Commonwealth of Pennsylvania
State Employees' Retirement System

Comprehensive Annual Financial Report

For the year ended December 31, 2006

06

A Component Unit of the Commonwealth of Pennsylvania

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State Employees' Retirement System

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For the year ended December 31, 2006

Prepared by the staff of the
Pennsylvania State Employees' Retirement System

Eric Henry
Executive Director

Francis J. Donlevy
Director, Office of Finance and Administration

State Employees' Retirement System
30 North Third Street, Suite 150
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A Component Unit of the Commonwealth of Pennsylvania

Commonwealth of Pennsylvania
State Employees' Retirement System
30 North Third Street, Suite 150
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www.sers.state.pa.us

Nicholas J. Maiale
Chairman

June 2007

Honorable Edward G. Rendell, Governor
Commonwealth of Pennsylvania

Members, Pennsylvania General Assembly

Members, Pennsylvania State Employees' Retirement System

Dear Governor Rendell, Legislators and Members:

The Board of the Pennsylvania State Employees' Retirement System ("SERS") is pleased to present our Comprehensive Annual Financial Report ("CAFR") on the SERS Fund for calendar year 2006. The CAFR provides us with a vehicle to compile and publicly disclose extensive financial, investment, and actuarial reports with introductions from SERS management and the fund's consulting actuary.

This 2006 report reflects a fourth consecutive year of strong investment performance for the Fund: Overall 2006 return on the portfolio was 16.4 percent, or more than $4.7 billion, net of fees. Investment earnings are critically important to SERS' long-term soundness, comprising by far our single largest source of revenue: Over the last 20 years, almost 79 percent of SERS funding has come from investment earnings, compared to less than 12 percent from employers and less than 10 percent from employees.

Our investment success is a direct result of an innovative and diversified investment strategy, which has drawn national recognition. That is reflected in the selection of our Chief Investment Officer by Money Management Letter to receive the publication's Lifetime Achievement Award, recognition that came just one year after Institutional Investor Magazine proclaimed SERS "Public Fund of the Year."

We believe that as a result of long–term investment portfolio planning and the prudent management of Fund assets, the System is well prepared to meet its obligations again this year and in the future.

The 11-member SERS Board represents the interest of public employees, public employers, and the taxpayer, in careful balance. SERS Board, staff, and I will continue to pursue prudent long–term investment strategies to assure the solvency of the Fund and the quality of pension–related services to all SERS members.

Sincerely,

Nicholas J. Maiale
SERS Board Chairman

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Certificate of Achievement for Excellence in Financial Reporting

Presented to

Commonwealth of Pennsylvania State Employees' Retirement System

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
December 31, 2005

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.

GOVERNMENT FINANCE OFFICERS ASSOCIATION OF THE UNITED STATES AND CANADA CORPORATION SEAL CHICAGO

President

Executive Director

SERS' Vision, Mission and Organizational Chart

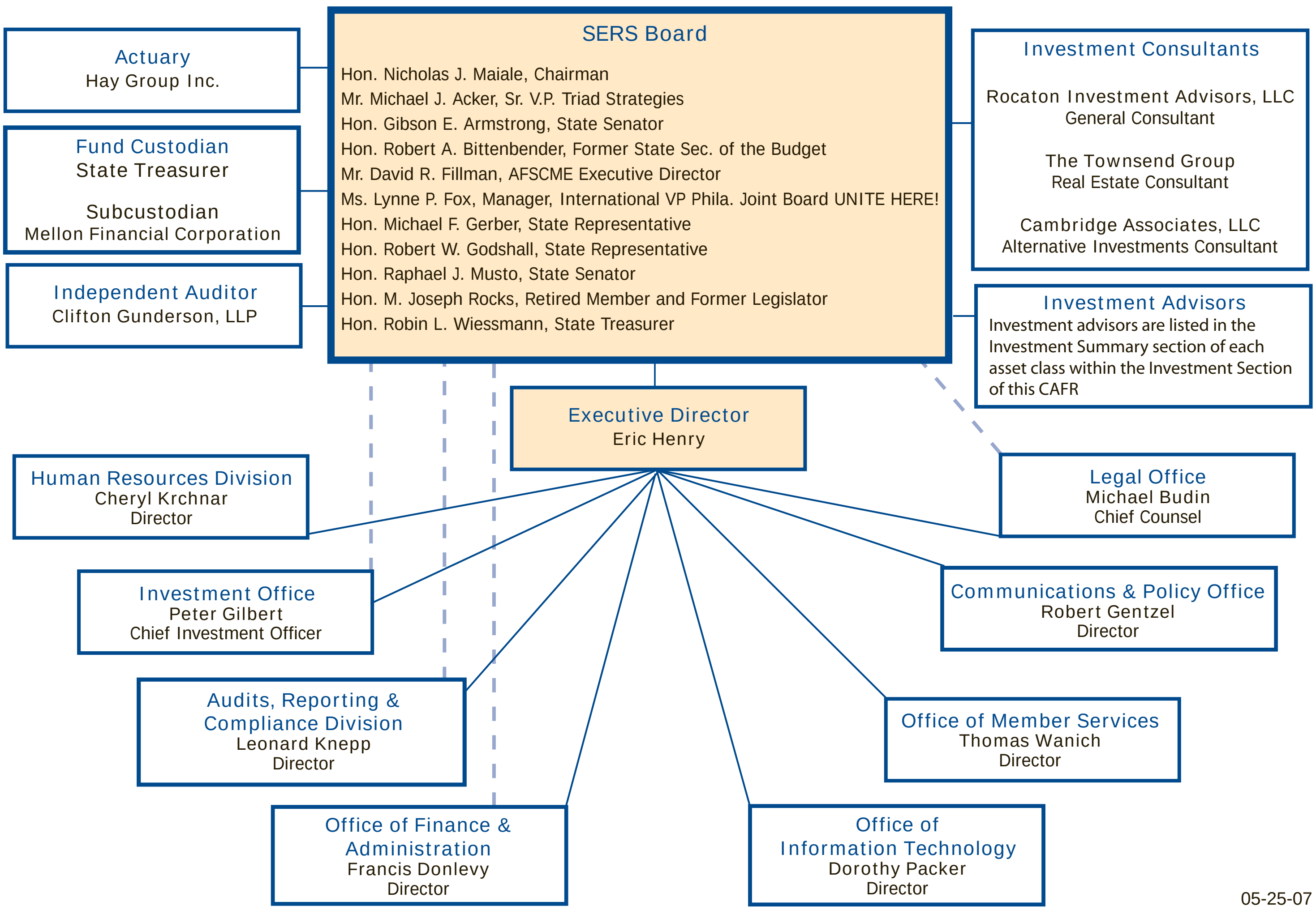
SERS' Vision

By 2010, SERS will be prepared for operational, financial, and public policy impacts of the Baby Boom generation while providing retirement benefits and services.

SERS' Mission

The mission of SERS is to provide retirement benefits and services to our members through sound administration and prudent investments.

SERS' Organizational Chart



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May 30, 2007

Mr. Chairman and Members of the Board:

We are pleased to present you with the Comprehensive Annual Financial Report (CAFR) of the Pennsylvania State Employees' Retirement System ("the System" or "SERS") for the calendar year ended December 31, 2006. Although SERS is not legally required to produce a CAFR, we do so in the interest of public accountability. Publication of this CAFR also serves to comply with the requirement, contained in the State Employees' Retirement Code, that SERS' financial statements be published, after auditing by an independent certified public accountant, on or before July 1 of each year.

Financial Information

The System's management is responsible for the preparation, accuracy and objectivity of the information included in this report, and accepts full responsibility for the contents, including not only the audited financial statements but all other information as well. The basic financial statements were prepared by management in accordance with generally accepted accounting principles as promulgated by the Governmental Accounting Standards Board, and have been audited by an independent auditor. Users of the financial statements are encouraged to review the Management's Discussion and Analysis ("MD&A"), which accompanies the basic financial statements and discusses the market conditions, legislation and changes in operations that affected the financial results and funded status of the System.

SERS maintains an effective system of internal controls designed to provide reasonable assurance that assets are properly safeguarded, transactions are properly executed and the financial statements conform to generally accepted accounting principles. It should be recognized, however, that all internal controls have inherent limitations. These limitations exist because of several factors, including cost: The cost of attempting to establish a perfect internal control system would far outweigh the benefits derived. Another limitation is the potential for controls to be overridden by management, either individually or through collusion of two or more staff. To mitigate the risk caused by these inherent limitations, the System's Audits, Reporting, and Compliance department provides a continuing review of the adequacy and effectiveness of the System's internal control structure. Also, our independent external auditor, Clifton Gunderson LLP, conducts an annual audit of the financial statements in accordance with generally accepted auditing standards. Their audit includes tests and procedures designed to provide reasonable assurance that the financial statements are fairly presented. The external auditors have full and unrestricted access to the SERS Board members to discuss their audit and related findings regarding the integrity of financial reporting and adequacy of the internal control structure.

In addition, SERS underwent two simultaneous in-depth fiduciary performance audits scrutinizing every aspect of its investment program. These audits, completed in September 2006, entailed a 17-month examination of SERS by both the Pennsylvania Department of the Auditor General and Independent Fiduciary Services (IFS), of Washington D.C., a nationally known consulting firm. The audits produced a number of valuable recommendations and observations and, we are pleased to report, also resulted in both groups of auditors commending SERS: Auditor General Jack Wagner said his audit showed SERS is "managed effectively and professionally," and IFS said SERS is "distinguished by the sophistication of its investment program" which it called, "clearly on the cutting edge of the public pension fund investment world." Both audit reports are posted in their entirety on the SERS Web site, www.sers.state.pa.us, along with related materials (under "News and Updates" see news release of September 26, 2006).

Together, the fiduciary audits and the annual financial audit show that the money entrusted to SERS is being properly managed so that we can continue meeting our obligation to our active and retired members, and their beneficiaries. Our members can be reassured that their retirement system is well managed and their benefits are secure.

The System also receives independent financial audits on all of its private equity, venture capital, pooled real estate, and absolute return fund–of–funds limited partnerships, as well as audits for its directly held real estate portfolios and collective trust fund statements.

Profile of SERS

SERS is a component unit of the Commonwealth of Pennsylvania, and administers a cost-sharing, multiple-employer defined benefit retirement plan. Founded in 1923, SERS is a mature pension plan with the number of annuitants and active members rapidly approaching a 1:1 ratio; as of December 31, 2006 the System had 110,972 active members and 102,060 annuitants and beneficiaries.

The System is administered by an independent 11 member administrative board comprised of: the State Treasurer, ex officio; two senators; two members of the House of Representatives; and six members appointed by the Governor. Through the Governor, the Board submits to the General Assembly an annual budget covering all proposed administrative expenditures, which includes proposed expenditures the Board intends to pay through the use of directed commissions. The expenditures are approved by the General Assembly in an appropriation bill and paid from the investment earnings of the fund.

Membership, Funding and Contribution Trends

As a mature plan, SERS pays out far more in benefits and refunds each year than it receives in contributions: $1.9 billion in payouts versus $514 million in contributions in 2006. The difference must come from the Fund's earnings and accumulated reserves, necessitating an investment policy that maintains the short-term liquidity required to fund payouts, while pursuing long-term returns of at least the actuarially assumed rate of 8.5%.

SERS achieved that goal again in 2006. The System posted an overall return of 16.4%, which placed it among the top quartile of all public pension funds nationwide. Although the 2006 return significantly exceeded the actuarial assumption, the System's funded ratio nonetheless declined slightly, from 92.9% to 92.7%. That is because SERS uses a five-year smoothing to establish its return for actuarial purposes, and therefore is still carrying a portion of the 2002 losses, and because Act 2003-40 adjusted SERS' amortization schedule in a way that effectively deferred increases in the employer contribution rate. A funded status of less than 100% is not cause for concern however, and SERS remains among the best-funded public pension plans in the United States.

Although the purpose of the CAFR is to provide information regarding SERS status as of December 31, 2006, readers also should be aware of two anticipated future developments:

First, as the Fund continues to mature, the number of retired members is expected to continue to grow, while the number of active members is expected to remain relatively constant. As the number of retirees grows, the amount that must be paid out in benefits is expected to continue to increase. It is projected that by 2010 the number of retired members will exceed the number of active members and by 2012 annual benefit payments will reach $3 billion, 57% more than in 2006.

Second, while employer contribution rates remain near historically low levels, as also discussed in more detail in the MD&A, it is anticipated that those rates will rise dramatically in future years. Act 2003-40, which changed the amortization period of SERS' unfunded liability, is expected to maintain employer contributions in single digits through 2011, even dropping back down to zero for four years, followed by a steep increase to 10.6% for the 2012-13 fiscal year. These projections assume no new COLAs are granted. If COLAs are granted during this time period, projected rates would be significantly higher. Conversely, future rates could be lower if the Legislature elects to adopt any one of several introduced bills that would extend or even increase the current 4% rate floor, rather than allowing rates to fall during the short term.

Initiatives

The SERS Board further diversified the investment portfolio in 2006, , obtaining greater global exposure in both the public and private equity asset classes, making an initial investment in micro-cap equities, expanding its "portable alpha" strategy in the domestic equity asset class and extending that strategy into international stocks, as well. Administrative initiatives included development of a leading-edge digital Content Management System, initially benefiting the Member Services and Legal offices, and further progress on succession planning.

Awards

We are very pleased to note that the Government Finance Officers Association of the United States and Canada (GFOA) again awarded the Certificate of Achievement for Excellence in Financial Reporting to the System for the year ended December 31, 2005. The Certificate of Achievement is a national award, recognizing conformance with the highest standards for preparation of a state and local government financial report.

A Certificate of Achievement is valid for a period of one year only. We believe that our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements, and we are submitting it to the GFOA to determine its eligibility for another certificate.

SERS also was honored that during 2006, Chief Investment Officer Peter M. Gilbert was chosen to receive a Lifetime Achievement Award from Money Management Letter, recognizing the fund's "stellar returns" and leadership role in implementing "cutting edge strategies," and Gilbert's "extensive work on corporate governance (that) has benefited the industry at large and investors everywhere."

Acknowledgements

This report reflects the dedicated efforts of the SERS staff under the direction of the SERS Board. We would like to take this opportunity to express our gratitude to the Board, the staff, our advisors and others who have worked diligently to administer the System, enhance delivery of member services and manage the Fund's assets in a prudent fashion.

We will continue to strive to administer the System in a manner that ensures the accurate, timely payment of benefits, prompt and courteous service, and prudent management of the Fund's assets on behalf of our members and the Commonwealth's taxpayers.

Respectfully submitted,

Eric Henry
Executive Director

Francis J. Donlevy
Director, Office of Finance and Administration

SERS Board

Honorable Nicholas J. Maiale

Chairman

Michael J. Acker

Senior Vice President Triad Strategies

Honorable Gibson E. Armstrong

State Senator

Honorable Robert A. Bittenbender

Former State Secretary of the Budget

David R. Fillman

Executive Director, AFSCME Council 13

SERS Board

Ms. Lynne P. Fox

Manager, International VP Phila. Joint Board UNITE HERE!

Honorable Michael F. Gerber

State Representative

Honorable Robert W. Godshall

State Representative

Honorable Raphael J. Musto

State Senator

Honorable M. Joseph Rocks

Retired Member and Former State Senator

Honorable Robin L. Wiessmann

State Treasurer

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Financial Section

Independent Auditors' Report

Clifton Gunderson LLP
Certified Public Accountants & Consultants

Independent Auditors' Report

Members of the Board
Commonwealth of Pennsylvania
State Employees' Retirement System

We have audited the accompanying statements of plan net assets of the Commonwealth of Pennsylvania State Employees' Retirement System (the System), a component unit of the Commonwealth of Pennsylvania, as of and for the year ended December 31, 2006, and the related statements of changes in plan net assets for the year then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements as of and for the year ended December 31, 2005 were audited by other auditors whose report dated April 10, 2006 expressed an unqualified opinion on those financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 2006 financial statements referred to above present fairly, in all material respects, the plan net assets of the Commonwealth of Pennsylvania State Employees' Retirement System as of December 31, 2006, and its changes in plan net assets for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The information included in Management's Discussion and Analysis and Required Supplemental Schedules 1 and 2 and the notes thereto is not a required part of the basic financial statements, but is supplementary 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 the supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The Supplemental Schedules 1 and 2 are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

The introductory section, investment section, actuarial section and statistical section as listed in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. The introductory, investment, actuarial and statistical sections have not been subject to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

Clifton Gunderson LLP

May 11, 2007
Baltimore, Maryland

Offices in 15 states and Washington, DC 1

Member of HLB International

Management's Discussion and Analysis

This section presents Management's Discussion and Analysis of the Pennsylvania State Employees' Retirement System's (the System) financial statements and the significant events and conditions which affected the operations and performance of the System during the years ended December 31, 2006 and 2005.

The Management's Discussion and Analysis includes forward-looking statements that involve certain risks and uncertainties. Actual results and performance may differ materially from those expressed or implied in the forward looking statements due to a wide range of factors including: changes in securities markets, general economic conditions, interest rates, energy policies, legislation and global conflicts.

