit (Retirement Type)
- Schedule of Retired Members by Type of Pension Benefit (Option Selected)
- Schedule of Average Benefit Payments - Pension

The actuarial valuation of SERS as of September 30, 2006 was performed by qualified actuaries in accordance with standards of practice prescribed by the Actuarial Standards Board and in compliance with applicable state statutes. It is our opinion that the calculated employer contribution meets the financial objective of the Retirement System.

Respectfully submitted,

Louise Gates

Louise Gates, ASA, MAAA

Alan E. Sonnanstine

Alan Sonnanstine, ASA, MAAA

LG/AES:lr

Gabriel Roeder Smith & Company

Summary of Actuarial Assumptions and Methods

1. The investment return rate used in making the valuations was 8% per year, compounded annually. This rate of return is not the assumed real rate of return. The real rate of return is the rate of investment return in excess of the inflation rate. Considering other financial assumptions, this investment return rate translates to an assumed long-term real rate of return of 4.5%. Adopted 2004.

2. The healthy life mortality table used in evaluating allowances to be paid was the 1994 Group Annuity Mortality Table, set forward one year for both men and women. Adopted 1998.

3. Sample probabilities of regular, unreduced retirement are shown in Schedule 1 on the next page. Adopted 2004.

4. Sample probabilities of withdrawal from service and disability, together with individual pay increase assumptions, are shown in Schedule 2 on the next page of this report. Adopted 2004.

5. The active member population is closed to new hires. This will result in a gradual reduction in the total active member payroll over time.

6. An individual entry age actuarial cost method of valuation was used in determining age and service allowance actuarial liabilities and normal cost. Adopted 1975. Unfunded actuarial accrued liabilities are financed over a declining 40-year period beginning October 1, 1996. Adopted or Re-Adopted 1996.

7. The Department of Management and Budget approved the use of market value of assets as of September 30, 2006, for valuation purposes. For investment gains and losses that occur after that date, a 5-year smoothing technique will be used. Specifically, the excess (shortfall) of actual investment income (including interest, dividends, realized and unrealized gains or losses) over the imputed income at the valuation interest rate is considered the gain (loss), which is spread over five years. Adopted 2007.

8. The data including people now covered and about present assets was furnished by the System's administrative staff. Although examined for general reasonableness, the data was not audited by the actuary.

9. The actuarial valuation computations were made by or under the supervision of a Member of the American Academy of Actuaries (MAAA). The assumptions used in the actuarial valuations were adopted by the System's Board after consulting with the actuary.

10. A 5-year experience investigation, covering the period from September 30, 1997, through September 30, 2002, was completed in April 2004. The purpose of the study was to analyze the actual experience of the System versus that anticipated by actuarial assumptions then in use. The combined effect of the recommended changes in assumptions was a decrease in actuarial accrued liabilities of approximately 1.3% and a 5.7% decrease in computed employer contributions. Adopted 2004.

11. Gabriel Roeder Smith & Co. was awarded the actuarial and consulting services contract beginning October 4, 2006.

12. Election of two person retiree health coverage is assumed to be between 75-100%for males and 60-100% for females depending on participant type.

13. A retiring member will have coverage for a surviving beneficiary or spouse (active and inactive members) is assumed to be 80% of male and 67% of female retirees.

14. Ten percent of pension recipients eligible for retiree health benefits will opt-out of the retiree health care plan.

Summary of Actuarial Assumptions and Methods (Continued)

SCHEDULE 1

Percent of Eligible Active Members Retiring Each Year

Retirement Ages	Correction Officers	Conservation Officers	Other Members
45		16 %	
48		16	
51	25 %	16	
55	15	16	18 %
58	12	15	12
61	15	15	14
64	22	22	20
67	25	25	25
70	50	50	50
75	100	100	100

SCHEDULE 2

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

			Percent of Active Members Becoming Disabled w/in Next Year		
Sample Ages	Years of Service	Percent of Active Members Withdrawing Within Next Year (Men and Women)	Non-Duty Disabilities	Duty Disabilities	Percent Increase In Pay During Next Year
All	0	12.00 %			
	1	8.50			
	2	6.50			
	3	5.00			
	4	4.00			
25	5 & Over	3.50	0.03 %	0.05 %	10.74 %
35		2.50	0.10	0.05	4.95
45		2.00	0.34	0.05	4.12
55		1.75	0.62	0.05	3.91
60		1.75	0.82	0.05	3.50

Actuarial Valuation Data

Schedule of Active Member Valuation Data

Valuation Date Sept. 30	Number	Reported Annual Payroll*	Average Annual Pay	% Increase	Average Age	Average Service
1997	55,434	$ 2,273,203	$ 41,007	4.0%	43.7	13.1
1998	49,717	2,107,996	42,400	3.4	44.8	14.8
1999	49,612	2,213,851	44,623	5.2	45.9	15.8
2000	47,778	2,253,818	47,173	5.7	46.7	16.7
2001	45,852	2,230,562	48,647	3.1	47.4	17.7
2002	43,064	2,133,477	49,542	1.8	48.0	18.6
2003	36,536	1,859,555	50,897	2.7	47.7	17.9
2004	34,749	1,889,410	54,373	6.8	48.4	19.0
2005	33,770	1,880,179	55,676	2.4	49.3	20.0
2006	32,575	1,847,653	56,720	1.9	50.1	21.0

*In thousands of dollars.