Overview of the Financial Statements and Accompanying Information

1) **Fund Financial Statements.** The System presents Statements of Plan Net Assets as of December 31, 2006 and 2005 and Statements of Changes in Plan Net Assets for the years then ended. These statements reflect resources available for the payment of benefits as of year-end, and the sources and use of those funds during the year.

2) **Notes to Financial Statements.** The notes to financial statements are an integral part of the financial statements. We encourage our readers to review them because the additional detailed information will provide a better understanding of the financial statements. The notes provide information about the System's organization, benefits and contributions, how asset values are determined, the use of derivatives in managing the System's assets, and contingencies and commitments.

3) **Required Supplementary Information.** The required supplementary information consists of:
   - Two schedules concerning the funded status of the System and employer contributions,
   - Related notes to those schedules discussing actuarial assumptions and information, and this
   - Management's Discussion and Analysis.

4) **Other Supplementary Schedules.** Other schedules include detailed information on administrative expenses incurred by the System, a breakout of investment related expenses, and fees paid to consultants for professional services.

Financial Analysis

The System provides retirement benefits to the employees of the Commonwealth of Pennsylvania and certain other public agencies. The System's benefits are funded through member and employer contributions, and investment income. The net assets of the System increased approximately $3.3 billion and $2.1 billion in each of the years ending December 31, 2006 and 2005, respectively, as reflected in the table on page 7. Investment returns for both 2006 and 2005 reflect strong returns from the global securities markets, which enabled the System's investments to earn approximately $4.7 billion and $3.6 billion, respectively, in net investment income. Returns were particularly strong in international equity, real estate, and private equity investment markets. The System's 2006 funded status of 92.7% dropped slightly from 92.9% in 2005. By comparison, as reported in the Wilshire Associates' "2007 Wilshire Report on State Retirement Systems," a compilation of 2006 data on 64 state pension plans, the average funding level was 88%. Every five years, the System undergoes an Actuarial Experience study to determine whether the assumptions used in the annual actuarial valuation are representative of current and anticipated trends. The latest experience study for the five year period 2001 - 2005 was completed in 2006. Annually, the System reviews and modifies, if necessary, its five-year investment plan. These processes enable the System to position itself to respond to changing dynamics and fulfill its primary mission of meeting its benefit obligations to the System's members. Benefit expenses, including refunds of contributions were $1.92 billion in 2006. This expense level represents a relatively small increase in benefit expenses over the last 3 years from $1.86 billion in 2004, and a small increase compared to historical norms. This trend is not expected to continue. Due to a combination of active members in the system rapidly approaching superannuation and recent employee contract changes, we expect benefit expenses to increase significantly over the next several years.

Funded Ratio

The funded ratio of the plan measures the ratio of actuarially determined assets against actuarial liabilities and is a good indicator of a pension fund's fiscal strength and ability to meet its obligations to its members. The System is required by statute to perform an annual actuarial valuation. The actuarial process to develop the funded ratio is highly dependent on estimates and assumptions, particularly those regarding investment returns, payroll increases, inflation and demographics. In addition, the selection of methods, such as amortization periods, affects employer contribution rates and the funded ratio of the plan. The plans funded ratio as of December 31, 2006 was 92.7%, a slight decrease from 92.9% at December 31, 2005. The funded ratio of the Plan was relatively unchanged because both components of the funded ratio, the actuarial value of assets and actuarial accrued liabilities, each increased approximately 5%, offsetting each other with minimal impact on the funded ratio. The increase in liabilities is attributed primarily to the increase in the present value of benefits for active participants, which reflects projected wage increases resulting from recent labor contract negotiations. The increase in actuarial assets is primarily from investment returns above the actuarial assumed rate of 8.5% over the prior four years.

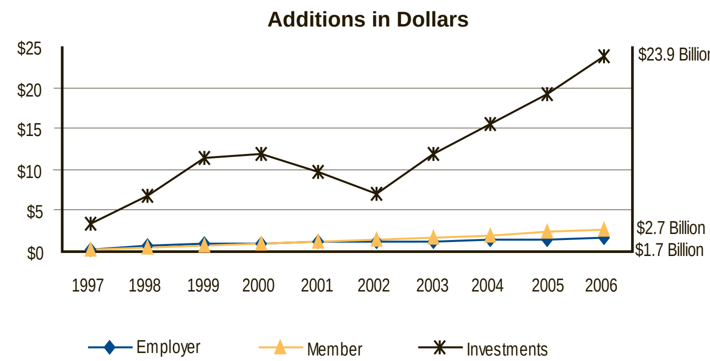
Member Contributions

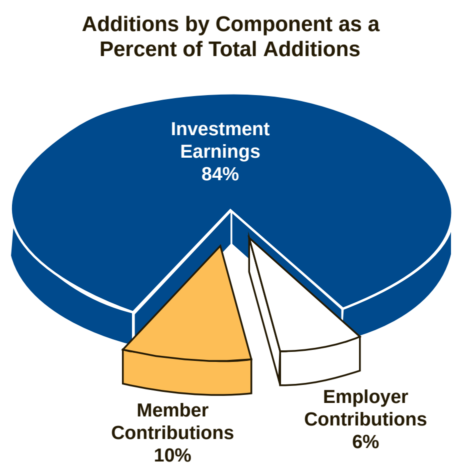
Additions to plan net assets include employer and member contributions and net income from investment activities. Member contributions were approximately $318 million, $306 million, and $310 million for the years ended December 31, 2006, 2005 and 2004, respectively, with 2006 contributions representing an increase of approximately $12 million compared to 2005. The employee rate of 6.25% of gross salary for most members is set by statute and has remained unchanged. The increase in gross salary of active members was the primary reason for the increase in contributions. The gross salary increased to $5.1 billion in 2006 from $4.9 billion in 2005.

Employer Contributions

Employer contributions were approximately $196 million, $148 million, and $107 million, for the years ended December 31, 2006, 2005, and 2004, respectively, for a year-over-year increase of $48 million and $41 million for 2006 and 2005. The increase is a result of an increase in the employer contribution composite rate for the same time period. The employer rates as of December 31, 2006, 2005, and 2004 were 4.02%, 3.02% and 2.03% of total employer payroll. The increases in the employer rates were due primarily to an increase in the statutory minimum rate established by the legislature in 2003. Although the employer contributions have steadily increased over the last three years, employer contributions have been relatively low when compared to historical standards. In fact, over the last 10 years, employer contributions have been, by far, the smallest component of additions to the System's plan net assets. From 1997 through 2006, employer contributions totaled $1.7 billion, representing only 6.1% of total additions to plan net assets, compared to $2.7 billion or 9.5% of total additions attributed to employee contributions and $23.9 billion or 84% of total additions attributed to investment earnings as demonstrated in the chart below.

Ten Year Cummulative Additions to Plan Net Assets

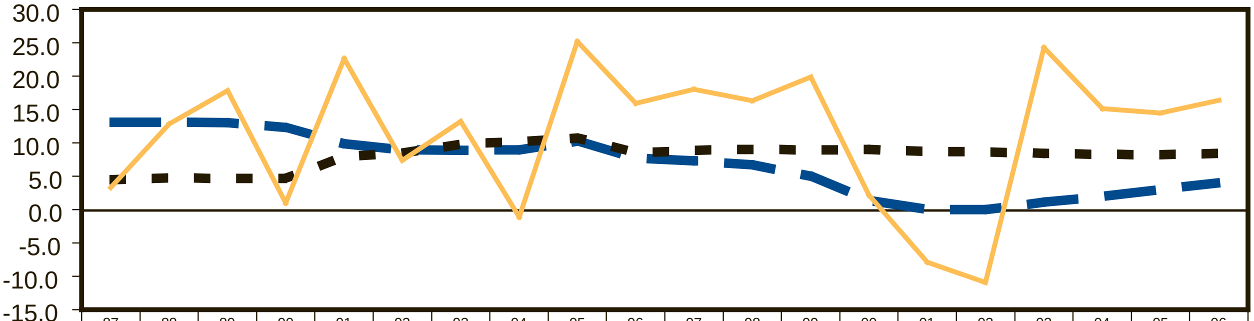




Over this time period, the active membership payroll has grown from $4 billion in 1997 to slightly over $5 billion.

The System's investment returns, which have exceeded the actuarial assumed rate of return of 8.5%, are the primary reason for the low employer contribution rate. The benefits of reduced employer contributions pass directly back to the participating Commonwealth agencies and the taxpayers of Pennsylvania. In fact, had the Commonwealth agencies paid the Employer Normal Cost rate over the last 10 years, the Commonwealth agencies would have paid over $2.5 billion more in employer contributions into the System. The Normal Cost is the cost of future benefits

History of SERS Employer Contribution Rates and Investment Returns



	87	88	89	90	91	92	93	94	95	96	97	98	99	00	01	02	03	04	05	06
Employer Contribution Rates %	13.1	13.1	13.0	12.3	9.9	8.9	8.9	8.9	10.3	7.7	7.3	6.7	5.0	1.4	-	-	1.1	2.0	3.0	4.0
Employer Normal Cost Rates %	4.5	4.7	4.7	4.7	7.9	8.5	9.8	10.2	10.7	8.5	8.9	9.0	9.0	9.0	8.7	8.6	8.4	8.3	8.3	8.4
Investment Returns %	3.3	12.8	17.8	1.0	22.6	7.4	13.2	(1.1)	25.2	15.9	18.0	16.3	19.9	2.2	(7.9)	(10.9)	24.3	15.1	14.5	16.4

that is allocated to the current year by the actuarial cost method. In theory, if the unfunded actuarial liability were zero, and there were no deviations from the actuarial assumptions or amendments to the Retirement Code, the Normal Cost would be that amount required to fund the on-going liabilities for plan participants. The above chart presents the relationship between investment returns and contribution rates. When returns are strong and above the actuarial assumed rate, as in the 1990's and the most recent four years, the employer's level of contributions will generally be below the Normal Cost. Conversely, when investment returns lag the actuarially assumed rate of 8.5%, those losses are amortized into the fund through increased employer contributions as reflected in the above chart.

Annual Rates of Returns

Asset Class	2006	2005	2004
Domestic Equities	18.8%	7.3	14.9
International Equities	26.7	19.3	20.6
Fixed Income Securities	7.7	4.9	7.7
Cash / STIF	4.9	2.9	1.7
Real Estate	17.6	30.9	14.6
Private Equity	23.2	36.5	25.7
Venture Capital	5.4	8.3	-2.6
Inflation Protection	-6.3	24.7	20.4
Total Fund	**16.4%**	**14.5**	**15.1**

Net Investment Income

Investment portfolio performance produced investment returns of 16.4%, 14.5%, and 15.1% for the years 2006, 2005 and 2004, respectively. That performance generated net investment income totaling approximately $4.7 billion during 2006, $3.6 billion in 2005, and $3.6 billion in 2004. Strong global equity markets continued to fuel performance in all three years as the domestic Russell 3000 index returned 15.7% for 2006 and 11.2% for the three year period ending 2006. The MSCI World ex. US Index returned 26.2% for 2006 and 20.6% for the three year period ending 2006. For the three and ten year period ending December 31, 2006, the System earned compounded annual rates of return of 15.3% and 10.2%, which exceeded the actuarial assumption of 8.5%. Following are the System's annual rates of returns by major asset class:

The most significant deduction from investment income is investment manager fees. The System's assets are managed 100% by external investment advisors hired by the Board. Many of these managers are paid a fee based on the assets under management. Accordingly, those managers were generally compensated more in 2006 than in prior years because of the effect of increasing asset values. However, the industry practice for the limited partnership investments is for the limited partners to pay fees to the general partner based on commitments to the partnership during the initial years. The $63 million increase in investment expenses in 2006 was due to several factors. International Equity manager fees were up $28 million, primarily as a result of incentive fees. Substantially all incentive fees were paid on excess earnings over a certain benchmark upon the liquidation of funds. Additionally, the replacement of passively managed portfolios with actively managed investment strategies increased fees by $22 million. The balance of the increase was the result of the market value increase of the overall System's investment portfolio.

Benefits, Refunds and Expenses

Benefits are the most significant recurring deduction from Plan Net Assets. During 2006 and 2005, the System paid out approximately $1.9 billion in benefits and refunds each year. There were 4,514 new retirees added to the annuity payroll in 2006 with an average annual benefit of $21,339. These new additions retired with a much higher annual benefit than those removed from rolls. There were 3,633 retirees removed from the rolls with an average annual benefit of $11,683. Despite the increase in new retirees added to the rolls in 2006, the increase in total benefit and refunds paid in 2006 was minimal. This was due to the fact that the supplemental payments associated with the larger than normal retirements in 2005 offset the increase in annuity payroll for the new retirees in 2006. Supplemental payments are mainly the result of members withdrawing their accumulated contributions and interest from the System. Those withdrawals reduce the retirees' annuity payments over the annuitants remaining life. The System expects retirees to be added to the rolls at increased rates for the next several years, thereby increasing annual benefit expenses. That expectation is based on the fact that more than 8,400 current employees have 30 years or more of service with average salaries of approximately $61,500.

The System was established in 1923 but did not pay more than $1 billion in annual benefits until 1997. Based on recent actuarial projections, the System expects benefit payments to reach $2 billion in 2007 and $3 billion by 2012. The table below shows the increase in retirees and monthly benefit payments since 2004.

Growth in Annuity Payroll

	Dec. 2006	Dec. 2005	Dec. 2004
Monthly Annuity Payroll	$138 million	133 million	124 million
Retirees	102,060	101,179	98,727

The administrative costs of the System represented less than .08% of average net assets in 2006 and 2005. All costs were within budget.

Plan Assets

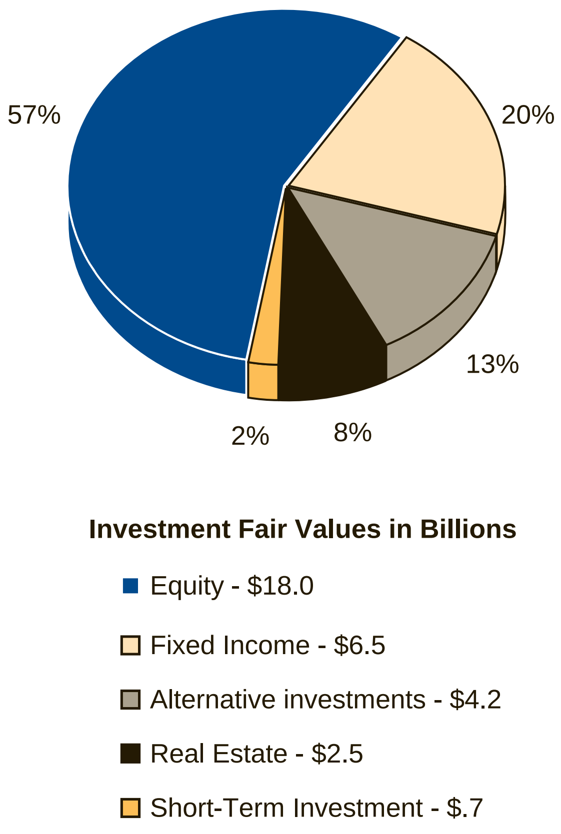
The System's investments are the most significant component of the System's assets. Investments increased to $31.9 billion in 2006 from $28.6 billion as of December 31, 2005. The $3.34 billion increase in investments is even more impressive considering the System paid out $1.9 billion in benefit payments in 2006. The increase continues to reflect the strong rebound in global equity markets since early 2003, and has resulted in strong returns in the domestic equities, international equities, real estate, and alternative investment asset classes. This rebound was also responsible for an increase of $2.0 billion in 2005 and $1.8 billion in 2004.

The System values its assets at "fair value" as discussed in the accounting polices footnote 2(c) to the financial statements. Fair value is the value the System expects to receive in a current sale between a willing buyer and a willing seller that are equally motivated; that is, other than a forced or liquidation sale. The value of publicly traded securities, stocks and bonds, are determined using the latest quote from national exchanges or pricing services. Those prices reflect the securities' pricing at the close of business and are affected by such items as liquidity, current events and the size of lots being traded. Real estate is valued by the investment advisor using discounted cash flows, recent comparable sales, and current market conditions to arrive at a fair value. The real estate portfolios undergo an annual independent financial audit of the estimated fair values as well as an independent appraisal process on a routine cycle conducted by approved appraisers who meet specified professional qualifications. The appraisal process involves a significant amount of judgment and estimating. As a result, the ultimate value on the sale of the asset may differ from the appraised value.

Values for investments in private equity and venture capital limited partnerships are determined by the general partners and by valuation committees. The partnerships' investments, as well as the assumptions and estimates used in developing the investment values, are subject to annual independent audits. Because the investments in those partnerships are generally illiquid and holding periods may last for several years, the ultimate value realized by the System on the disposition may differ from the estimated values reflected in the financial statements, and those differences could be material.

As of December 31, 2006, equity fair values were $18.0 billion, an increase of $2.8 billion from December 31, 2005. This was a result of the System's strong equity returns for both domestic and foreign equity holdings. The alternative investment and real estate asset classes increased $616 million and $573 million respectively, due to strong returns in those asset classes. The total fixed income asset class' fair value was relatively unchanged. The total investment portfolio fair value of $31.9 billion was comprised as shown by the chart below:

Investments at Fair Value and Distribution Percentages
As of December 31, 2006



The System earns additional investment income by lending investment securities to brokers. The brokers provide collateral to the System for borrowed securities generally equal to 102% to 105% of the borrowed securities. The System invests the collateral to earn interest. Income, net of expenses, from security lending is dependent on the volume of lending generated at the custodian bank and the spreads (profits) on those loaned securities. Although volume was only slightly down from 2005, net security lending revenue was down 16% in 2006. Net security lending revenue was $10.5 million, in 2006, a decrease of $2 million from 2005 lending revenue of $12.5 million. Approximately $1 million of the $2 million decrease was the result of significantly reduced spreads in the sovereign debt securities loaned from the System's emerging market debt portfolios. Within those portfolios, certain bonds were in very high demand in 2005, increasing 2005 income. In 2006, that same demand declined, and therefore, reduced income in that sector. The remaining $1 million decrease was the result of reduced spreads across most of the other asset classes, particularly TIP securities, U.S. equities, and U.S. corporate fixed income securities.

Derivatives

The System uses derivatives as a means to provide market exposure to domestic and global equity markets, and commodity asset classes, and to manage interest rate risk in the fixed income portfolios. Used properly, these derivatives deliver returns similar to indexed returns in the respective asset classes in a cost-efficient manner without disrupting the liquidity needs of the System. The System's investment advisors manage counterparty credit risk by entering into contracts with parties with strong credit ratings and by establishing collateral requirements. The System monitors derivative levels and types to ensure that portfolio derivatives are consistent with the intended purpose and at the appropriate level.

Liquidity

The System's liquidity needs are met through employee and employer contributions and earnings from investments and its well diversified investment portfolio. At December 31, 2006, the fund held over $1.8 billion in core fixed, high quality securities. In addition, exposure to commodity markets is achieved, in part, using swap contracts to generate returns consistent with the GSCI Commodity Index. Those contracts overlay a highly liquid, intermediate duration U.S. TIPS portfolio of approximately $1.2 billion. The fund also holds over $3 billion in highly liquid large cap equity securities. Investments in real estate and alternative investments are generally considered illiquid. Because of their characteristics, investments in emerging markets, high yield fixed income securities, and fund-of-fund strategies, are not considered a primary source of liquidity.

Condensed Financial Information
(in Millions)

Net Assets

Assets	2006	Increase (Decrease)	2005	Increase (Decrease)	2004
Total receivables	$374	(354)	728	403	325
Total investments	31,934	3,357	28,577	1,973	26,604
Securities lending collateral pool	3,239	123	3,116	187	2,929
Total assets	35,547	3,126	32,421	2,563	29,858
Liabilities					
Accounts payable and accrued expenses	69	(3)	72	36	36
Investment purchases	186	(295)	481	229	252
Obligations under security lending	3,239	123	3,116	187	2,929
Total liabilities	3,494	(175)	3,669	452	3,217
Total net assets	**$32,053**	**3,301**	**28,752**	**2,111**	**26,641**

Changes in Net Assets

Additions	2006	Increase (Decrease)	2005	Increase (Decrease)	2004
Member contributions	$318	12	306	(4)	310
Employer contributions	196	48	148	41	107
Investment gain	4,730	1,107	3,623	54	3,569
Total additions	5,244	1,167	4,077	91	3,986
Deductions					
Benefits and refunds	1,919	(24)	1,943	83	1,860
Administrative expenses	24	1	23	2	21
Total deductions	1,943	(23)	1,966	85	1,881
Increase in net assets	**$3,301**	**1,190**	**2,111**	**6**	**2,105**

Statements of Plan Net Assets
December 31, 2006 and 2005
(Dollar Amounts in Thousands)

	2006	2005
Assets:		
Receivables:		
Plan members	$682	710
Employers	7,824	7,145
Investment income	86,140	94,824
Investment proceeds	275,157	622,848
Miscellaneous	4,536	2,397
Total receivables	374,339	727,924
Investments:		
Short-term investments	717,568	1,253,567
United States government securities	2,356,929	2,791,290
Corporate and foreign bonds and notes	2,777,464	2,947,015
Common and preferred stocks	15,796,971	12,128,447
Collective trust funds	3,535,532	3,896,820
Real estate	2,521,418	1,948,283
Alternative investments	4,227,663	3,611,344
Total investments	31,933,545	28,576,766
Securities lending collateral pool	3,239,461	3,115,916
Total assets	35,547,345	32,420,606
Liabilities:		
Accounts payable and accrued expenses	68,822	72,284
Investment purchases	186,232	480,535
Obligations under securities lending	3,239,461	3,115,916
Total liabilities	3,494,515	3,668,735
Net assets held in trust for pension benefits	**$32,052,830**	**28,751,871**

(A Schedule of Funding Progress is presented on page 21.)
These financial statements should be read only in connection with the accompanying notes to the financial statements.

Statements of Changes in Plan net Assets
December 31, 2006 and 2005
(Dollar Amounts in Thousands)

	2006	2005
Additions:		
Contributions:		
Plan members	$317,790	305,624
Employers	196,420	148,375
Total contributions	514,210	453,999
Investment gain:		
Net appreciation in fair value of investments	3,723,160	2,811,470
Collective trust fund appreciation and income	641,718	420,888
Interest	350,783	368,610
Dividends	152,690	128,480
Real estate	145,871	112,057
Miscellaneous	3,519	3,537
	5,017,741	3,845,042
Investment expenses	(298,204)	(234,760)
Net gain from investing activities	4,719,537	3,610,282
From securities lending activities:		
Securities lending income	170,675	116,477
Securities lending expenses	(160,169)	(103,939)
Net income from securities lending activities	10,506	12,538
Total net investment gain	4,730,043	3,622,820
Total additions	5,244,253	4,076,819
Deductions:		
Benefits	1,911,330	1,936,428
Refunds of contributions	8,096	7,215
Administrative expenses	23,868	22,704
Total deductions	1,943,294	1,966,347
Net increase	3,300,959	2,110,472
Net assets held in trust for pension benefits:		
Balance, beginning of year	28,751,871	26,641,399
Balance, end of year	**$32,052,830**	**28,751,871**

These financial statements should be read only in connection with the accompanying notes to the financial statements.

Notes to Financial Statements
December 31, 2006 and 2005
(Dollar Amounts in Thousands)

(1) Organization and Description of the System

(a) Organization

The Commonwealth of Pennsylvania State Employees' Retirement System (the System) was established as of June 27, 1923, under the provisions of Public Law 858, No. 331. The System was developed as an independent administrative board of the Commonwealth and is directed by a governing board that exercises control and management of the System, including the investment of its assets. The System's board has eleven members including the State Treasurer (ex officio), two Senators or former Senators, two members or former members of the House of Representatives, and six members appointed by the Governor, one of whom is an annuitant of the System. At least five board members are active members of the System and at least two have ten or more years of credited service.

The System is the administrator of a cost-sharing multiple-employer defined benefit retirement system established by the Commonwealth to provide pension benefits for employees of state government and certain independent agencies. The System is a component unit of the Commonwealth and is included in the Commonwealth's financial report as a pension trust fund. Administration costs are financed through contributions and investment earnings.

Membership in the System is mandatory for most state employees. Members and employees of the General Assembly, certain elected or appointed officials in the executive branch, department heads, and certain employees in the field of education are not required, but are given the option to participate. At December 31, 2006 and 2005, System membership consisted of:

System Membership

	2006	2005
Retirees and beneficiaries currently receiving benefits	102,060	101,179
Terminated employees entitled to benefits but not yet receiving them	5,843	5,461
Current active employees	110,972	109,981
Total members	**218,875**	**216,621**
Number of participating agencies	108	108

(b) Pension Benefits

The System provides retirement, death, and disability benefits. Cost of Living Adjustments (COLA) are provided at the discretion of the General Assembly. Article II of the Commonwealth of Pennsylvania's Constitution assigns the authority to establish and amend the benefit provision of the plan to the General Assembly.

Employees who retire at age 60 with 3 years of service, or with 35 years of service if under age 60, are entitled to a normal annual retirement benefit. Members of the General Assembly and certain employees classified in hazardous duty positions can retire with full benefits at age 50, with at least 3 years of service.

Most members of the System, and all state employees hired after June 30, 2001 (except State Police officers and certain members of the judiciary and legislators), are Class AA members. The multiplier for Class AA is 1.25, which translates into an annual benefit of 2.5% of the member's highest three-year average salary times years of service and became effective for members July 1, 2001. The general annual benefit for Class A members is 2% of the member's highest three-year average salary times years of service. State police are entitled to a benefit equal to a percentage of their highest annual salary, excluding their year of retirement. The benefit is 75% of salary for 25 or more years of service and 50% of salary for 20-24 years of service. Judges are entitled to a benefit of 4% of final average salary for each of the first 10 years of service and 3% for subsequent years. District Justices are entitled to a benefit of 3% of final average salary for each year of service. Act 9 also created a new class of service for current legislators, Class D-4. The multiplier for Class D-4 is 1.5, which translates into an annual benefit of 3% of the final average salary for each year of service. Most members vest with 5 years of credited service.

According to the Retirement Code, all obligations of the System will be assumed by the Commonwealth should the System terminate.

(Dollar Amounts in Thousands)

(c) Contributions

The System's funding policy, as set by the System's Board, provides for periodic active member contributions at statutory rates. The System's funding policy also provides for periodic employer contributions at actuarially-determined rates, expressed as a percentage of annual covered payroll, such that they, along with employee contributions and an actuarially determined rate of investment return, are adequate to accumulate assets to pay benefits when due. A variation of the entry-age normal actuarial cost method is used to determine the liabilities and costs related to all of the System's benefits, including superannuation, withdrawal, death, and disability benefits, and to determine employer contribution rates. The significant difference between the method used for the System and the typical entry-age normal actuarial cost method is that the normal cost is based on the benefits and contributions for new employees rather than for all current employees from their date of entry. The System believes that this variation should produce approximately the same results as the typical method over the long run. These rates are computed based upon actuarial valuations on the System's fiscal year end of December 31 and applied to the Commonwealth based on its fiscal year end June 30; therefore, the employer contribution rates, in effect for the System's year-end of December 31, reflect a blended average of calculated rates. The blended contribution rates were as follows:

Blended Contribution Rates

	2006	2005
Employer normal cost	8.32%	8.29
Amortization of unfunded actuarial assets in excess of liabilities	(12.16)	(14.65)
Amortization of supplemental annuities	5.35	5.44
Act 2003-40 Minimum rate factor	2.01	3.45
Total employer cost	**3.52%**	**2.53**

In addition to the employer normal cost, the total employer cost includes other costs and credits resulting from COLAs, differences between actual investment results and actuarial estimated returns, and changes in benefits. These additional costs and credits are amortized over a period of future years as set by the Legislature. On December 10, 2003, Act 2003-40 (Act 40) revised the amortization periods of these additional costs and credits to the following amortization periods:

Pre-Act 2001-9 funding credit	10 years
Act 2001-9 Liability	30 years
Post 2000 gains and losses	30 years
Existing and future COLAs	10 years

Additionally, Act 40 revised minimum employer contribution rates to 2%, 3%, 4% effective July 1, 2004, 2005, and 2006, respectively.

The general membership contribution rate for all Class A and Class AA members is 5% and 6.25% of salary, respectively. The contribution rate for Class D-4 members is 7.5%. Judges and district justices have the option of electing special membership classes requiring a contribution of 10% and 7.5%, respectively. All employee contributions are recorded in an individually identified account that is credited with interest, calculated at 4% per annum, as mandated by statute. Accumulated employee contributions and credited interest vest immediately and are returned to the employee upon termination of service if the employee is not eligible for other benefits.

(d) Benefits Completion Plan (BCP)

Act 2002-234 amended the State Employees Retirement Code by adding Section 5941 to the Code. Section 5941 directs the State Employees Retirement Board to establish and serve as trustee of a retirement benefit plan that is in conformity with Internal Revenue Code (IRC) Section 415(m), the Benefits Completion Plan. The BCP is a separate trust fund established to provide benefits to all annuitants of the System's Defined Benefit Plan and their survivor annuitants and beneficiaries whose retirement benefit exceeds the IRC Section 415(b) limits.

The BCP is funded on an annual basis. A monthly annuity or death benefit is paid under the BCP only if a corresponding monthly annuity or death benefit is paid from the Defined Benefit Plan to the extent permitted by IRC Section 415(b) and the Retirement Code. At December 31, 2006, there were 9 members in the BCP.

(2) Summary of Significant Accounting Policies

(a) Basis of Accounting

The financial statements of the System are prepared on the accrual basis of accounting under which expenses are recorded when the liability is incurred, revenues are recorded in the accounting period in which they are earned and become measurable, and investment purchases and sales are recorded as of their trade date. Member and employer contributions are based on when member salaries are earned and are recognized when due, pursuant to statutory requirements and formal commitments. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

(b) Use of Estimates

Management of the System has made certain estimates and assumptions relating to the reporting of assets and liabilities, and the disclosure of contingent assets and liabilities, to prepare these financial statements in conformity with accounting principles generally accepted in the United States of America. Actual results could differ from those estimates.

Investments in venture capital, alternative investments, and real estate are generally illiquid. Because of the inherent uncertainty in valuing privately held securities, the fair value may differ from the values that would have been used had a ready market for such securities existed, and the difference can be material. Accordingly, the realized value received upon the sale of the asset may differ from the fair value.

(c) Investments

The System's investments are reported at fair value. Fair value is the amount that a plan can reasonably expect to receive for an investment in a current sale between a willing buyer and a willing seller – that is, other than in a forced or liquidation sale. The investments in short-term investment funds, including those managed by the Treasurer of the Commonwealth of Pennsylvania, are reported at cost plus allocated interest, which approximates fair value. The security lending collateral pool, which is a fund operated by the securities lending agent, also is accounted for at cost plus accrued interest, which approximates fair value. U.S. government obligations, corporate and foreign bonds and notes, and common and preferred stocks, are generally valued based on published market prices and quotations from national security exchanges and securities pricing services. Securities that are not traded on a national security exchange are valued by the asset manager or third parties based on similar sales. The System has entered into certain swap contracts with a notional amount equivalent to the System's original investment in the absolute return fund-of-funds and global macro limited partnerships to provide S&P 500 returns, Russell small / midcap, and Morgan Stanley's Europe, Australasia, and Far East (EAFE) indices returns. The combination of the swaps and the underlying investments are designed to provide a return consistent with an investment in those respective indices. Accordingly, those investments have been classified as common and preferred stocks on the statement of net assets. Real estate is primarily valued based on independent appraisals performed by independent appraisers or, for properties not appraised, at the present value of the projected future net income stream. Alternative investments, which include interests in limited partnerships invested in venture capital, leveraged buyouts, private equities, and other investments are valued based on estimated fair value amounts established by valuation committees, which are subject to an annual independent audit. Foreign exchange and futures contracts are marked-to-market daily with changes in fair value recognized as part of investments and investment income. The fair value of swaps are determined no less than monthly based on the return of the underlying indices, which is generally exchanged for a short-term rate plus a spread.

The collective trust funds (CTF) consist primarily of domestic and international institutional mutual and index funds. The funds do not pay interest or dividends to shareholders, and reinvest all income earned on securities held by the fund. The fair value of CTF is based on the reported share value of the respective fund.

Unsettled investment sales are reported as investment proceeds receivable and unsettled investment purchases are reported as investment purchases payable. Investment expenses consist of investment managers' fees and those expenses directly related to the System's investment operations.

(d) Commitments

As of December 31, 2006 and 2005, the System had contractual commitments totaling approximately $3.7 billion and $3.0 billion, respectively, to fund future alternative investments, and $548 million and $236 million, respectively, to fund future real estate investments.

(e) Compensated Absences

The System accrues a liability for vacation leave as the benefits are earned by the employees to the extent the System will compensate the employee for the benefits through paid time off or some other means, such as cash payments at termination or retirement. Vacation leave vests 100% at the time it is earned up to 45 days, which is carried over to the next year at December 31. The System also accrues a liability for sick leave as the benefits are earned by the employees to the extent the System will compensate the employee for the benefits through cash payments at termination or retirement. Retiring employees of the System that meet service, age, or disability requirements are paid between 30% and 100% of sick days available at retirement, up to 163 maximum days. As of December 31, 2006 and 2005, $2.8 million and $2.6 million, respectively, was accrued for unused vacation and sick leave for System employees.

(f) Federal Income Taxes

Management believes the System meets the definition of a Governmental Plan. In the System's communications with the Internal Revenue Service (IRS), it has been treated as a qualified plan, and is, therefore, considered exempt from federal income taxes. Therefore, the System has not requested a determination letter from the IRS relating to the status of the System under the Internal Revenue Code.