Schedule of Changes in the Retirement Rolls

Year Ended Sept. 30	Added to Rolls		Removed from Rolls		Rolls–End of Year		% Increase in Annual Allowances	Average Annual Allowances
	No.	Annual Allowances*	No.	Annual Allowances*	No.	Annual Allowances*		
1997	6,098	$ 121,005	1,068	$ 7,878	36,123	$ 421,060	36.7 %	$ 11,656
1998	1,279	21,085	1,217	9,689	36,185	432,456	2.7	11,951
1999	1,409	21,227	1,248	9,516	36,346	444,167	2.7	12,221
2000	1,540	22,421	1,181	2,619	36,705	463,969	4.5	12,640
2001	1,648	22,501	1,242	15,063	37,111	471,407	1.6	12,703
2002	3,806	80,871	1,251	5,310	39,666	546,968	16.0	13,789
2003 **	6,448	163,673	623	2,034	45,491	708,607	29.6	15,577
2004	1,561	23,195	1,433	2,715	45,619	729,087	2.9	15,982
2005	1,542	25,024	1,360	6,683	45,801	747,428	2.5	16,319
2006	1,728	41,794	1,549	20,126	45,980	769,096	2.9	16,727

*In thousands of dollars
**Revised actuarial data

Prioritized Solvency Test

The System's funding objective is to meet long term benefit promises through contributions that remain approximately level from year to year as a percent of member payroll. If the contributions to the System are level in concept and soundly executed, the System will pay all promised benefits when due, the ultimate test of financial soundness. Testing for level contribution rates is the long-term solvency test.

A prioritized solvency test is another means of checking a system's progress under its funding program. In a short condition test, the plan's present assets (cash and investments) are compared with: (1) active member contributions on deposit; (2) the liabilities for future benefits to present retired lives; and (3) the liabilities for service already rendered by active and inactive members. In a system following the discipline of level percent of payroll financing, the liabilities for active member contributions on deposit (liability 1) and the liabilities for future benefits to present retired lives (liability 2) will be fully covered by present assets (except in rare circumstances). In addition, the liabilities for service already rendered by active members (liability 3) are normally partially covered by the remainder of present assets. Generally, if the System has been using level-cost financing, the funded portion of liability 3 will increase over time. Liability 3 being fully funded is not necessarily a by-product of level percent of payroll funding methods.

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

($ in millions)

	Actuarial Accrued Liability (AAL)							
	(1)	(2)	(3)					
Valuation Date Sept. 30	Active Member Contributions	Retirants and Beneficiaries	Active and Inactive Members (Employer Financed Portion)	Valuation Assets	Portion of AAL Covered by Assets (1)	(2)	(3)	(4) [3]
1997 [1,2]	$ 3	$ 4,300	$ 3,798	$ 8,834	100 %	100 %	119.3 %	109.0 %
1998	27	4,360	3,987	9,109	100	100	118.4	108.8
1998 [2]	27	4,484	3,986	9,109	100	100	115.4	107.2
1999	35	4,538	4,456	9,648	100	100	113.9	106.9
2000	29	4,659	4,786	10,337	100	100	118.0	109.1
2001	34	4,677	5,167	10,633	100	100	114.6	107.6
2002	123	5,512	5,118	10,616	100	100	97.3	98.7
2003	57	7,386	4,318	10,441	100	100	69.4	88.8
2004 [2]	78	7,503	4,423	10,149	100	100	58.1	84.5
2005	97	7,607	4,696	9,897	100	100	46.7	79.8
2006	107	7,607	5,085	10,111	100	100	47.1	79.0
2006 [1]	107	7,607	5,085	10,890	100	100	62.5	85.1

[1] Revised asset valuation method.

[2] Revised actuarial assumptions.

[3] Percents funded on a total valuation asset and total actuarial accrued liability basis.

Analysis of System Experience

Gains/(Losses) in Accrued Liabilities During Year Ended September 30, 2006
Resulting from Differences Between Assumed Experience & Actual Experience

	Type of Activity	Gain/(Loss)
1.	**Retirements (including Disability Retirement).** If members retire at older ages or with lower final average pay than assumed, there is a gain. If younger ages or higher average pays, a loss.	$ 8,717,240
2.	**Withdrawal From Employment** (including death-in-service). If more liabilities are released by withdrawals and deaths than assumed, there is a gain. If smaller releases, a loss.	(2,236,860)
3.	**Pay Increases.** If there are smaller pay increases than assumed, there is a gain. If greater increases, a loss.	80,535,169
4.	**Investment Income.** If there is greater investment income than assumed, there is a gain. If less income, a loss.	(73,433,506)
5.	**Death After Retirement.** If retirants live longer than assumed, there is a loss. If not as long, a gain.	2,570,366
6.	**New entrants.**	(20,886,697)
7.	**Other.** Miscellaneous gains and losses resulting from data adjustments, timing of financial transactions, etc.	31,685,553
8.	**Composite Gain (or Loss) During Year**	$ 26,951,265

Summary of Plan Provisions

Our actuarial valuation of the System as of September 30, 2006, is based on the present provisions of the Michigan State Employees' Retirement Act, which are summarized in this section.

Regular Retirement (no reduction factor for age)

Eligibility — Age 55 with 30 years service, or age 60 with 10 or more years of service. Corrections Officers may retire at age 51 with 25 or more years of service, or age 56 with 10 or more years of service. Conservation Officers may retire after 25 years of service regardless of age.

Annual Amount — Total service times 1.5% of FAC. For members with 20 or more years of service, a $3,000 minimum annual benefit is payable. Corrections Officers receive an additional temporary supplement to age 62 equal to the product of supplemental service times 0.5% of FAC. Conservation Officers retiring after 25 years receive a benefit equal to 60% of FAC.

Final Average Compensation — Regular retirement benefit is based on final average compensation (FAC), which is the average of highest 3 consecutive years (2 years for Conservation Officers).

Early Retirement (age reduction factor used)

Eligibility — Age 55 with 15 or more years of service.

Annual Amount — Computed as regular retirement benefit but reduced by 0.5% for each month under age 60.

Deferred Retirement (vested benefit)

Eligibility — 10 years of service (5 years for unclassified persons in the executive or legislative branch). Benefit commences at age 60.

Annual Amount — Computed as regular retirement benefit based on service and FAC at termination.