(g) Risk Management

The System is exposed to various liabilities and risks of loss related to theft or destruction of assets, injuries to employees, and court challenges to fiduciary decisions. As an administrative agency of the Commonwealth, the System is accorded sovereign immunity. The System participates in certain Commonwealth pooled insurance programs and requires asset managers to carry certain insurance coverage. Purchased insurance for director and officer liability was effective until January 14, 2004. Since that time the System has elected self-insurance for fiduciary and director and officer liability. During the past three fiscal years, insurance settlements did not exceed insurance coverage.

(3) Description of Funds

The Retirement Code requires the System to maintain the following funds representing the net assets held for future and current benefit payments:

The *Member Savings Account* accumulates contributions and interest earnings of active employees. Member balances are transferred to the Annuity Reserve Accounts as members retire.

The *State Accumulation Account* accumulates contributions of the employer and the net earnings of the fund. Funds are transferred to the Annuity Reserve Accounts as members retire. The amount transferred is determined actuarially.

The *Supplemental Annuity Account* accumulates contributions for supplemental annuities. The negative balances represent the liability for past cost of living adjustments that are being amortized to actuarial required contributions. The balance in this account is actuarially determined.

The *Annuity Reserve Accounts* are the accounts from which all death and retirement benefits and supplemental annuities are paid. The balance in this account is actuarially determined.

The *Interest Reserve Account* accumulates all income earned by the fund and from which all administrative and investment expenses incurred by the fund and the Board necessary for operation of the System are paid. Any balance in this reserve is transferred to the State Accumulation Account at year-end.

The *Benefit Completion Plan (BCP) Reserve Account* accumulates all BCP employer contributions, net earnings of the fund less any benefits paid out of the fund.

(Dollar Amounts in Thousands)

Fund balances at December 31, 2006 and 2005 are listed in the below table.

Funds

	2006	2005
Members Savings Account	$3,916,841	3,696,477
State Accumulation Account	14,960,940	12,607,133
Supplemental Annuity Account	(1,173,628)	(1,333,961)
Annuity Reserve Accounts:		
Annuitants and Beneficiaries	12,992,383	12,485,799
State Police	1,310,797	1,250,195
Enforcement Officers	41,780	43,369
Benefit Completion Plan Reserve Account	3,717	2,859
Total	**$32,052,830**	**28,751,871**

(4) Investments

As provided by statute, the System's Board has exclusive control and management responsibility of System funds and full power to invest the funds. In exercising its fiduciary responsibility to System membership, the Board is governed by the "prudent investor" rule in establishing investment policy. The "prudent investor" rule, requires the exercise of that degree of judgement, skill and care under the circumstances then prevailing which persons of prudence, discretion and intelligence, who are familiar with such matters, exercise in the management of their own affairs not in regard to speculation, but in regard to permanent disposition of the funds, considering the probable income to be derived therefrom, as well as the probable safety of their capital. The Board has adopted its Statement of Investment Policy to formally document investment objectives and responsibilities. This policy, as well as applicable state law, establishes guidelines for permissible investments of the System.

The System has investments that are subject to various risks. Among these risks are custodial credit risk, credit risk, interest rate risk, and foreign currency risk. Each one of these risks is discussed in more detail below.

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the System would not be able to recover the value of investment or collateral securities that are in the possession of an outside party. Pursuant to Title 71, Pennsylvania Consolidated Statutes Section 5931 [c], the State Treasurer serves as custodian of the fund. In accordance with a contractual relationship between the Commonwealth's Treasury Department and its custodial agent, substantially all investments, where securities are used as evidence of the investment, are held by the custodian in book-entry form in the System's name. Those investments are defined as insured or registered investments for which the securities are held by the System or its agent and, therefore, have very minimal level of custodial credit risk losses. All remaining investments do not have securities that are used as evidence of the investments. These investments are primarily in collective trust funds and limited partnerships, which include real estate, alternative investments, and absolute return fund-of-funds.

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The credit risk of a debt instrument is measured by nationally recognized statistical rating agencies such as Moody's Investors Services (Moody's). As directed by the System's investment policy, each year the Board approves an Annual Five-Year Investment Plan. This plan manages the overall credit risk of the fixed income asset class through a clearly defined long-term asset allocation policy, which established a long-term target allocation to the fixed income asset class at 24% of the Fund. Of the 24% allocation, 15% of the Fund will be allocated to a core segment of the fixed income asset class and composed of investment grade, relatively liquid public domestic securities. These securities will be comprised of two components: a) intermediate duration, and b) longer duration strategies based on the Lehman Aggregate Index. In addition to the core segment, the system will also allocate fixed income investments to a high yield segment. The high yield segment is composed primarily of less liquid, public and private securities and has a target allocation of 5% of the Fund. The high yield component will focus on debt instruments offering higher return premiums and different risk characteristics than traditional core fixed income securities. The fixed income class also has dedicated a 4% allocation of the fund to emerging market debt. Emerging market debt investments are made using dollar denominated sovereign debt as well as local currency sovereign and corporate debt. For securities exposed to credit risk in the fixed income portfolio, the following table discloses aggregate fair value, by major Moody's credit quality rating category at December 31, 2006 and 2005:

Notes to Financial Statements
December 31, 2006 and 2005
(Dollar Amounts in Thousands)

Fixed Income Securities Exposed to Credit Risk

Moody's Rating[a]	2006 Fair Value	2005 Fair Value
AGY[b]	$457,369	538,272
AAA	607,179	479,429
AA	73,426	82,075
A	192,881	180,486
BAA	362,952	466,378
BA	676,537	859,625
B	703,816	573,491
CAA	149,795	136,521
CA	3,575	10,320
C	1,963	1,201
D	3,662	—
NA[c]	149,871	237,573
S-T Mkt Neutral and STIF[d]	573,698	1,192,355
Total	**$3,956,724**	**4,757,726**

a. *The Moody's rating represents all of the securities that fall within subcategories of the ratings shown in this table. For example, a security with a rating of Ba1 is shown as a rating of BA in this table.*

b. *AGY rating is assigned to securities issued by privately owned government sponsored enterprises (GSEs) such as Federal National Mortgage Association (Fannie Mae), Federal Home Loan Bank Corporation (Freddie Mac) and several other entities that do not have a Moody's rating. Although created by Congress as a publicly chartered entity, GSE issued securities are not U.S backed government securities and, therefore, subject to credit risk.*

c. *NA represents securities that were either not rated by Moody's, or had a withdrawn rating. NA also includes the market value of certain swaps, which by nature do not have credit quality ratings. See footnote (6) for additional information regarding the nature of these swap agreements.*

d. *STIF represents investments in the Commonwealth Treasury Department's Short-Term Investment Fund. This fund is comprised of short-term, investment grade securities, which are mainly US Treasuries, agencies, or repurchase agreements. Also included are cash and cash equivalents of the System's Market Neutral investment strategy. Those investments represent deposits for short sales and cash collateral and are invested primarily in U.S. Treasuries.*

U.S. Treasuries with a fair value of $1.9 billion and $2.2 billion as of December 31, 2006 and 2005, respectively, were not included in the above table because they are not subject to credit risk.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. As a means for limiting the System's exposure to fair value losses arising from rising interest rates, the System's' long-term asset allocation policy diversifies its fixed income core segment between intermediate duration and longer duration strategies based on the Lehman Aggregate Index. Duration is a measure of an investment's sensitivity to changes in interest rates. The higher the duration, the greater the changes in fair value when interest rates change. The System measures interest rate risk using option adjusted duration, which considers the effect of a security's embedded options on cash flows. At December 31, 2006 and 2005 the System's fixed income portfolio had the option-adjusted durations by fixed income sector shown in the table on the next page.

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. As part of the System's program to manage risk and enhance returns, the System invests in global markets. As provided in the System's Annual Five-Year Investment Plan, the System's contracts with certain advisors to overlay foreign currency exposure in the international equity asset class by entering into foreign exchange contracts to hedge foreign currency exposure. At December 31, 2006 and 2005, the System had the currency exposures listed in the tables starting on the next page.

(5) Securities Lending

In accordance with a contract between the Commonwealth's Treasurer and its custodian, the System participates in a securities lending program. State statutes neither specifically authorize nor prohibit the lending of the System's securities.

The custodian, acting as lending agent, lends the System's equity, debt, and money market securities for cash, securities, or letter-of-credit collateral. Collateral is required at 102% of the fair value of the securities loaned except for

Notes to Financial Statements
December 31, 2006 and 2005
(Dollar Amounts in Thousands)

Fixed Income Portfolio Option-Adjusted Durations

	2006		2005	
Fixed Income Sector	Fair Value	Option-Adjusted Duration	Fair Value	Option-Adjusted Duration
Agencies	$201,960	2.2	$199,888	2.3
Asset Backed Securities	332,130	1.0	345,688	1.2
CMBS and CMO	294,246	1.4	93,839	2.5
Corporates	1,290,576	3.3	1,147,058	3.2
Government	1,898,745	4.2	2,235,217	3.7
Sovereign Debt	561,376	5.6	900,040	6.2
U.S. Govt Mortgages	256,225	2.8	356,185	2.4
U.S. Private Placements	345,986	3.9	310,856	3.0
S-T Mkt Neutral and STIF	573,698	0.1	1,192,355	0.1
Other Investments[a]	97,019	N / A	210,746	N / A
Total Fixed Income and STIF	**$5,851,961**		**$6,991,872**	

[a] *Other Investments represents certain securities with maturities ranging through the year 2046 and the value of swap agreements as of December 31.*

Foreign Currency Exposures 2006

Currency	Short Term Investments[a]	Fixed Income	Equity	Real Estate	Alternative Investments	Total
Euro Currency Unit	$35,573	8,630	1,292,941	52,434	165,942	1,555,520
British Pound Sterling	(707)	-	918,534	64,835	-	982,662
Japanese Yen	(1,486)	-	735,881	61,299	-	795,694
Hong Kong Dollar	1,158	-	314,094	35,942	-	351,194
Swiss Franc	(607)	-	340,506	-	-	339,899
South Korean Won	(559)	-	213,389	-	-	212,830
Australian Dollar	(141)	-	101,932	56,959	-	158,750
Swedish Krona	(364)	-	122,224	5,019	-	126,879
Singapore Dollar	365	-	82,377	10,249	-	92,991
New Taiwan Dollar	1,274	-	88,684	-	-	89,958
Norwegian Krone	3,280	-	81,396	2,444	-	87,120
S African Comm Rand	2,429	-	52,853	-		55,282
Brazil Real	467	730	49,011	-	-	50,208
Canadian Dollar	17	3,568	25,197	13,086	-	41,868
Mexican New Peso	137	3,186	36,035	-	-	39,358
Danish Krone	144	-	38,748	-	-	38,892
Indian Rupee	2,147	-	33,692	-	-	35,839
Malaysian Ringgit	44	-	27,785	-	-	27,829
Thailand Baht	53	-	22,401	-	-	22,454
Other Currencies (13)	1,019	-	87,705	-	1	88,725
Total	**$44,243**	**16,114**	**4,665,385**	**302,267**	**165,943**	**5,193,952**

[a] *Includes receivables and payables as of December 31, for securities sold and purchased.*

Notes to Financial Statements
December 31, 2006 and 2005
(Dollar Amounts in Thousands)

Foreign Currency Exposures 2005

Currency	Short Term Investments[a]	Fixed Income	Equity	Real Estate	Alternative Investments	Total
Euro Currency Unit	$(2,741)	10,791	1,340,076	12,674	101,556	1,462,356
British Pound Sterling	(4,030)	-	1,004,709	5,220	2,111	1,008,010
Japanese Yen	(12,930)	-	978,616	14,519	-	980,205
Swiss Franc	(1,384)	-	313,184	-	-	311,800
South Korean Won	(98)	-	225,206	-	-	225,108
Hong Kong Dollar	(3,657)	-	124,840	3,998	-	125,181
Swedish Krona	(102)	-	116,759	-	-	116,657
New Taiwan Dollar	936	-	97,622	-	-	98,558
Australian Dollar	1,070	-	77,706	-	-	78,776
Danish Krone	-	-	66,871	-	-	66,871
S African Comm Rand	258	-	60,333	-	-	60,591
Singapore Dollar	(1,100)	-	56,767	1,034	-	56,701
Brazil Real	945	-	54,478	-	-	55,423
Norwegian Krone	(263)	-	49,134	-	-	48,871
Thailand Baht	14	-	38,190	-	-	38,204
New Turkish Lira	55	-	25,832	-	-	25,887
Mexican New Peso	26	-	25,303	-	-	25,329
Indian Rupee	196	-	25,128	-	-	25,324
Other Currencies (11)	979	2,210	116,576	-	-	119,765
Total	**$(21,826)**	**13,001**	**4,797,330**	**37,445**	**103,667**	**4,929,617**

[a] *Includes receivables and payables as of December 31, for securities sold and purchased.*

the equity securities of non-U.S. corporations, for which collateral of 105% is required. Collateral is marked-to-market daily. If the collateral falls below guidelines for the fair value of the securities loaned, additional collateral is obtained. Cash collateral is invested by the lending agent in accordance with investment guidelines approved by the Board. The lending agent cannot pledge or sell securities collateral unless the borrower defaults.

As of December 31, 2006 and 2005, the System's credit exposure to individual borrowers was limited because the amounts the System owed the borrowers exceeded the amounts the borrowers owed the System. The Treasurer's contract with the lending agent requires the agent to indemnify the System if the borrowers fail to return the underlying securities and the collateral is inadequate to replace the loaned securities or if the borrowers fail to pay income distributions on the loaned securities.

All loaned securities at December 31, 2006 and 2005 could be terminated on demand by either the lending agent or the borrower. Cash collateral is invested, together with the cash collateral on loaned securities of other Commonwealth entities, in a short-term collective investment pool. The duration of the investments in the pool at December 31, 2006 and 2005 was 31 days and 25 days, respectively. The relationship between the average maturities of the investment pool and the System's loans is affected by the maturities of the loans made by other entities in the investment pool. In addition, the interest rate risk posed by mismatched maturities is affected by other program features, such as the lending agent's ability to reallocate loaned securities among all of its lending customers.

As of December 31, 2006 and 2005, the fair value of loaned securities was $3.3 billion for each year; the fair value of the associated collateral was $3.4 billion for each year, of which $3.2 billion and $3.1 billion was cash, respectively. The securities lending collateral pool is not categorized because securities are not used as evidence of the investment.

Notes to Financial Statements
December 31, 2006 and 2005
(Dollar Amounts in Thousands)

(6) Derivative and Structured Financial Instruments and Restricted Assets

The System enters into certain derivative and structured financial instruments primarily to enhance the performance and reduce the volatility of its portfolio. It enters into foreign exchange contracts and foreign currency options contracts to hedge foreign currency exposure, futures contracts to gain or hedge exposure to certain equity markets and to manage interest rate risk, and swaps to gain equity exposure on its absolute return fund-of-funds investments, as well as hedge against the effects of inflation.

Foreign exchange contracts are agreements to exchange the currency of one country for the currency of another country at an agreed-upon price and settlement date. The System uses these contracts primarily to hedge the currency exposure of its international investments. To reduce the risk of counterparty nonperformance, the System generally enters into these contracts with institutions regarded as meeting high standards of credit worthiness. The unrealized gain / loss on contracts is included in the System's net assets and represents the fair value of the contracts on December 31. At December 31, 2006 and 2005, the System's contracts to purchase and sell by major foreign currencies were as listed in the below table.

Foreign Exchange Contracts

Contracts as of December 31, 2006

Currency	Purchases	Unrealized Gain/(Loss)	Sells	Unrealized Gain/(Loss)
Japanese Yen	$2,035,285	(99,167)	2,926,774	106,071
Euro Currency Unit	1,494,543	34,171	1,627,684	(49,116)
British Pound Sterling	979,649	36,015	1,101,384	(46,925)
Swiss Franc	607,661	(2,890)	712,462	(3,192)
Swedish Krona	110,668	5,054	121,841	(6,957)
Australian Dollar	76,156	2,271	87,091	(3,893)
Other	6,390	34	8,203	(34)
Total	**$5,310,352**	**(24,512)**	**6,585,439**	**(4,046)**

Contracts as of December 31, 2005

Currency	Purchases	Unrealized Gain/(Loss)	Sells	Unrealized Gain/(Loss)
Japanese Yen	$1,410,659	(90,722)	1,992,241	132,658
Euro Currency Unit	1,222,845	(30,204)	2,124,291	43,857
British Pound Sterling	714,559	(23,850)	971,482	22,779
Swiss Franc	352,716	(15,309)	565,176	18,227
Swedish Krona	133,593	(2,879)	178,620	2,687
Australian Dollar	85,128	(3,197)	140,869	3,048
Other	3,732	25	8,740	(61)
Total	**$3,923,232**	**(166,136)**	**5,981,419**	**223,195**

Notes to Financial Statements
December 31, 2006 and 2005
(Dollar Amounts in Thousands)

Futures contracts are standardized, exchange-traded contracts to purchase or sell a specific financial instrument at a predetermined price. Gains and losses on futures contracts are settled daily based on a notional (underlying) principal value and do not involve an actual transfer of the specific instrument. Because of daily settlement, the futures contracts have no fair value.