Duty Disability Retirement

Eligibility — No age or service requirement.

Annual Amount — Disability after age 60: Computed as regular retirement benefit with minimum benefit based on 10 years service. Disability prior to age 60: To age 60, benefit is two-thirds of FAC but limited to $6,000 per year. Additional limitation, such that benefit plus workers' compensation does not exceed final compensation. After age 60, benefit is recomputed as a regular retirement benefit with service granted for period in receipt of disability benefit before age 60 (benefit not reduced after age 60).

Non-Duty Disability Retirement

Eligibility — 10 years of service.

Annual Amount — Computed as regular retirement benefit based on service and FAC at time of disability. Minimum annual benefit is $600.

Summary of Plan Provisions (Continued)

Duty Death Before Retirement

Eligibility — No age or service requirement. Also applies to duty disability retirants who die within 3 years of disability and before age 60.

Annual Amount — Accumulated employee contributions are refunded. Surviving spouse receives annual benefit of one-third of final compensation until death. Unmarried children under age 18 each receive an equal share of one-fourth of final compensation (if no spouse each child receives one-fourth, to a maximum of one-half for all children). If no spouse or eligible children, each dependent parent receives one-sixth of final compensation. Total benefits payable are limited to $2,400 per year. Additional limitation such that benefits plus workers' compensation does not exceed final compensation.

Non-Duty Death Before Retirement

Eligibility — 10 years of service. In the case of a deceased vested former member, the survivor benefit commences when the deceased former member would have attained age 60.

Annual Amount — Computed as regular retirement benefit but reduced in accordance with a 100% joint and survivor election.

Post-Retirement Cost-of-Living Adjustments

One-time upward adjustments have been made in 1972, 1974, 1976, 1977 and 1987. Beginning in 1983, some benefit recipients share in a distribution of a portion of investment income earned in excess of 8% annually (supplemental payment). Beginning in 1988, all benefit recipients are eligible for automatic 3% annual (non-compounded) benefit increases, with a maximum $300 annual increase. Eligibility for the above benefits:

Retired before October 1, 1987	Greater of supplemental payment or the combination of the 1987 one-time adjustment and the automatic increases.
Retired on or after October 1, 1987	Automatic increases only.

Post-Retirement Health Insurance Coverage

Persons in receipt of retirement allowance (including members who did not retire directly from the System, but come from a vested deferred status), and their dependents, are eligible for 95% System paid health insurance coverage and 90% System paid dental and vision insurance.

Member Contributions

None.

Defined Contribution

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

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

Summary of Plan Provisions (Continued)

2002 Early Out Window

Members who retired between April 1, 2002, and November 1, 2002, and whose combined age and service equaled 80 points, or who were age 60 or older with 10 or more years of service were eligible to receive a benefit equal to 1.75% of their final average compensation multiplied by years of credited service. Members, who had previously transferred to the Defined Contribution plan, were eligible to receive a benefit equal to 0.25% of their final average compensation multiplied by years of credited service.

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STATISTICAL SECTION

STATISTICAL SECTION

This part of the System's comprehensive annual financial report presents detailed information as a context for understanding what the information in the financial statements, note disclosures, and required supplementary information says about the System's overall financial health.

Contents

Financial Trends

These schedules contain trend information to help the reader understand how the System's financial performance and fiscal health has changed over time. The schedules are presented for the last ten fiscal years. Schedules included are:

- Schedule of Pension Plan Revenues by Source
- Schedule of Health Plan Revenues by Source
- Schedule of Pension Plan Expenses by Type
- Schedule of Health Plan Expenses by Type
- Schedule of Changes in Net Assets – Pension Plan
- Schedule of Changes in Net Assets – Health Plan
- Schedule of Pension Benefits and Refunds by Type
- Schedule of Health Benefits and Refunds by Type

Operating Information

These schedules contain contextual information to assist the reader's understanding of how the System's financial information relates to the combination of participating members and the benefits it provides. Schedules are presented for the last ten fiscal years, except where noted. Schedules included are:

- Schedule of Retired Members by Type of Pension Benefit
- Schedule of Retired Members by Type of Health Benefit
- Schedule of Average Benefit Payments – Pension
- Schedule of Average Benefit Payments – Health
- Schedule of Average Benefit Payments – Dental
- Schedule of Average Benefit Payments – Vision
- Ten Year History of Membership

Schedule of Pension Plan Revenues by Source

Last Ten Years

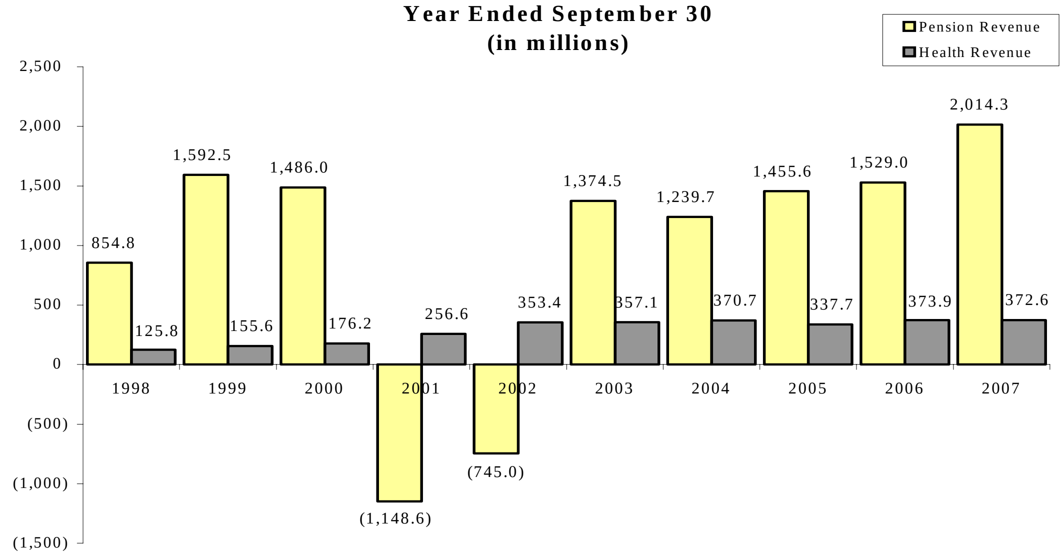
Fiscal Year Ended Sept. 30	Member Contributions	Employer Contributions Dollars	Employer Contributions % of Annual Covered Payroll	Net Investment & Other Income	Total
1998	$ 5,158,744	$ 147,599,551	7.0 %	$ 702,058,316	$ 854,816,611
1999	6,186,018	121,119,857	5.5	1,465,196,232	1,592,502,107
2000	4,606,662	121,817,366	5.4	1,359,608,718	1,486,032,746
2001	3,341,381	112,299,808	5.0	(1,264,290,456)	(1,148,649,267)
2002	173,232,835	87,486,128	4.1	(1,005,732,436)	(745,013,473)
2003	80,185,475	79,291,845	4.3	1,215,018,189	1,374,495,509
2004	37,682,883	103,873,294	5.5	1,098,149,414	1,239,705,591
2005	30,395,040	256,433,052	13.6	1,168,811,938	1,455,640,030
2006	9,434,310	270,705,017	14.7	1,248,845,519	1,528,984,846
2007	19,696,132	150,858,506	N/A	1,843,763,625	2,014,318,263

Schedule of Health Plan Revenues by Source

Last Ten Years

Fiscal Year Ended Sept. 30	Member Contributions	Employer Contributions Dollars	Employer Contributions % of Annual Covered Payroll	Net Investment & Other Income	Total
1998	$ 4,619,101	$ 112,199,628	5.3 %	$ 8,998,673	$ 125,817,402
1999	4,861,628	144,515,766	6.5	6,219,220	155,596,614
2000	5,056,971	166,833,573	7.4	4,339,752	176,230,296
2001	5,793,284	249,214,002	11.2	1,586,567	256,593,853
2002	6,326,267	257,730,817	12.1	89,328,292	353,385,376
2003	11,144,737	320,838,540	17.2	25,157,754	357,141,031
2004	9,723,230	357,554,699	18.9	3,380,735	370,658,664
2005	10,701,614	324,305,023	17.3	2,712,374	337,719,011
2006	11,528,041	356,674,243	19.3	5,660,782	373,863,066
2007	11,760,544	359,375,055	N/A	1,500,072	372,635,671

Total Revenue
Year Ended September 30
(in millions)



Schedule of Pension Plan Expenses by Type

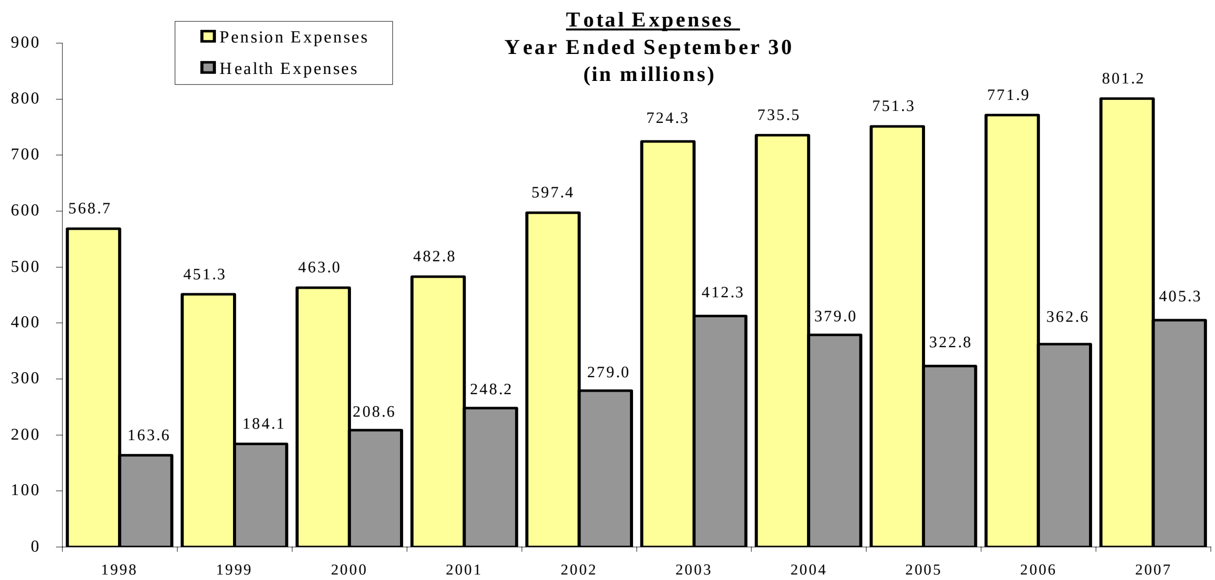
Last Ten Years

Fiscal Year Ended Sept. 30	Benefit Payments	Refunds and Transfers	Administrative and Other Expenses	Total
1998	$ 429,879,875	$ 134,533,763	$ 4,297,092	$ 568,710,730
1999	446,219,254	728,366	4,330,623	451,278,243
2000	458,803,774	222,163	3,954,992	462,980,929
2001	478,525,328	91,699	4,149,284	482,766,311
2002	503,453,879	87,504,459	6,432,819	597,391,157
2003	701,664,432	17,484,652	5,192,039	724,341,123
2004	731,009,109	183,126	4,316,433	735,508,668
2005	746,673,263	306,643	4,297,985	751,277,891
2006	767,000,706	256,533	4,628,043	771,885,282
2007	795,842,013	229,600	5,115,226	801,186,839