The System has entered into certain futures contracts maturing through June 15, 2009. The notional value of these contracts at December 31, 2006 and 2005 is listed below.

The exchange on which futures contracts are traded assumes the counterparty risk and generally requires margin payments to minimize such risk. The System pledges investment securities to provide the initial margin requirements on the futures contracts it buys. In addition to that collateral, the System also pledges securities for sales of securities that it does not presently own (short sales). The System enters into those short sales to neutralize the market risk of certain equity positions.

Swap agreements provide for periodic payments between parties based on the change in value of underlying assets, indexes, rates and credit worthiness. During 2006 and 2005, the System entered into commodity swaps, S&P 500 total return swaps, Russell 2000 swaps, MSCI-EAFE swaps, credit default swaps, and interest rate swaps. Under the commodity swap arrangement, the System receives the net return of the Goldman Sachs Commodity Index from the swap counterparty in return for a spread, which it pays to the counterparty. The commodity swaps are used as an inflation hedge and settle on a monthly basis. The S&P 500 total return swaps, Russell 2000 swaps, and MSCI-EAFE swaps are used to gain equity exposure on its absolute return fund-of-funds and global macro investments. Under those arrangements, the System receives the net return of the respective equity indices in exchange for a short-term rate plus a spread. The System uses multiple contracts with counterparties as well as collateral posting requirements to manage its credit risk. The contracts have varying maturity dates ranging from March 16, 2007 through December 17, 2007. Credit default swaps are agreements with counterparties to either purchase or sell credit protection. The System's advisors use credit default swaps to either increase or decrease credit exposure to certain credit markets. Interest rate swaps are over-the-counter contracts that allow counterparties to exchange a fixed rate liability for a floating rate liability. The System uses interest rate swaps as the most cost-effective way of gaining exposure to certain sectors of the fixed income market. The below table presents the System's swap exposure at December 31.

Futures Contracts

	2006		2005	
	Buy Contracts	Sell Contracts	Buy Contracts	Sell Contracts
Treasury Futures	$236,184	28,972	52,851	86,589
S&P 500 Futures	-	-	319,347	-
Eurodollar Futures	168,337	142,155	-	-

Swap Exposure

	Notional Value		Receivable/(Payable)	
	2006	2005	2006	2005
S&P 500 Total Return Index	$5,493,078	5,343,776	440,484	125,321
MSCI EAFE Index	2,451,978	-	97,293	-
Goldman Sachs Commodity Index	1,595,177	1,438,123	(117,788)	35,287
Russell 2000 Index	498,704	392,236	(500)	-
Interest Rate	22,550	11,000	867	-
Credit Default	239,200	8,900	1,577	152

Notes to Financial Statements
December 31, 2006 and 2005
(Dollar Amounts in Thousands)

The System mitigates its legal risk on investment holdings, including the previously discussed instruments, by carefully selecting portfolio managers and extensively reviewing their documentation. It manages its exposure to market risk within risk limits set by management.

The System also indirectly holds foreign exchange contracts, futures contracts, and certain swap contracts through its investments in collective trust funds. Those collective trust funds invest in those instruments directly, and indirectly (through a securities lending collateral pool), to hedge foreign exchange exposure, to synthetically create equity-like returns, and to manage interest rate risk by altering the average life of the portfolio.

(7) Commission Recapture Program

The System has commission recapture contracts with several brokers. These contracts generally stipulate that the brokers rebate a percentage of commissions earned on investments directly to the System. During the years ended December 31, 2006 and 2005, the System earned $310 and $714 of benefits resulting from a commission recapture program, respectively. No expenditures were paid from the program in 2006. In 2005, the System used the program to pay approximately $46 of consulting, advisory, and other expenditures. At December 31, 2006 and 2005, the System has accumulated $3,176 and $2,865, respectively, that are available for future expenditures.

(8) Pension Plan for Employees of the System

The System also makes employer contributions. The System's employees' contribution requirements and benefits are described in Note 1 to these financial statements. The System's contributions for the years ended December 31, 2006 and 2005 were $291, and $186, respectively, which were equal to the required contributions each year.

(9) Litigation and Contingencies

The System is involved in various individual lawsuits, generally related to benefit payments, which, if settled adversely, could increase estimated actuarial liabilities by approximately $1 billion. Some of the individual cases involve legal issues that, if extended to the entire membership, may result in significant costs to the System. If such an event were to occur, the additional costs would be recovered by the System through adjustments to the employer contribution rate.

This information is an integral part of the accompanying financial statements.

Required Supplementary Information
(Unaudited)

Schedule1
Schedule of Funding Progress
(Dollar Amounts in Millions)

Actuarial Valuation Year	Actuarial Value of Assets	Actuarial Accrued Liabilities (AAL)	Unfunded Actuarial Accrued Liabilities (UAAL)	Ratio of Assets to AAL	Covered Payroll	UAAL As a Percentage of Covered Payroll
2006	$28,149	30,365	2,216	92.7%	$5,662	39.1%
2005	26,794	28,852	2,058	92.9	5,138	40.1
2004	26,900	27,999	1,099	96.1	5,094	21.6
2003	27,466	26,180	(1,286)	104.9	4,965	(25.9)
2002	27,498	25,650	(1,848)	107.2	5,093	(36.3)
2001	27,505	23,659	(3,846)	116.3	4,872	(78.9)

Schedule 2
Schedule of Employer Contributions
(Dollar Amounts in Thousands)

Year Ended December 31,	Annual Required Contributions	Percentage Contributed
2006	$548,745	35.6%
2005	319,190	46.1
2004	105,229	100.0
2003	55,079	123.4
2002	22,906	221.9
2001	52,104	147.2

During the years 2004, 2003, and 2002, actual contributions exceeded the Annual Required Contributions (ARC). For the period July 1, 2001 through June 30, 2003 the ARC was set at zero. However, the System required payment from certain agencies that provided age 50 retirement and from special classes for payment for past liabilities for retro-active benefit enhancements. Collection of those amounts resulted in the actual contributions exceeding the ARC.

See accompanying notes to required supplementary schedules of funding progress and employer contributions.

Notes to Required Supplementary Schedules
December 31, 2006 and 2005

Actuarial Information as of the Latest Actuarial Valuation

Valuation date	December 31, 2006
Actuarial cost method (b)	Variation of entry age actuarial cost method
Amortization method (a)	10 year and 30 year schedules with level payments
Remaining amortization period (a)	7-30 years, closed
Asset valuation method	5-year smoothed market
Actuarial assumptions:	
Investment rates of return (c)	8.5%
Projected salary increases (c)	4.9% - 20.2%, average of 7.1%
Cost-of-living adjustments (d)	As described below

GASB 25 establishes a range of actuarial cost and amortization methods for the Unfunded Actuarial Accrued Liability. The scheduled payments for the year beginning July 1, 2005 are below the minimum amount required to meet the GASB 25 minimum. This is a temporary result of financing implemented by Act 2003-40 in December 2003. After 2011, the employer contribution is expected to exceed the GASB 25 minimum.

(a) The December 31, 2001 valuation included the effect of Act 9, which increased the actuarial accrued liabilities by approximately $2.7 billion. Act 2003-40 revised the amortization method and remaining amortization periods as discussed in footnote 1(c) to the audited financial statements.

(b) A variation of the entry-age normal actuarial cost method is used to determine the liabilities and costs related to all of the System's benefits including superannuation, withdrawal, death and disability benefits. The significant difference between the method used for the System and the typical entry-age normal actuarial cost method is that the normal cost is based on the benefits and contributions for new employees rather than for all current employees from their date of entry. This variation should produce approximately the same results as the typical method over the long run.

(c) Includes inflation at 3%.

(d) Information presented in the required supplementary schedules was determined as part of the actuarial valuation at the dates indicated. The effects of COLAs granted to annuitants were included in the respective valuations as presented in the table below:

Effects of COLAs

Valuation Year	Effective Retirement Date	COLA Range (based on date of retirement)	Effective Date of COLA	Increase to Actuarial Accrued Liabilities
2002	Between July 2, 1990 and July 1, 2002	2.271% - 9.0%	July 1, 2003	$396 million
2002	On or before July 1, 1990	8.0 - 25.0	July 1, 2002	257 million
1997	On or before june 30, 1997	1.86 - 25.0	July 1, 1998	478 million

Additional Financial Information
December 31, 2006

Schedule of Administrative Expenses

Personnel services:		
Salaries	$10,122	
Benefits	4,070	
Temporary personnel wages, overtime, and outservice training	168	
Total personnel services		$14,360
Professional services:		
Consultant fees	2,250	
Consultant contractual services vendor provided	752	
Commonwealth Central services	625	
Consultant services EDP	409	
Treasury Department services	923	
Legal fees	45	
Total professional services		5,004
Rentals:		
Real estate rent	1,557	
Other equipment rental	225	
Total rentals		1,782
Communication:		
Postage	644	
Telephone	400	
Printing and advertising	108	
Total communication		1,152
Other expenses:		
EDP Software	639	
Supplies	480	
Travel and conferences	212	
EDP and office equipment	115	
Subscriptions and memberships	48	
Maintenance	76	
Total other expenses		1,570
Total administrative expenses		**$23,868**

Additional Financial Information
Summary of Investment Expenses and Consulting Fees
December 31, 2006

Investment Expenses

	Fees
Investment manager fees:	
Stocks	$141,968
Alternative investments	93,138
Real estate	22,826
Fixed income	19,666
Commodities	7,466
Total investment manager fees	285,064
Investment Related Expenses:	
Alternative investments	6,710
Real estate	5,909
Custodial	148
Other	373
Total investment related fees	13,140
Total investment expenses	**$298,204**

Consulting Fees

Firm	Category	Fees
Cambridge Associates, LLC	Private Equity	$1,083
Rocaton Investments Advisors, LLC	General Consultant	447
Hay Goup Inc.	Actuary	309
The Townsend Group	Real Estate	224
Institutional Shareholder Services	Proxy Services	103
Other		84
Total consulting fees		**$2,250**

Investment Section

Report on Investment Activity

Peter M. Gilbert
Chief Investment Officer

June 2007

Dear Members:

I am pleased to present the results of the investment operations for SERS for the calendar year 2006. The data contained in the Investment Section was compiled in conjunction with SERS investment, financial reporting and auditing staff; consultants Rocaton Investment Advisors, Cambridge Associates and the Townsend Group, and our custodian, Mellon Trust.

The SERS Investment Office, in conjunction with the Fund's three consultants, performs a review of the asset allocation annually, recommending modifications to asset classes and future allocations as appropriate. The recommendations are reviewed by the Board and, if it concurs, adopted. The asset allocation decisions are among the most important decisions the Board makes in striving to achieve the Fund's investment objectives. The Fund invests in a broad range of diversified asset classes and strategies. Review of the Investment Summary in the following pages will reveal the diversification of both asset classes and investment manager styles. Some highlights of the investment program during 2006 follow.

The investment return for the Total Fund for 2006 was 16.4%. The 2006 performance ranked SERS among the top public pension funds nationwide for the year. The lion's share of the 2006 return was attributable to the asset allocation policy in place during the year. The 16.4% return followed on the heels of the 14.5% return in 2006, the 15.1% return in 2004 and the 24.3% return in 2003. The annualized return of the Fund for these four years was 17.5%. This represents earnings over two times the 8.5% assumed rate used to determine employer contributions. Performance was calculated using the Modified Dietz day weighted return methodology.

As always, the performance across asset classes was mixed. The success achieved in 2006 is the result of a combination of traditional domestic and international stock asset classes as well as alternative asset class returns. The asset classes driving 2006 performance were Domestic Stocks 18.8%, International Stocks 26.7%, Private Equity 23.2% and Real Estate 17.6%.

Longer term, SERS' ten year performance was 10.2%, placing SERS in the top quartile of a universe of large public pension funds. This 10.2% return handily exceeded the actuarial return assumption of 8.5%. This superior long-term performance contributed significantly to reducing employer contributions to the statutorily required floor of 4.0%, well below the 8.21% normal employer contribution rate. In addition, these strong returns helped to maintain the well-funded status of the Fund.

Fund assets climbed to $32.1 billion at year-end, achieving an all-time high for the Fund. The success of the program can be attributed to the Board's establishment of the Fund's broadly diversified investment structure.

SERS continues to invest in the Commonwealth of Pennsylvania, providing funding for investments that have a positive impact on the economy of the State. In aggregate, the Fund had $1.4 billion, or 4.6% of the Total Fund, invested in Pennsylvania. Those investments include U.S. stocks, fixed income, real estate, venture capital and private equity asset classes.

During 2006, three new initiatives were included in the Fund structure: adding a dedicated allocation to global stocks, equal weighting domestic and international stocks to gain a more global stock structure overall and replacing the international stock regional strategy with portable alpha. In addition to these new assignments, the Board committed funds to real estate, and numerous new venture capital and private equity partnerships.

Most importantly, the growth and changes to the Fund were managed in accordance with the investment policy and objectives set out by the Board, operating as fiduciaries in the sole interest of the beneficiaries and members of the Fund. The primary investment objective is to assure the adequate accumulation of reserves in the Fund at the least cost to the citizens of the Commonwealth while preserving the principal of the Fund against erosion from inflation. The objectives further state that the Board seeks to meet these objectives within acceptable risk parameters through adherence to the aforementioned policy of diversification of investments by type, industry, investment manager style and geographic location. As a long–term investor, this concept of diversification is key, as it allows the Fund to achieve its return objectives while at the same time controlling risk.

SERS has achieved outstanding investment returns over the past decade and, in particular, during the past four years. When returns have been so strong for such an extended period, there can emerge a tendency to anticipate a continuation of above-normal returns and to underestimate risk going forward. Markets tend to be cyclical; unfortunately, good times do not last forever. The last time the financial markets had five great years in a row was immediately followed by three miserable years of the longest and deepest market correction since the Great Depression of the 1930s.

Although the markets seem priced to perfection at the moment with tight credit spreads and reasonable price to earnings ratios based on continued strong corporate profits, we still live in a world capable of unpleasant surprises. There is a lot that could go wrong: we continue to have record twin budget and current account deficits, the wars in Afghanistan and Iraq persist, the risk of terrorism remains, energy costs continue to climb as we are dependent on middle east suppliers, and much of our debt is financed abroad. But more often than not, market disrupting surprises can come from unexpected sources.

SERS' Investment Office continuously monitors economic and market events and works to position the Fund through broad diversification to be in a position to perform well under a wide variety of economic scenarios. Under the supervision and guidance of the Board, the Fund is well positioned to ensure that SERS' members receive the financial security that they have earned and that is due them.

Sincerely,

Peter M. Gilbert
Chief Investment Officer

Investment Policy

The State Employees' Retirement Board originally adopted a formal Statement of Investment Policy in 1979. It has been revised periodically, principally to reflect and incorporate legislative changes governing investments. The latest Statement of Investment Policy was adopted in 2004. The purpose of the statement is to formalize the Board's investment objectives, policies, and procedures: to establish guidelines for the investment of Fund assets, and to define the duties and responsibilities of the various entities involved in the investment process. The major elements of the statement are:

- As fiduciaries, the Board will exercise that degree of judgment, skill and care under the circumstances then prevailing which persons of prudence, discretion and intelligence, who are familiar with such matters, exercise in the management of their own affairs in investment matters;
- The Fund's overall investment objective is to provide a total rate of return, over full economic cycles, which exceeds the return of a fully diversified market portfolio within each asset class. The Board seeks to meet this objective within acceptable risk parameters through adherence to a policy of diversification of investments by type, industry, quality and geographic location;
- The Board employs an investment staff and also contracts with investment advisors and consultants to provide expert, professional judgment in all investment decisions;
- An annual Investment Plan is prepared to control the allocation of funds during the year among investment advisors and categories of assets;
- Guidelines are established for each category of assets used by the Fund's investment advisors to provide a framework for monitoring quality, diversification and liquidity; and
- Where investment characteristics, including yield, risk and liquidity, are equivalent, the Board's policy favors investments which have a positive impact on the economy of Pennsylvania.

Investment Objectives

To assure an adequate accumulation of reserves in the Fund at the least cost to the citizens of the Commonwealth and to provide some protection against the erosion of principal by inflation, the long–term investment objectives of the Fund, are:

- Achieve a net total return equivalent to the actuarial return assumption, or preferably in excess of this rate in order to improve the funded ratio of the Fund through investment earnings.
- Achieve in Global Stocks a total return that exceeds the total return of the MSCI World Index;
- Achieve in Domestic Stocks a total return that exceeds the total return of the Russell 3000 Index;
- Achieve in International Stocks a total return that exceeds the total return of the SERS Custom International Stock Benchmark;
- Achieve in the Fixed Income asset class a total return that exceeds the total return of the SERS Fixed Income Custom Benchmark;
- Achieve in Inflation Protection a total return that exceeds the total return of the SERS Inflation Protection Custom Benchmark;
- Achieve in the Equity Real Estate asset class a total return that exceeds the total return of the Townsend Stylized Benchmark;
- Achieve in the Cash asset class a total return that exceeds the total return on U.S. Treasury Bills (90 days);
- Achieve in the Venture Capital asset class a total return that exceeds the Cambridge Venture Capital Benchmark;
- Achieve in the Private Equity asset class a total return that exceeds the Cambridge Private Equity Benchmark.