Schedule of Health Plan Expenses by Type

Last Ten Years

Fiscal Year Ended Sept. 30	Benefit Payments	Refunds and Transfers	Total
1998	$ 163,574,055		$ 163,574,055
1999	184,127,475		184,127,475
2000	208,627,602	$ 8	208,627,610
2001	248,246,380		248,246,380
2002	278,998,333		278,998,333
2003	354,084,838	58,211,100	412,295,938
2004	354,649,665	24,363,516	379,013,181
2005	322,834,138		322,834,138
2006	362,597,685		362,597,685
2007	363,975,051	41,304,031	405,279,082



Schedule of Changes in Net Assets-Pension Plan

Last Ten Years
(in thousands)

	Fiscal Year									
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Member contributions	$ 5,159	$ 6,186	$ 4,607	$ 3,341	$ 173,233	$ 80,185	$ 37,683	$ 30,395	$ 9,435	$ 19,696
Employer contributions	147,600	121,120	121,817	112,300	87,486	79,292	103,873	256,433	270,705	150,858
DC savings subaccount	-	-	-	-	-	-	-	-	-	-
Net investment income	702,058	1,465,196	1,359,606	(1,264,292)	(1,005,733)	1,215,018	1,073,758	1,168,690	1,248,616	1,801,588
Transfer from other systems	-	-	-	-	-	-	26	120	123	106
Transfer from pension/ OPEB plan	-	-	-	-	-	-	24,364	-	-	41,304
Miscellaneous income	-	-	3	2	-	-	2	2	106	766
Total Additions	854,817	1,592,502	1,486,033	(1,148,649)	(745,014)	1,374,495	1,239,706	1,455,640	1,528,985	2,014,318
Pension benefits	429,880	446,219	458,804	478,525	503,454	701,664	731,009	746,673	767,000	795,842
Health care benefits	-	-	-	-	-	-	-	-	-	-
Refunds of member contributions	19	21	43	15	5	118	163	292	254	222
Transfer to pension/ OPEB plan	-	-	-	-	87,486	17,365	-	-	-	-
Tranfer to other systems	134,515	707	179	77	13	2	20	15	3	8
Administrative expenses	4,297	4,331	3,955	4,149	6,433	5,192	4,317	4,298	4,628	5,115
Total Deductions	568,711	451,278	462,981	482,766	597,391	724,341	735,509	751,278	771,885	801,187
Changes in net assets	$ 286,106	$ 1,141,224	$ 1,023,052	$ (1,631,415)	$ (1,342,405)	$ 650,154	$ 504,197	$ 704,362	$ 757,100	$ 1,213,131

Schedule of Changes in Net Assets - Health Plan

Last Ten Years
(in thousands)

	Fiscal Year									
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Member contributions	$ 4,619	$ 4,862	$ 5,057	$ 5,793	$ 6,326	$ 11,145	$ 9,723	$ 10,702	$ 11,528	$ 11,761
Employer contributions	112,200	144,516	166,833	249,214	257,731	320,838	357,555	324,305	356,674	359,375
DC savings subaccount	-	170	574	412	-	-	-	-	-	-
Net investment income	8,999	6,049	3,766	1,175	1,842	7,793	3,381	2,712	5,661	1,500
Transfer from other systems	-	-	-	-	-	-	-	-	-	-
Transfer from pension/						-				
OPEB plan	-	-	-	-	87,486	17,365	-	-	-	-
Miscellaneous income	-	-	-	-	-	-	-	-	-	-
Total Additions	125,818	155,597	176,230	256,594	353,385	357,141	370,659	337,719	373,863	372,636
Pension benefits	-	-	-	-	-	-	-	-	-	-
Health care benefits	163,475	184,128	208,628	248,246	278,998	354,085	354,650	322,834	362,598	363,975
Refunds of member contributions	-	-	-	-	-	-	-	-	-	-
Transfer to pension/ OPEB plan	-	-	-	-	-	-	24,364	-	-	41,304
Tranfer to other systems	-	-	-	-	-	58,211	-	-	-	-
Administrative expenses	-	-	-	-	-	-	-	-	-	-
Total Deductions	163,475	184,128	208,628	248,246	278,998	412,296	379,014	322,834	362,598	405,279
Changes in net assets	$ (37,657)	$ (28,531)	$ (32,398)	$ 8,348	$ 74,387	$ (55,155)	$ (8,355)	$ 14,885	$ 11,265	$ (32,643)

STATISTICAL SECTION

Schedule of Pension Benefits and Refunds by Type

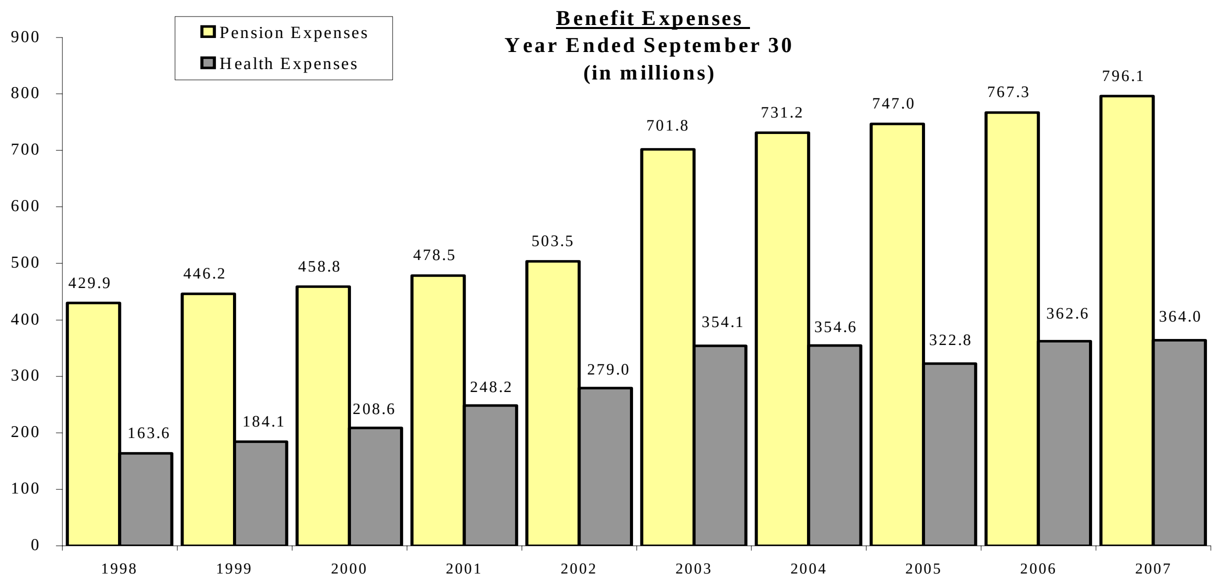
Last Ten Years

Fiscal Year Ended Sept. 30	Regular Benefits	Disability Benefits	Survivor Benefits	Supplemental Check	Refunds	Total
1998	$ 401,855,102	$ 28,024,773			$ 18,555	$ 429,898,430
1999	417,313,133	28,227,807		$ 678,314	21,110	446,240,364
2000	427,500,808	30,867,062		435,896	43,486	458,847,252
2001	444,244,814	33,902,047		378,467	14,900	478,540,228
2002	467,909,032	35,544,847			4,870	503,458,749
2003	664,188,203	37,476,229			117,595	701,782,027
2004	690,942,422	40,066,687			163,418	731,172,527
2005	704,890,377	41,782,886			291,592	746,964,855
2006	676,029,503	37,961,735	$ 53,009,468		253,886	767,254,592
2007	688,989,246	38,666,660	68,186,107		222,039	796,064,052

Schedule of Health Benefits and Refunds by Type

Last Ten Years

Fiscal Year Ended Sept. 30	Health Benefits	Dental Benefits	Vision Benefits	Refunds	Total
1998	$ 148,458,180	$ 15,115,875	N/A		$ 163,574,055
1999	169,003,923	12,501,788	$ 2,621,764		184,127,475
2000	193,427,912	12,548,519	2,651,171	$ 8	208,627,610
2001	229,870,026	15,737,224	2,639,130		248,246,380
2002	257,587,230	18,453,322	2,957,781		278,998,333
2003	327,707,446	22,732,630	3,644,762		354,084,838
2004	327,143,997	23,831,344	3,674,324		354,649,665
2005	295,431,830	23,740,953	3,661,355		322,834,138
2006	328,528,595	29,583,938	4,485,152		362,597,685
2007	329,714,449	29,750,672	4,509,930		363,975,051



Schedule of Retired Members by Type of Pension Benefit

September 30, 2006

Amount of Monthly Pension Benefit	Number of Retirees	Type of Retirement * 1	2	3	4	5	6	7	8
$ 1 - 200	636	288	238	11	74	-	10	-	15
201 - 400	3,065	1,754	654	7	398	-	78	1	173
401 - 600	5,328	2,909	678	373	801	17	213	6	331
601 - 800	5,033	2,961	602	6	839	-	263	16	346
801 - 1,000	4,183	2,593	400	5	686	-	214	46	239
1,001 - 1,200	3,993	2,637	311	6	566	-	206	89	178
1,201 - 1,400	3,929	2,950	293	2	353	-	155	72	104
1,401 - 1,600	3,493	2,859	210	1	159	-	105	95	64
1,601 - 1,800	3,132	2,669	146	-	107	-	59	119	32
1,801 - 2,000	2,787	2,444	93	-	46	-	38	146	20
Over 2,000	10,401	9,255	179	2	28	-	77	831	29
Totals	45,980	33,319	3,804	413	4,057	17	1,418	1,421	1,531

* Type of Retirement

1 - Normal retirement for age & service
2 - Survivor payment - normal or early retirement
3 - Duty disability retirement (incl. survivors)
4 - Non-duty disability retirement (incl. survivors)
5 - Survivor payment - duty death in service
6 - Survivor payment - non-duty death in service
7 - Retirees with supplemental benefits for early retirement incentive factors
8 - Retirees with reduced benefits for early retirement reduction factors

Source: Gabriel Roeder Smith & Company

Schedule of Retired Members by Type of Pension Benefit (Continued)

September 30, 2006

Amount of Monthly Pension Benefit	Number of Retirees	Selected Option **							
		Reg.	Opt. A	Opt B	Opt. C	Opt. E	Opts E1	Opt. E2	Opt. E3
$ 1 - 200	636	149	191	208	4	57	14	13	-
201 - 400	3,065	1,152	800	667	37	271	62	75	1
401 - 600	5,328	2,330	1,380	820	65	457	110	161	5
601 - 800	5,033	2,096	1,367	843	71	443	69	142	2
801 - 1,000	4,183	1,801	1,158	764	60	258	67	73	2
1,001 - 1,200	3,993	1,809	1,156	699	68	155	44	60	2
1,201 - 1,400	3,929	1,787	1,186	688	69	107	41	47	4
1,401 - 1,600	3,493	1,409	1,095	705	102	102	37	39	4
1,601 - 1,800	3,132	1,210	957	607	141	96	59	50	12
1,801 - 2,000	2,787	986	800	534	129	169	65	83	21
Over 2,000	10,401	3,414	2,713	1,922	643	879	282	432	116
Totals	45,980	18,143	12,803	8,457	1,389	2,994	850	1,175	169

**Selected Option

Reg. - Straight life allowance
Opt. A - 100% survivor option
Opt. B - 50% survivor option
Opt. C - 75% survivor option
Opt. E - Social Security equated
Opt. E1 - Social Security equated w/100% survivor option
Opt. E2 - Social Security equated w/50% survivor option
Opt. E3 - Social Security equated w/75% survivor option