Total return includes income and both realized and unrealized gains and losses and is computed on market value. The Board seeks to meet these objectives within acceptable risk parameters through adherence to a policy of diversification of investments by type, industry, investment manager style and geographic location.

Investment Results

Schedule of Portfolio Returns* After Fees

For the period ending December 31, 2006

Asset Class	1 Year Total Return	3 Year Total Return	5 Year Total Return	10 Year Total Return
Domestic Stocks	18.8%	13.6	9.3	9.6
Russell 3000 Index[a.]	*15.7*	*11.2*	*7.2*	*8.5*
International Stocks	26.7	22.2	16.7	10.8
SERS Custom International Stock Benchmark (26% Hedged)[b.]	*28.2*	*23.6*	*17.6*	*9.1*
Fixed Income	7.7	6.7	7.9	7.1
SERS Fixed Income Custom Benchmark	*7.6*	*5.8*	*7.1*	*6.4*
Cash	4.9	3.2	2.7	3.9
90 day U.S. T–bills	*4.9*	*3.1*	*2.4*	*3.8*
Real Estate[c.]	17.6	20.8	15.5	13.8
Townsend Stylized Benchmark	*20.1*	*18.5*	*14.2*	*13.1*
Private Equity[c.]	23.2	28.6	17.2	16.8
Cambridge Private Equity Benchmark	*22.6*	*26.0*	*15.6*	*14.8*
Venture Capital[c.]	5.4	3.6	–7.1	7.0
Cambridge Venture Capital Benchmark	*9.5*	*10.8*	*–3.5*	*16.7*
Inflation Protection[d.]	–6.3	12.0	17.5	N / A
Inflation Protection Custom Benchmark	*–6.5*	*10.9*	*16.8*	*5.6*
Total Fund	**16.4%**	**15.3**	**11.2**	**10.2**
Total Fund Benchmark	*16.0*	*14.7*	*10.6*	*9.5*

** Returns for periods longer than one year are annualized.*

[a.] The Domestic Stocks Benchmark is the Wilshire 5000 Index through 12/31/98, and the Russell 3000 thereafter.

[b.] The International Stocks Composite and the Custom International Index were unhedged prior to 5/1/96.

[c.] Results for the Real Estate, Private Equity, Venture Capital and Indices are lagged one quarter.

[d.] Inflation Protection was initially funded in November, 2001.

Note: Performance was calculated using the Modified Dietz day weighted return methodology.

Largest Assets Held

At December 31, 2006

Domestic Equity

Holding	Fair Value
NTL Inc.	$48,706,007
Autoliv Inc.	14,037,348
Wabtec	11,388,247
Ansys Inc.	11,360,936
II-VI Inc.	11,321,288
Ansoft Corp	10,982,696
Airgas Inc.	10,729,696
Ametek Inc.	10,666,400
Alltel Corp	10,366,032
Advanta Corp	10,200,389

International Equity

Holding	Fair Value
Nestle	$66,791,323
Cadbury Schweppes	44,036,304
UBS AG	43,872,214
Total SA	39,133,035
BP PLC	33,493,867
RWE AG	32,899,043
Royal Bank of Scotland	32,453,577
China Mobile Ltd	31,386,930
Novartis AG	31,168,913
Imperial Tobacco Group	30,407,371

International Fixed Income

Holding	Fair Value
Federative Republic of Brazil, 8.0% January 15, 2018	$53,006,978
Russian Federation Bond STEP, March 31, 2030	52,861,728
Mexico Mtn 5.875%, January 15, 2014	28,659,839
Federative Republic of Brazil, 8.75% February 4, 2025	19,542,200
Republic of Turkey, 9.5% January 15, 2014	13,747,313
Republic of Argentina, Variable Rate August 3, 2012	12,240,173
Mexico Notes 6.625%, March 3, 2015	11,991,746
Federative Republic of Brazil, 7.875% March 7, 2015	11,868,586
Republic of El Salvador, 7.65% June 15, 2035	11,715,470
Republic of Venezuela, 8.5% October 8, 2014	11,254,785

US Government and Government Related

Holding	Fair Value
U S Treasury Inflation Index Note, 3.375% January 15, 2012	$274,068,745
U S Treasury Inflation Index Note, 3.0% July 15, 2012	238,061,031
U S Treasury Inflation Index Note, 0.875% April 15, 2010	210,542,601
U S Treasury Inflation Index Note, 2.375% April 15, 2011	204,624,465
U S Treasury Inflation Index Note, 4.25% January 15, 2010	159,560,873
U S Treasury Inflation Index Note, 3.5% January 15, 2011	138,557,771
U S Treasury Bond Stripped Principal Payment, 8.75% August 15, 2020	56,493,489
U S Treasury Note, 6.5% February 15, 2010	52,778,207
U S Treasury Note, 4.875% July 31, 2011	41,802,950
U S Treasury Note, 3.75% May 15, 2008	33,687,000

Domestic Corporate Fixed Income

Holding	Fair Value
Comcast Corp SR Sub Deb, 10.625% July 15, 2012	$16,707,838
Pemex Project FDG MTN, 8.625% February 1, 2022	15,974,400
NRG Energy Inc Senior Note, 7.375% February 1, 2016	15,225,750
General Motors Corp Senior Deb, 8.375% July 15, 2033	13,320,000
General Motors Acceptance Note, 8.0% November 1, 2031	12,543,211
Triads Hospital Inc., 7.000% November 15, 2013	12,225,938
Davita Inc. Senior Sub Note, 7.25% March 15, 2015	12,199,200
Aldelphia Communications Corp Senior Note, 9.375% November 15, 2009	11,953,875
Nalco Company Senior Sub Note, 8.875% November 15, 2013	11,593,313
Citibank Credit Card Issue 2000-A3, 6.875% November 16, 2009	10,255,717

Note: A detailed list of SERS' investment holdings at December 31, 2006, may be viewed at www.sers.state.pa.us

Schedule of Trading Broker Commissions

Year Ended December 31, 2006

Broker	Commissions
Merril Lynch	$1,015,499
U.B.S. Securities	940,788
Deutsche Bank	888,115
Credit Suisse First Boston	750,032
Salomon Smith Barney	653,356
Morgan Stanley	583,139
Goldman Sachs	527,171
Lehman Brothers	468,031
J. P. Morgan	462,351
Cazenove	421,000
ABM Amro	382,817
Citigroup Global Markets	377,135
Credit Lyonnais	353,520
Bear Stearns	310,304
Pershing	268,955
Brockhouse & Cooper	252,958
Macquarie Bank	227,246
Nomura Bank International	221,867
Bank of New York	221,787
Kleinwort Benson	192,775
Carnegie	165,984
Union Bank of Switzerland	159,534
Credit Agricole	157,807
Exane	147,243
Mitsubishi Finance Int	128,259
Weeden & Company	128,065
Deutsche Securities	127,698
KBC Bank N V	123,580
Berenborg Gossler	118,427
Heflin & Company	112,599
Daiwa Bank	111,415
Liquidnet	105,844
HSBC Securities	103,940
Julius Baer Securities	102,491
Samsung Securities	100,051
Kay Hian James Capel Ptd	99,439
Sanford C Bernstein & Co	90,264
Capital Institutional Investors	$89,023
Cantor Fitzgerald	86,725
Investment Technology Group	85,708
ING Bank	85,669
Instinet	80,764
SG Securities	80,537
ABG Securities	77,921
KAS Bank	77,779
Rochdale Securties	73,422
Petercam	71,908
Banco Santander	71,504
Jones & Associates	71,397
Bank Am Bellevue	64,685
Banc of America Securities	64,006
La Branche Financial	62,944
Societe Generale	61,664
Davy Stockbrokers	57,644
Mizuho Securities	57,389
Oddo Securities	57,296
Pulse Trading	56,372
BNP Capital Markets	54,581
Westminster Research Associates	51,626
Investec Bank Ltd.	50,888
Jefferies & Company	49,452
B Trade Services	45,950
Citibank	45,644
Cheuvreux De Virieu	43,644
Fortis Securities	43,375
Svenska Handelsbanken	43,546
Nesbitt Burns	43,343
Euromobilare	43,300
Enskilda Securities	43,223
Beeson Gregory	40,974
Raymond James & Assoc Inc	40,507
Screaming Eagle Trading	40,312
Warburg Dillon Read	37,769
Oppenheimer	37,586

Schedule of Trading Broker Commissions *(continued)*

Year Ended December 31, 2006

Broker	Commissions
Redburn Partners	$35,031
Wachovia Securities	34,526
Mainfirst Bank Ag	32,819
Anderson & Strudwick Inc	32,163
Knight Securities Broadcort	32,103
RBC Dominion Securities Corp	31,522
Williams De Broe	31,139
Banco Espirito Santo	30,165
GK Goh Securities	29,654
Seslia Securities	29,522
Intermonte Sec Cim	28,509
Rabobank Nederland	28,367
Boston Institutional Services	27,917
Green Street Advisors	27,643
CIBC World Markets	27,602
Egnatia Securities SA	25,992
Stifel Nicolaus	25,707
Lombard Odier Et Cie	25,055
Neue Zuricher Bank	25,052
West Deutsche Landesbanken	24,853
American Technology Research	23,972
DSP Merrill Lynch Ltd	23,789
Chase Manhattan Bank	23,489
Pereire-Tod Ltd	23,409
Wave Securities	23,262
Caib Securites	23,095
Numis Securities Ltd	23,067
Dexia Bank	22,969
Boenning & Scattergood	22,544
NZB Neue Zuercher Bank	22,534
Fox-Pitt Kelton	21,774
Renaissance Capital	20,465
Janney Montgomery Scott	20,125
NKB	19,959
Oien Securities Inc	19,682
Dain Rauscher	18,652
Williams Capital Group	18,459
Banco Pactual SA	17,766

Broker	Commissions
Citation Group	$17,668
Intersecurities Inc	17,367
Prudential Securities	17,078
First Albany	16,409
Keefe Bruyette & Woods	16,343
Suntrust Equitable Sec	15,901
Saritoga Capital	15,710
SG Cowen Securities	15,597
Friedman Billings	15,432
Collins Stewart	15,372
KBC Peel Hunt	15,371
Bank of China	15,315
Ci Nordic Securities	15,278
Fidentiis Equities Sv Sa	15,015
Allen & Company	14,901
Peel Hunt	13,992
Source Capital Group Inc	13,578
Kaupthing Bank Sverige Ab	13,318
Sal Oppenheim	12,481
Daewoo Securties	12,001
Lazard Freres	11,890
PCS Securities	11,827
A.G. Edwards & Sons Inc.	11,631
Guzman & Company	11,489
Europeenne D'Intermediation	11,454
Kempen	11,403
Shore Capital Stockbrokers	11,347
Dongwon Securities	11,317
Autranet	11,143
Tokyo Mitsubishi PLC	10,885
Garantia DTVM	10,803
Buckingham Research Group Inc	10,720
Brics Securities	10,493
McDonald & Company Securities	10,284
Caylon Securities	10,160
Den Danske Bank	10,144
Man Financial Limited	10,111
Other (196)	611,873
Total Commissions	**$15,869,017**

Investment Summary

as of December 31, 2006

SERS' assets are administered by the SERS Board. The Board has adopted an Investment Policy (Policy) that incorporates the provisions of the Retirement Code which govern the investment of SERS' assets. The Policy provides investment objectives and guidelines. An Investment Plan is reviewed and updated annually for strategic asset allocation purposes, as well as for diversification needs within each asset class.

Market Value as of December 31, 2006: SERS' assets had an unaudited market value of approximately $32,100.5 million.

SERS Asset Allocation

Asset Class	Market Value (Unaudited) $ (millions)	%	2006 Target Allocation	Long–Term Target Allocation
Global Stocks	$1,584.7	4.9%	4.8	5.0
Domestic Stocks	9,929.2	30.9	32.9	27.5
International Stocks	6,582.5	20.5	18.8	14.5
Fixed Income	4,911.9	15.3	16.5	24.0
Cash	380.1	1.2	0.0	0.0
Real Estate	2,527.9	7.9	8.0	8.0
Alternative Investments	4,226.1	13.2	12.0	14.0
Inflation Protection	1,958.1	6.1	7.0	7.0
Total	**$32,100.5**	**100.0%**	**100.0**	**100.0**

Numbers may not add due to rounding.

Number of Investment Advisors: SERS had 180 external investment advisory firms managing portfolios. There are 47 advisors in the public markets domain and 155 covered alternative investments and real estate. Fifteen of these advisors manage 36 portfolios across asset classes.

- 2 Global Stock advisors
- 1 Cash advisor
- 12 U.S. Stock advisors
- 2 Inflation Protection advisors
- 12 International Stock advisors
- 25 Real Estate advisors
- 2 Currency Overlay advisors
- 53 Venture Capital general partners managing limited partnerships
- 16 Fixed Income advisors
- 77 Private Equity general partners managing limited partnerships

In addition, Board appointments included four domestic stock advisors, one venture capital general partnership, and two real estate advisors.

Number of Investment Portfolios: SERS had 403 investment portfolios/accounts. Fifty–four of these accounts are public market investments, while 349 covered private markets.

- 2 Global Stock advisors
- 1 Cash portfolio
- 13 U.S. Stock portfolios
- 2 Inflation Protection portfolios
- 16 International Stock portfolios
- 55 Real Estate portfolios
- 2 Currency Overlay portfolios
- 111 Venture Capital limited partnership interests
- 18 Fixed Income portfolios
- 183 Private Equity limited partnership interests

In addition, Board appointments included four domestic stock accounts, five real estate portfolios, three private equity limited partnerships, and two venture capital limited partnerships.

Investment Summary - Global Stock Investments

as of December 31, 2006

Global stocks is a component of the stock asset class, one of eight major asset classes which SERS uses to diversify the investments of the Fund. SERS' investment plan diversifies stock investments while maintaining a reasonable risk posture relative to the benchmarks. SERS contracts with external investment advisors to manage portfolios.

Policy: Stock investments are employed by the Fund primarily because their expected large return premiums versus inflation will, if realized, help preserve and enhance the real value of the Fund over long periods of time. The global stocks accounts are managed on a total return basis.

SERS' long term investment objective for the global stock component of the stock asset class is to achieve a total return, net of fees, that exceeds the total return of the MSCI World Index.

SERS' 2006 Investment Plan targets an allocation of 5% of Fund assets to global stocks.

Market Value as of December 31, 2006: Global stocks had a $1,584.7 million market value, 4.9% of the total Fund's $32,100.5 million market value.

Number of Investment Advisors: SERS had contracts with two external investment advisors to manage global stock portfolios.

Number of Investment Portfolios: SERS had two global stock portfolios managed by the two investment advisors.

Type of Investment Portfolios: As of December 31, 2006, SERS global stock allocation was to large cap strategies.

	Global Stock Investment Advisor	Investment Style	Market Value[a.] as of 12/31/06 ($ millions)
1.	Walter Scott & Partners Limited	Growth	$646.1
2.	Marathon-London Global Fund	Contrarian sector relative value	938.6
	Total Global Stocks		$1,584.7

[a.] *Includes stocks and cash which the manager had available for investment.*

Numbers may not add due to rounding

Investment Summary - U.S. Stock Investments

as of December 31, 2006

U.S. Stocks is one of eight major asset classes which SERS uses to diversify the investments of the Fund. SERS' investment plan diversifies stock investments while maintaining a reasonable risk posture relative to the benchmark. SERS contracts with external investment advisors to manage portfolios.

Policy: Stock investments are employed by the Fund primarily because their expected large return premiums versus inflation will, if realized, help preserve and enhance the real value of the Fund over long periods of time. The U.S stock asset class is managed on a total return basis.

SERS' long term investment objective in the U.S. Stock asset class is to achieve a total return, net of fees, that exceeds the total return of the Russell 3000 Index.

Stock investments shall include, but not be limited to, publicly traded securities which provide SERS with an equity interest, (e.g, common stock, preferred stock, convertible preferred stock, and convertible bonds); as well as derivative instruments that provide stock like returns.

SERS' 2007 Investment Plan targets a long–term allocation of 21.0% of assets to U.S. Stocks. SERS U.S. stock portfolio, in aggregate, will strive to reflect the risk characteristics of the Russell 3000 Index, which is a good proxy for the broad, investable U.S. market.

The large cap segment of the portfolio is benchmarked to the S&P 500 Index utilizing enhanced indexed and transportable alpha strategies including global macro and funds–of–hedge funds. The remainder of the portfolio represents the medium and small capitalization segments of the domestic stock market. Exposure to the medium and small capitalization segment of the market is achieved with actively managed traditional long–only advisors and global macro transportable alpha strategies benchmarked to the Russell 2000 and 2500 Indices.

Market Value as of December 31, 2006: U.S. Stocks had a $9,929.2 million market value, 30.9% of the total fund's $32,100.5 million market value.

Number of Investment Advisors: SERS had contracts with 12 external investment advisors to manage U.S. Stock portfolios.

Number of Investment Portfolios: SERS had 13 U.S. Stock portfolios managed by the 12 investment advisors.

Type of Investment Portfolios: As of December 31, 2006, 81.9% of SERS U.S. Stock allocation was in large capitalization stock strategies, including the equitized fund–of–hedge funds absolute return strategies, and 18.1% was in medium / small capitalization stock strategies. The alpha transport strategies, used in both the large capitalization and medium / small capitalization segments, replicate a broad market return benchmark through derivatives and then add alpha through uncorrelated return streams. SERS has one equitization manager to replicate the benchmarks for the alpha transport strategies.

Investment Summary - U.S. Stock Investments (continued)

	U.S. Stock Investment Advisor	Investment Style	Market Value[a] As of 12/31/06 ($ millions)
1.	AQR	Small Cap Global Macro	$390.4
2.	AXA Rosenberg Investment Management	Russell 2500, risk controlled	243.9
3.	Barclays Global Investors	Enhanced indexing	690.3
4.	Blackstone Alternative Asset Management (BAAM)	Absolute return Fund–of–hedge funds	1,902.4
5.	Bridgewater	Large Cap Global Macro	215.3
	Bridgewater	Small Cap Global Macro	423.7
6.	Emerald	PA stocks	243.3
7.	Iridian Asset Management	Mid–cap private business value	254.6
8.	Mellon Equity Associates	PA stocks	242.6
9.	Mesirow Financial	Absolute return Fund–of–hedge funds	1,630.3
10.	Morgan Stanley Alternative Investment Partners	Absolute return Fund–of–hedge funds	1,398.9
11.	NISA Advisors	Absolute return strategy equitization[b]	418.2
12.	PAAMCO Absolute Return	Absolute return Fund–of–hedge funds	1,875.2
	Total		**$9,929.2**

[a] *Includes stocks and cash which the manager had available for investment.*

[b] *The $418.2 million balance represents the accrued gain/loss for the equitization of the absolute return fund of funds as of December 31, 2006.*

Numbers may not add due to rounding.

Investment Summary - Non-U.S. Stock Investments

as of December 31, 2006

Non-U.S. stocks is a component of the stock asset class, one of eight major asset classes that SERS uses to diversify the investments of the Fund. SERS' investment plan diversifies stock investments while maintaining a reasonable risk posture relative to the benchmarks. SERS contracts with external investment advisors to manage portfolios.

Policy: Stock investments are employed by the Fund primarily because their expected large return premiums versus inflation will, if realized, help preserve and enhance the real value of the Fund over long periods of time. The Non-U.S. Stock asset class is managed on a total return basis.

SERS' long term investment objective for the non-U.S. stock component of the stock asset class is to achieve a total return, net of fees, that exceeds the total return of the MSCI EAFE Index, a proxy for large cap stocks in non-U.S. developed markets, the S&P / Citigroup Extended Market Index Europe and Pacific, a proxy for small cap stocks in non-U.S. developed markets, and the MSCI Emerging Markets Index, a proxy for stocks in emerging markets.

SERS' 2006 Investment Plan targets an allocation of 5.2% of Fund assets to funds of hedge funds with an EAFE Index swap overlay, 8.4% of Fund assets to stocks in non-U.S. developed markets, 3.4% of Fund assets to strategies dedicated to small-cap stocks in non-U.S. markets, and 4.0% of Fund assets to strategies dedicated to stocks in emerging markets, by the end of 2010.

Market Value as of December 31, 2006: Non-U.S. Stocks had a $6,609.8 million market value, 20.6% of the total Fund's $32,100.5 million market value. In addition, the fair value of forward exchange contracts in the currency overlay program amounted to ($27.3) million.

Number of Investment Advisors: SERS had contracts with 12 external investment advisors to manage non-U.S. stock portfolios. In addition, SERS had contracts with two external advisors to manage the currency overlay program.

Number of Investment Portfolios: SERS had 16 accounts managed by the 12 investment advisors and two accounts for the currency overlay program.

Type of Investment Portfolios: As of December 31, 2006, 4.5% of total Fund assets was allocated to funds of hedge funds with an EAFE Index swap overlay, 7.8% of total Fund assets was allocated to stocks in non-U.S. developed markets, 4.2% of total Fund assets was allocated to strategies dedicated to small-cap stocks in non-U.S. markets, and 4.0% was allocated to strategies dedicated to stocks in emerging markets.

Investment Summary - Non-U.S. Stock Investments (continued)

	Non-U.S. Stock Investment Advisor	Investment Style	Market Value[a] as of 12/31/06 ($ millions)
Large Cap			
MSCI EAFE Index swaps and funds of hedge funds			
1.	NISA Advisors	MSCI EAFE Equitization[b]	$97.3
2.	Arden Asset Management	Absolute Return Fund-of-funds	679.6
3.	Rock Creek Group, LLC	Absolute Return Fund-of-funds	669.2
Traditional large cap non-U.S. developed markets mandates			
4.	Artisan Partners Limited Partnership	Growth stocks	707.5
5.	Morgan Stanley Investment Management Limited (London)	Free cash flow value	877.9
6.	Templeton Investment Counsel, LLC	5-year stock value	919.9
Small Cap			
7.	Harris Associates L.P.	Small cap - intrinsic value	475.3
8.	BlackRock Investment Management International Limited	Small cap - growth	425.2
9.	Pictet Asset Management Limited International small cap equity team	Small cap - value with growth	458.3
Emerging Markets			
10.	Bernstein Investment Research and Management	Global emerging markets - value	168.2
	Pictet Asset Management Limited Emerging markets equity team	Global emerging markets - value	371.5
11.	Rexiter Capital Management Limited	Global emerging markets - core	170.7
	Templeton Asset Management Ltd. Global emerging markets team TIFI Emerging Markets Series	Global emerging markets - value	370.8
	Templeton Asset Management Ltd. Templeton Strategic Emerging Markets Fund team Templeton Strategic Emerging Markets Fund, L.P	Global emerging markets private placements with public companies	0.4
	Templeton Strategic Emerging Markets Fund II, L.P.	Global emerging markets private placements with public companies	70.6
12.	Oaktree Capital Management, LLC OCM Emerging Markets Feeder Fund, L.P.	Pacific basin emerging and developed - long / short	146.5
	Total Non-U.S. Stocks		**$6,609.8**

[a] Includes stocks and cash which the manager had available for investment.

[b] The $97.3 million balance represents the accrued gain/loss for the equitization of the absolute return fund of funds as of December 31, 2006

Numbers may not add due to rounding.

Investment Summary - Non-U.S. Stock Investments (continued)

	Currency Overlay Investment Advisor	Investment Style	Market Value [a] as of 12/31/06 ($ millions)
1.	Pareto Partners	Currency overlay	$(17.0)
2.	Record Treasury	Currency overlay	(10.3)
	Total Currency Overlay		**(27.3)**
	Total Non-U.S. and Currency Overlay		**$6,582.5**

[a] *Includes stocks and cash which the manager had available for investment.*
Numbers may not add due to rounding

Investment Summary - Fixed Income Investments

as of December 31, 2006

Fixed Income is one of eight major asset classes that SERS uses to diversify the investments of the Fund. The SERS' Investment Plan diversifies Fixed Income investments and strategies. SERS contracts with external investment advisors to manage portfolios.

Policy: The Fixed Income asset class is employed by the Fund because of its ability to generate current income from interest payments, increase the value of the Fund through the reinvestment of those interest payments, serve as a Benefit Payment Reserve during periods of financial stress, serve as a hedge against disinflation and / or deflation and to help diversify the overall Fund. The Fixed Income asset class is managed on a total return basis.
In the Fixed Income asset class, SERS' long–term investment objective is to achieve a total return, net of fees, that exceeds the total return of the SERS Custom Fixed Income Index which is comprised of the Lehman Intermediate, Lehman Aggregate, the Citigroup High Yield Market and J.P. Morgan Emerging Market Bond indices. SERS' 2006 Investment Plan targets a long–term allocation of 24.0% of assets of the total Fund to the Fixed Income asset class. Of this amount, 63% is targeted to the core strategies and 37% to specialty strategies (high-yield and emerging market debt).

Market Value as of December 31, 2006: Fixed Income had a $4,911.9 million market value, 15.3% of the total Fund's $32,100.5 million market value.

Number of Investment Advisors: SERS had contracts with 16 external investment advisors to manage portfolios within the Fixed Income asset class as of December 31, 2006.

Number of Investment Portfolios: SERS had a total of 18 portfolios within the Fixed Income asset class.

Type of Investment Portfolios: The Fixed Income asset class is divided into core and specialty segments.

Core: Core portfolios invest in relatively liquid, high quality, fixed income securities with intermediate term durations that meet return, disinflation /deflation, high quality liquidity and diversification needs of the Fund. SERS had five actively managed core bond portfolios; three Lehman Intermediate actively managed portfolios, two Lehman Aggregate actively managed portfolios with a market value of $1,845.0 million and one passively managed core bond portfolio with a market value of $267.4 million. The combination of core portfolios represented 43.0% of the asset class.

Specialty: The specialty strategy portfolios (high-yield, emerging market debt, whole-loan mortgages, subordinated debt, and mezzanine debt) focus on debt instruments offering higher return premiums and different risk characteristics than core fixed income securities. SERS has corporate high yield portfolios with a market value of $1,160.9 million, emerging market debt portfolios with a market value of $1,318.5 million, one high yield commercial mortgage-backed securities portfolio with a market value of $304.5 million, one whole-loan mortgage portfolio with a market value of $6.3 million, one subordinated debt portfolio with a market value of $5.2 million that invests in Pennsylvania companies, and one mezzanine debt portfolio with a market value of $4.1 million. The specialty portfolios represent 57.0% of the asset class.

Investment Summary - Fixed Income Investments (continued)

as of December 31, 2006

	Fixed Income Investment Advisor	Investment Style	Market Value[a] As of 12/31/06 ($ millions)
Core			
1.	Goldman Sachs Asset Management	Active domestic intermediate duration	$388.2
2.	MDL Capital Management	Active domestic intermediate duration	95.8
3.	Standish (Mellon)	Domestic – index	267.4
4.	Morgan Stanley	Active domestic	865.4
5.	NISA Investment Advisors	Active domestic intermediate duration	390.3
6.	Taplin, Canida & Habacht	Active domestic	105.4
Specialty			
7.	Legg Mason	Whole–loan mortgages	6.3
8.	Berwind (Eureka) Financial Group	PA Capital Fund	5.2
9.	Oaktree Capital Management	Mezzanine Fund	4.1
10.	Fidelity Management Trust Company	Commercial mortgage backed securities	304.5
11.	W. R. Huff Asset Management	High yield bonds	485.4
12.	Stone Harbor (Salomon)	Global High yield	675.4
	Stone Harbor (Salomon)	Emerging Market Debt	402.1
13.	Ashmore AEMDF	Emerging Market Debt ($U.S.)	233.0
	Ashmore LCD	Emerging Market Debt – Local	149.7
14.	Gramercy Advisors	Emerging Market Debt – absolute return	113.9
15.	Greylock Capital Management	Emerging Market Debt – absolute return	110.5
16.	PIMCO	Emerging Market Debt	309.4
	Total		**$4,911.9**

[a] *Includes securities and cash that the manager had available for investment.*
Numbers may not add due to rounding.

Investment Summary - Cash Investments

as of December 31, 2006

Cash is one of eight major asset classes that SERS uses for investments of the Fund. The SERS' Investment Plan calls for minimizing cash balances while meeting cash flow requirements.

Policy: Cash investments are employed by the Fund to provide for SERS' liquidity needs and to accumulate funds for future permanent investment. The Cash asset class is to be managed on a total return basis, with the exception that temporary investments such as overnight repurchase agreements ("repo"), commercial paper, and banker's acceptance may alternatively be evaluated on a yield–to–maturity basis given their extremely short maturities.

In the Cash asset class, SERS' long term investment objectives are to achieve a total return, net of fees, that exceeds the total return on 90 day U.S. Treasury Bills. SERS' current Investment Plan targets an allocation of 0% of assets to the Cash asset class.

Market Value as of December 31, 2006: Cash had a $380.1 million market value, 1.2% of the total Fund's $32,100.5 million market value.

Number of Investment Advisors: In accordance with SERS' 2006 Investment Plan, SERS utilizes the Pennsylvania State Treasury Department to manage its cash accounts.

Number of Investment Portfolios: SERS' cash portfolio is managed primarily by the Treasurer.

Type of Investment Portfolios: SERS Cash asset class currently employs a money market short–term investment strategy. The portfolio also contains the uninvested cash balances held by other SERS investment advisors in other asset classes.

In the aggregate, the State Treasury managed approximately $571 million on behalf of SERS and SERS' external investment advisors as of December 31, 2006.

Investment Summary - Real Estate Investments

as of December 31, 2006

Equity Real Estate is one of eight major asset classes that SERS uses to diversify the investments of the Fund. SERS' investment plan diversifies Real Estate investments and balances real estate management styles. In accordance with the plan, SERS contracts with external investment advisors to manage portfolios.

Policy: Equity Real Estate investments are generally long–term, illiquid investments that due to their high correlation with inflation provide an inflation hedge and, due to their low correlation with stocks and bonds, provide diversification within the total portfolio. It is expected that the long–term total return (income and appreciation) for real estate will fall between that of stocks and bonds. The Equity Real Estate asset class is managed on a total return basis.

In the Equity Real Estate asset class, SERS' long–term investment objective is to achieve a total net return that exceeds the total return of the NCREIF Index for rolling five year periods. SERS' 2006 Investment Plan targets a long-term allocation of 8% of assets to the Equity Real Estate asset class.

Investments are made through commingled fund investments, limited partnerships, REITs and separate account portfolios where SERS contracts with external investment advisors to own properties directly or with other co–investors. SERS' Equity Real Estate portfolio provides for diversification by:

- Transaction structure;
- Property type;
- Geographic location; and
- Development phase.

Market Value as of December 31, 2006: Real Estate had an estimated $2,527.9 million market value, approximately 7.9% of the total Fund's December 31, 2006 market value. This market value represents September 30, 2006 actual numbers adjusted for cash flows, which occurred in the fourth quarter 2006. Real estate market values and detailed property data is lagged by one quarter due to the timing of the receipt of the private market valuations and information.

Number of Investment Advisors: SERS had contracts with 25 external investment advisors to manage real estate portfolios as of September 30, 2006.

Number of Investment Portfolios: SERS had investments in 55 real estate portfolios managed by the 25 investment advisors.

Type of Investment Portfolios: As of September 30, 2006, the composition of the real estate portfolio was:

- 31% pooled funds, 69% separate accounts
- 25% office, 6% industrial, 7% retail, 21% residential, 13% hotel / motel, 7% timber, 21% other
- 13% Pennsylvania, 23% East excluding PA, 30% West, 15% South, 5% Midwest, 14% International
- 33% of the market value of the separate accounts was invested in sixteen investments located in Pennsylvania.