Source: Gabriel Roeder Smith & Company

Schedule of Retired Members by Type of Health Benefit

September 30, 2006

Amount of Monthly Pension Benefit	Eligible Retirees	Type of Other Postemployment Benefits: Health	Dental	Vision
$ 1 – 200	636	438	418	424
201 – 400	3,065	2,393	2,305	2,339
401 – 600	5,328	4,543	4,508	4,525
601 – 800	5,033	4,456	4,411	4,430
801 – 1,000	4,183	3,788	3,775	3,798
1,001 – 1,200	3,993	3,674	3,648	3,662
1,201 – 1,400	3,929	3,659	3,652	3,658
1,401 – 1,600	3,493	3,281	3,284	3,284
1,601 – 1,800	3,132	2,942	2,953	2,951
1,801 – 2,000	2,787	2,615	2,639	2,634
Over 2,000	10,401	9,724	9,829	9,824
Totals	45,980	41,513	41,422	41,529

Source: Gabriel Roeder Smith & Company

Schedule of Average Benefit Payments - Pension

Last Ten Years

Payment Periods	Credited Service (Years)							
	0-5	5-10	10-15	15-20	20-25	25-30	30+	Total
Period 10/1/96 to 9/30/97:								
Average Monthly Benefit	$ 367	$ 357	$ 400	$ 632	$ 877	$ 1,272	$ 1,536	$ 971
Average Final Average Salary	11,007	26,932	22,665	25,373	27,707	32,426	33,096	28,415
Number of Active Retirants	396	440	6,207	6,947	6,410	7,030	8,693	36,123
Period 10/1/97 to 9/30/98:								
Average Monthly Benefit	$ 373	$ 369	$ 414	$ 651	$ 901	$ 1,298	$ 1,571	$ 996
Average Final Average Salary	10,322	28,458	23,509	26,087	28,395	33,076	33,906	29,148
Number of Active Retirants	411	449	6,246	6,906	6,389	7,074	8,710	36,185
Period 10/1/98 to 9/30/99:								
Average Monthly Benefit	$ 375	$ 379	$ 433	$ 673	$ 926	$ 1,329	$ 1,600	$ 1,018
Average Final Average Salary	9,939	29,279	24,597	26,881	29,163	33,685	34,435	29,846
Number of Active Retirants	432	457	6,328	6,939	6,421	7,091	8,678	36,346
Period 10/1/99 to 9/30/00:								
Average Monthly Benefit	$ 398	$ 390	$ 453	$ 694	$ 952	$ 1,388	$ 1,656	$ 1,053
Average Final Average Salary	9,908	30,734	25,784	27,734	29,943	34,218	35,149	30,620
Number of Active Retirants	450	454	6,476	6,984	6,488	7,145	8,708	36,705
Period 10/1/00 to 9/30/01								
Average Monthly Benefit	$ 663	$ 578	$ 474	$ 711	$ 970	$ 1,373	$ 1,653	$ 1,059
Average Final Average Salary	22,101	29,518	26,928	28,637	30,998	34,818	35,868	31,509
Number of Active Retirants	771	697	6,429	6,929	6,485	7,204	8,598	37,113
Period 10/1/01 to 9/30/02								
Average Monthly Benefit	$ 670	$ 542	$ 491	$ 733	$ 1,007	$ 1,460	$ 1,789	$ 1,149
Average Final Average Salary	18,504	31,089	27,935	29,554	32,211	36,772	38,742	33,313
Number of Active Retirants	827	626	6,505	6,962	6,710	7,985	10,051	39,666
Period 10/1/02 to 9/30/03								
Average Monthly Benefit	$ 731	$ 559	$ 510	$ 758	$ 1,074	$ 1,573	$ 1,990	$ 1,298
Average Final Average Salary	23,640	29,738	28,338	29,985	33,205	39,023	42,071	35,175
Number of Active Retirants	1,056	653	6,632	7,036	7,221	9,889	13,004	45,491
Period 10/1/03 to 9/30/04								
Average Monthly Benefit	$ 475	$ 429	$ 528	$ 783	$ 1,112	$ 1,618	$ 2,036	$ 1,332
Average Final Average Salary	6,315	34,463	29,897	31,520	34,992	40,396	43,751	36,939
Number of Active Retirants	687	454	6,842	7,262	7,287	9,951	13,136	45,619
Period 10/1/04 to 9/30/05								
Average Monthly Benefit	$ 491	$ 437	$ 545	$ 807	$ 1,136	$ 1,650	$ 2,077	$ 1,360
Average Final Average Salary	5,754	34,264	29,838	31,806	34,749	40,329	43,302	36,774
Number of Active Retirants	712	453	6,850	7,272	7,303	10,035	13,176	45,801
Period 10/1/05 to 9/30/06								
Average Monthly Benefit	$ 381	$ 432	$ 562	$ 831	$ 1,158	$ 1,673	$ 2,094	$ 1,394
Average Final Average Salary	20,190	35,841	31,723	33,730	36,861	41,827	45,468	39,123
Number of Active Retirants	221	459	6,896	40	7,380	10,235	13,449	45,980

Source: Gabriel Roeder Smith & Company

Schedule of Average Benefit Payments - Health

September 30, 2006

Payment Periods	Credited Service (Years)							
	0-5	**5-10**	**10-15**	**15-20**	**20-25**	**25-30**	**30+**	**Total**
Period 10/1/04 to 9/30/05								
Average Monthly Benefit	$ 303	$ 447	$ 568	$ 837	$ 1,169	$ 1,665	$ 2,097	$ 1,403
Average Final Average Salary	24,519	32,338	31,463	33,062	36,386	41,099	44,724	38,580
Number of Active Retirants	139	625	5,807	6,476	6,787	9,409	12,064	41,307*
Period 10/1/05 to 9/30/06								
Average Monthly Benefit	$ 337	$ 446	$ 582	$ 851	$ 1,190	$ 1,693	$ 2,127	$ 1,427
Average Final Average Salary	25,056	32,732	32,188	34,003	37,149	41,689	45,360	39,296
Number of Active Retirants	136	623	5,812	6,510	6,805	9,469	12,158	41,513

*Participating member totals displayed in this schedule and the information presented in Note 1 of this report may differ. These variances are the result of a mid-year data conversion.

Source: Gabriel Roeder Smith & Company

Schedule of Average Benefit Payments - Dental

September 30, 2006

Payment Periods	Credited Service (Years)							
	0-5	**5-10**	**10-15**	**15-20**	**20-25**	**25-30**	**30+**	**Total**
Period 10/1/04 to 9/30/05								
Average Monthly Benefit	$ 306	$ 452	$ 571	$ 843	$ 1,175	$ 1,673	$ 2,107	$ 1,412
Average Final Average Salary	25,022	32,929	31,707	33,355	36,623	41,323	44,940	38,843
Number of Active Retirants	139	623	5,782	6,413	6,732	9,378	12,098	41,165*
Period 10/1/05 to 9/30/06								
Average Monthly Benefit	$ 340	$ 450	$ 585	$ 856	$ 1,196	$ 1,700	$ 2,135	$ 1,435
Average Final Average Salary	25,468	33,213	32,422	34,280	37,377	41,889	45,557	39,535
Number of Active Retirants	138	620	5,810	6,457	6,754	9,444	12,199	41,422

*Participating member totals displayed in this schedule and the information presented in Note 1 of this report may differ. These variances are the result of a mid-year data conversion.

Source: Gabriel Roeder Smith & Company

Schedule of Average Benefit Payments - Vision

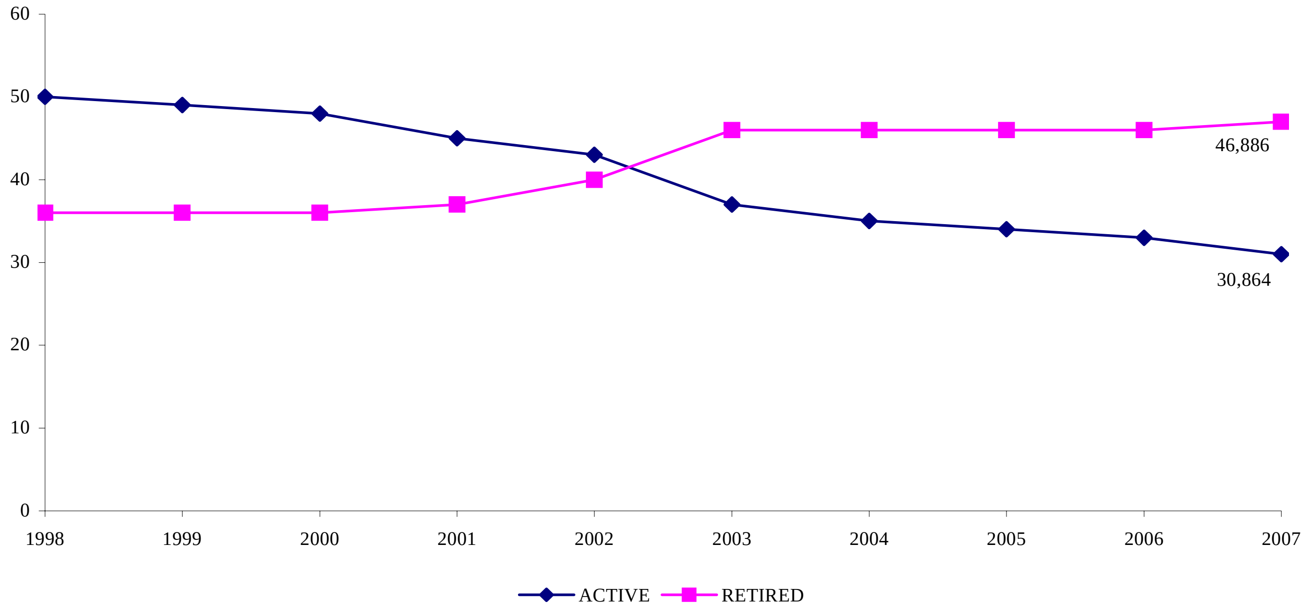
September 30, 2006

Payment Periods	Credited Service (Years)							
	0-5	5-10	10-15	15-20	20-25	25-30	30+	Total
Period 10/1/04 to 9/30/05								
Average Monthly Benefit	$ 308	$ 449	$ 570	$ 841	$ 1,174	$ 1,670	$ 2,106	$ 1,409
Average Final Average Salary	24,976	32,829	31,607	33,272	36,587	41,240	44,911	38,774
Number of Active Retirants	131	627	5,809	6,449	6,752	9,410	12,095	41,273*
Period 10/1/05 to 9/30/06								
Average Monthly Benefit	$ 342	$ 447	$ 583	$ 855	$ 1,194	$ 1,698	$ 2,135	$ 1,432
Average Final Average Salary	25,428	33,135	32,307	34,214	37,321	41,802	45,536	39,465
Number of Active Retirants	131	624	5,835	6,490	6,777	9,477	12,195	41,529

*Participating member totals displayed in this schedule and the information presented in Note 1 of this report may differ. These variances are the result of a mid-year data conversion.

Source: Gabriel Roeder Smith & Company

Ten Year History of Membership
Fiscal Year Ended September 30



Source: Gabriel Roeder Smith & Company

ACKNOWLEDGMENTS

The *Michigan State Employees' Retirement System Comprehensive Annual Financial Report* is prepared by Financial Services, Fiscal Management Division. Staff of the division for the fiscal year 2006-2007 report included:

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The report may be viewed on-line at: www.michigan.gov/ors