Investment Summary - Real Estate Investments (continued)

	Real Estate Investment Advisor	SERS Initial Funding	Property Type	Transaction Structure	Market Value[a.] as of 9/30/06 ($ millions)
1.	Apollo – AREF III	06/26/98	Opportunistic	equity and debt	$32.0
2.	Berwind – BPG Fund IV	04/20/98	Opportunistic	equity and debt	4.5
	BPG Fund V	11/29/99	Opportunistic	equity and debt	16.0
	BPG Fund VI	09/09/02	Opportunistic	equity and debt	21.1
	BPG Fund VII	09/12/05	Opportunistic	equity and debt	12.5
3.	Blackstone – BREP III	10/22/99	Opportunistic	equity and debt	4.7
	BREP IV	12/08/03	Opportunistic	equity and debt	20.9
	BREP V	01/24/06	Opportunistic	equity and debt	17.8
4.	Campbell Group		Timber	equity ownership	-
5.	Cliffwood Select Equity Fund	08/04/00	Long/Short REITs	public securities	41.5
6.	ING Real Estate Securities	01/31/96	REITs	public securities	465.6
7.	Filmore Capital Partners	06/29/06	Debt	equity and debt	9.2
8.	Forest Investment Assoc.	10/30/92	Timber	equity ownership	168.5
9.	Hawkeye Partners – Scout Fund		Opportunistic	equity and debt	-
10.	Heitman Capital Mgmt	12/28/87	Diversified	equity ownership	60.0
11.	LaSalle Investment Mgmt	10/01/93	Diversified	equity ownership	213.5
12.	Grosvenor Investment Mgmt.	10/01/93	PA diversified	equity ownership	236.9
	Eastern Retail Holdings	01/07/99	Retail	equity and debt	0.6
13.	Lowe Enterprises	10/01/93	Diversified	equity ownership	416.8
14.	Lubert–Adler Fund II	10/30/98	Opportunistic	equity and debt	11.8
	Lubert–Adler Fund III	11/10/00	Opportunistic	equity and debt	14.0
	Lubert-Adler Fund IV	03/31/04	Opportunistic	equity and debt	22.0
	Lubert-Adler Fund V	04/10/06	Opportunistic	equity and debt	3.3
15.	Miller Global Fund III	01/19/99	Diversified	equity and debt	1.0
16.	Oaktree Capital Management:				
	TCW Fund VI	04/20/94	Opportunistic	equity and debt	0.4
	OCM Opportunity Fund A	05/09/96	Opportunistic	equity and debt	10.7
	OCM Opportunity Fund II	12/15/98	Opportunistic	equity and debt	6.0
	OCM Opportunity Fund III	03/05/03	Opportunistic	equity and debt	30.0
17.	Oxford Development	01/09/97	Industrial	equity ownership	0.2
	Oxford Fund		Development	equity and debt	-
18.	Prudential - Senior Housing I	12/22/98	Senior housing	equity and debt	1.8
	Senior Housing II	06/12/01	Senior housing	equity and debt	31.1
	Senior Housing III	01/12/06	Senior housing	equity and debt	13.7
	Mexico Retail Fund	09/19/06	Opportunistic	equity and debt	10.1
19.	Rockpoint Group - Fund I	09/28/04	Opportunistic	equity and debt	20.1
	Rockpoint Fund II	09/27/05	Opportunistic	equity and debt	13.8
	Finance Fund		Opportunistic	equity and debt	-
20.	Sentinel Corp.	07/31/84	Diversified	equity ownership	78.0
21.	Starwood: SOF IV	03/24/97	Opportunistic	equity and debt	5.0
	SOF V	05/14/99	Opportunistic	equity and debt	3.7
	SOF VI	03/27/03	Opportunistic	equity and debt	52.5
	SOF VII	01/13/06	Opportunistic	equity and debt	12.4

Investment Summary - Real Estate Investments (continued)

	Real Estate Investment Advisor	SERS Initial Funding	Property Type	Transaction Structure	Market Value[a.] as of 9/30/06 ($ millions)
22.	UBS–Brinson: PMSA	09/30/83	Diversified	equity mortgages	$70.1
	RESA	06/3/ /84	Diversified	equity ownership	82.2
	Multifamily Trust	08/02/99	Residential	equity ownership	1.0
23.	Urdang Investment Mgmt.	05/15/02	REITs	public securities	64.6
24.	Westbrook Partners: WREF II	06/16/97	Opportunistic	equity and debt	6.8
	WREF III	09/01/98	Opportunistic	equity and debt	8.3
	WREF IV	05/01/01	Opportunistic	equity and debt	12.2
	WREF V	02/16/05	Opportunistic	equity and debt	18.6
	WREF VI	05/10/06	Opportunistic	equity and debt	8.9
	WREF VII		Opportunistic	equity and debt	-
25.	Goldman Sachs: Whitehall V&VI	04/20/94	Opportunistic	equity and debt	2.6
	Whitehall V–S & VI–S	12/11/95	Opportunistic	equity and debt	0.2
	Whitehall VII & VIII	05/28/96	Opportunistic	equity and debt	2.9
	September 30, 2006 Total				**$2,362.1**
	4th Quarter 2006 Net Cash Flow Adjustments				**165.8**
	December 31, 2006 Total				**$2,527.9**

[a.] *Market values are lagged by one quarter due to the timing of the receipt of private market valuations and information.*

Numbers may not add due to rounding.

Investment Summary - Alternative Investments

as of December 31, 2006

Alternative Investments is comprised of Venture Capital and Private Equity investments, both of which take the form of limited partnerships, and is one of eight major asset classes that SERS uses to diversify the investments of the fund.

Venture Capital and Private Equity Defined

Venture Capital is the financing of young, rapidly growing companies, typically at three stages of development. (1) Seed and Early Stage: Seed is the form of venture capital that supports companies in their conceptual phase, i.e., a product and market are identified, and a corporation may have been formed. Early Stage financing supports companies pursuing a business plan but not yet generating meaningful revenues. The product has been developed and may have been shipped to customers for testing. Management positions have been filled and an operating team is in place. (2) Late Stage financing supports companies that have proven revenues, and are in the process of rolling out operations and building sales to achieve profitability. (3) Growth or Expansion financing supports profitable or nearly profitable businesses that, lacking access to significant debt financing, need capital for growth and expansion. Companies at either the later stage or growth or expansion stage may be nearing a strategic sale to another company or an initial public offering.

Private Equity primarily refers to investments in the equity and subordinated debt of established companies. Private equity approaches undertaken by SERS' limited partnerships include: (1) Leveraged buyouts and management buyouts in which companies are acquired through the use of borrowed funds, or a combination of borrowed funds and contributed equity capital. The acquired company's assets serve as collateral for the borrowed funds, which are repaid from the company's cash flows. (2) Distressed debt investing involves: (a) deleveraging of debt–laden, but successful, companies by infusing capital to permit debt reduction in exchange for an equity stake in the company, or (b) acquiring debt of a troubled, sometimes bankrupt company, at steep discounts to face value, followed by assistance to return the company to profitability to permit selling of the debt securities at levels above the discounted purchase price. (3) Secondary interests in established private equity funds – these interests are purchased from other investors who seek liquidity or desire to realign or rebalance their investment portfolios, often for non–financial reasons. Such partnership interests can be purchased at significant discounts to net asset value and often occur when the acquired partnerships begin to realize profits.

Investment Objective: SERS' long term investment objective for Alternative Investments is to achieve a risk–adjusted total return, net of fees, in excess of the return generated by the S&P 500 Index. SERS' 2006-2007 Investment Plan anticipates a long–term allocation range with a midpoint of 14%.

Market Value as of December 31, 2006: The asset class total market value stood at $4,226.1 million after adjusting the September valuation for subsequent cash flows in the 4th quarter. Alternative investment market values lag one quarter due to timing of the receipt of private market valuations, reports and other information. These values do not include 4th quarter unrealized appreciation / depreciation. Alternative investments represent 13.2% of the Fund. Sub–asset class market values and fund percentages were as follows:

Alternative Investments

	Unfunded Commitments ($ millions)	Market Value ($ millions)	Percent of Total Fund
Venture Capital	$1,069.0	$1,094.2	3.4%
Private Equity	2,676.0	3,131.9	9.8
Total Alternative Investments	$3,745.0	$4,226.1	13.2%

Investment Summary - Alternative Investments (continued)

Number of Limited Partnerships: As of December 31, 2006, SERS had commitments to 294 active Alternative Investments limited partnerships, 111 to Venture Capital partnerships and 183 to Private Equity partnerships. (This does not include twenty five partnerships – seventeen Venture Capital and eight Private Equity – that are now "inactive," or in the liquidation phase, and investments pending contract approval.)

Portfolio: SERS' Alternative Investment program's scope has expanded over the years to include top investment funds nationally and internationally. The program holds indirect investment interests in approximately 4,000 companies. The Venture Capital program includes investments working to commercialize novel solutions to current and future challenges in information technology, communications, and medicine. In addition to direct fund investments, the venture capital program includes investments in several funds–of–funds. A fund-of-funds is a limited partnership that, in turn, invests in other limited partnerships. Five of these fund–of–funds commitments have the strategic goal of enabling SERS to gain indirect exposure to many top–tier venture capital funds that SERS would otherwise have difficulty accessing directly. Another two of these commitments are to funds investing in minority–focused venture capital funds. The remaining fund-of-funds commitments target region specific and emerging market funds.

The Private Equity program invests in buyout, distressed, international, and secondary oriented partnerships. Buyout transactions are privately negotiated or result from investment bank sponsored auctions, and are usually completed with present management in place; hostile acquisitions are generally avoided. Distressed investment managers employ differentiated strategies, i.e., they employ control or non–control approaches, and accordingly, have differing degrees of active influence over the companies in which they invest. European funds are attempting to capitalize on trends favoring the restructuring of large companies, generational succession in businesses established after World War II, and cross–border business opportunities within the region since the formation of the European Economic Union and currency harmonization. Asian investments focus on the expanded opportunities in the region created by attractive valuations, favorable demographic trends, economic growth, and changing attitudes in many Asian countries regarding foreign investment. The portfolio's exposure to other energy markets is also expanding. Additionally, SERS utilizes one manager to oversee stock distributions.

Alternative Investment Portfolio Allocation: The Alternative Investment program is well-diversified by stage of investment, industry focus, and geography. As of September 30, 2006, based on market value, the program was allocated as listed in the below tables.

By Sub Sector:

U.S. Private Equity	48.3%
U.S. Venture Capital	22.8
International	13.9
Distressed / Opportunistic	7.2
Pennsylvania	5.7
Other	2.1

By Style:

LBO	37.8%
Expansion Stage	16.8
Early Stage	11.5
Start-Up	9.7
Senior Debt LBO	5.5
Acquisition / Platform	6.1
Other	12.6

By Industry:

Communications	23.9%
Consumer	19.8
Healthcare	15.5
Manufacturing	7.6
Financial	9.0
Software	7.9
Electronics	4.4
Energy	3.4
Other	8.5

By Geography:

U.S. Northeast	17.7%
U.S. Mid-Atlantic	8.4
U.S. West Coast	14.9
U.S. Other	28.8
United Kingdom	6.1
Germany	3.3
Scandinavia	3.2
Rest of World	17.6

Investment Summary - Alternative Investments (continued)

SERS Venture Capital Committed, Drawn and Distributed

As of December 31, 2006

The Capital Committed column represents total dollars allocated from SERS to each limited partnership. Capital Drawn is the portion of SERS capital commitments drawn by the General Partner to be invested with underlying portfolio companies. The Distributions column shows the value of original capital and profits returned to SERS.

	Active Venture Capital Funds Limited Partnership	Financing Stage Focus	SERS Initial Funding	Capital Committed	Capital Drawn	Distributions
1.	APAX Excelsior VI	Later Stage	7/3/2000	$35,000,000	32,846,153	21,063,976
	P/A Fund I	Later Stage	6/2/1993	30,000,000	29,999,999	64,201,030
	P/A Fund III	Later Stage	4/1/1997	100,000,000	100,000,000	151,420,448
2.	APEX Investment Fund IV	Early Stage	8/31/1999	25,000,000	25,000,000	257,565
	APEX Investment Fund V	Early Stage	7/25/2001	20,000,000	16,600,000	729,846
3.	Abingworth Bioventures IV, L.P.	Seed/Early Stage	7/16/2003	20,000,000	11,900,000	0
4.	Adams Capital Management II	Early Stage	9/30/1999	30,000,000	30,000,000	0
	Adams Capital Management III	Early Stage	10/25/2000	30,000,000	24,450,000	4,761,905
5.	Advanced Technology Ventures VI	Early Stage	3/9/2000	10,000,000	9,750,000	240,896
	Advanced Technology Ventures VII LP	Early Stage	12/6/2000	27,000,000	18,697,200	3,370,102
6.	Alloy Annex I, L.P.	Seed/Early Stage	7/16/2003	5,000,000	3,000,000	0
	Alloy Ventures 2000 L.P.	Early Stage	4/26/2000	20,000,000	18,000,000	2,074,620
	Alloy Ventures 2002 LP	Early Stage	3/20/2002	25,000,000	15,250,000	2,602,018
	Alloy Ventures 2005, L.P.	Seed/Early Stage	7/13/2005	25,000,000	5,500,000	0
7.	Artiman Ventures II, L.P.	Seed/Early Stage	*	25,000,000	0	0
8.	Atlas Venture Fund IV	Early Stage	3/23/1999	26,000,000	22,880,753	4,579,621
	Atlas Venture Fund V L.P.	Early Stage	1/28/2000	37,200,000	36,125,920	5,454,623
	Atlas Venture Fund VI	Early Stage	1/24/2001	24,800,000	20,014,447	2,199,824
9.	Austin Ventures IX	Early Stage	1/26/2005	20,932,140	1,857,142	0
	Austin Ventures VIII	Early Stage	1/29/2001	20,932,140	17,298,477	2,539,024
10.	Bachow Investments III	Later Stage	11/9/1994	25,000,000	25,073,149	25,267,385
11.	Birchmere Ventures III	Early Stage	3/18/2004	10,000,000	3,976,524	0
12.	Care Capital Investments III, L.P.	Later Stage	12/14/2005	25,000,000	1,250,000	0
13.	Charles River Partnership XI LP	Early Stage	1/31/2001	11,032,259	8,770,646	1,120,980
14.	Clearstone Venture Partners III-A, L.P.	Early/Late Stage	4/21/2004	25,000,000	9,250,000	0
15.	Cross Atlantic Technology Fund	Early Stage	2/14/2000	20,000,000	19,749,041	2,866,261
	Cross Atlantic Technology Fund II	Early Stage	12/28/2001	32,900,000	28,952,000	2,460,790
	Novo Vita	Early Stage	10/25/2000	11,616,498	11,363,996	61,064
16.	Devon Park Bioventures, L.P.	Early/Late Stage	*	20,000,000	0	0
17.	Draper Fisher Jurvetson VI	Early Stage	8/13/1999	8,000,000	7,640,000	94,810
	Draper Fisher Jurvetson Fund VII LP	Early Stage	7/26/2000	20,000,000	16,181,716	2,224,687
18.	Draper Triangle Ventures	Early Stage	8/31/1999	20,000,000	20,924,608	2,150,823
	Draper Triangle Ventures II, L.P.	Early Stage	9/10/2003	12,000,000	2,274,987	0
19.	Edison Venture Fund III	Later Stage	3/1/1994	25,000,000	25,000,000	45,769,784
20.	Fairview Capital	Fund of Funds	9/28/1994	10,000,000	10,000,000	4,434,328
	Fairview II	Fund of Funds	3/1/1998	10,000,000	9,600,000	2,420,297
21.	Frazier Healthcare III	Early Stage	2/4/1999	30,000,000	28,575,000	5,645,014
	Frazier Healthcare IV	Early Stage	3/14/2001	30,000,000	21,342,010	3,569,576
	Frazier Healthcare V	Early/Late Stage	12/8/2004	30,000,000	5,775,000	0

Investment Summary - Alternative Investments

SERS Venture Capital Committed, Drawn and Distributed (continued)

As of December 31, 2006

	Active Venture Capital Funds Limited Partnership	Financing Stage Focus	SERS Initial Funding	Capital Committed	Capital Drawn	Distributions
22.	Grotech PA III	Later Stage	6 / 29 / 1990	$3,000,000	3,014,865	2,910,452
	Grotech Partners IV	Later Stage	11 / 1 / 1993	25,000,000	25,157,827	44,089,796
	Grotech Partners V	Later Stage	9 / 18 / 1998	25,000,000	25,125,000	22,628,391
23.	Halpern Denny Fund II	Later Stage	4 / 23 / 1998	25,000,000	25,116,871	4,513,556
	Halpern Denny Fund III	Later Stage	4 / 26 / 2000	25,000,000	23,056,740	15,103,708
24.	HarbourVest Partners VI	Fund of Funds	5 / 7 / 1999	200,000,000	162,586,055	39,806,920
	HarbourVest Partners VII	Fund of Funds	4 / 24 / 2002	75,000,000	28,125,000	1,113,750
	HarbourVest Partners VIII	Fund of Funds	*	100,000,000	0	0
25.	Healthcare Ventures III	Early Stage	7 / 9 / 1992	15,000,000	15,000,000	30,778,200
	Healthcare Ventures V	Early Stage	10 / 17 / 1997	25,000,000	24,312,500	51,302,628
	Healthcare Ventures VI	Early Stage	6 / 19 / 2000	35,000,000	34,125,000	3,462,611
	Healthcare Ventures VII	Early Stage	7 / 24 / 2002	35,000,000	21,437,500	0
	Healthcare Ventures VIII, L.P.	Early Stage	7 / 13 / 2005	30,000,000	3,600,000	0
26.	Highland Capital Partners VI	Early Stage	10 / 25 / 2000	25,000,000	18,937,500	13,246,314
	Highland Capital Partners VII	Early Stage	*	35,000,000	0	0
27.	IP II L.P.	Early Stage	12 / 17 / 2001	8,600,000	6,692,074	1,006,296
	IP III, L.P.	Seed / Early Stage	10 / 27 / 2004	8,000,000	2,940,000	0
28.	InterWest Partners IX, L.P.	Early Stage	7 / 14 / 2004	20,000,000	4,000,000	0
	InterWest Partners VIII L.P.	Early Stage	8 / 25 / 2000	25,000,000	21,250,000	5,323,829
29.	J.H. Whitney Equity Fund III LP	Later Stage	3 / 12 / 1998	20,000,000	20,171,316	37,142,836
	J.H. Whitney IV LP	Later Stage	2 / 1 / 2000	20,000,000	16,712,208	1,596,861
30.	JMI Equity Fund V, L.P.	Early / Late Stage	6 / 10 / 2005	24,000,000	10,853,205	0
31.	JP Morgan Venture Capital Investors	Fund of Funds	7 / 8 / 1999	100,000,000	93,928,649	13,319,035
	JP Morgan Venture Capital Investors II	Fund of Funds	8 / 23 / 2000	100,000,000	60,244,224	9,127,321
	JP Morgan Venture Capital Investors III	Fund of Funds	12 / 7 / 2005	100,000,000	1,989,609	3,580
32.	Keystone V	Later Stage	12 / 26 / 1997	25,000,000	25,117,132	2,082,064
	Keystone Venture IV	Later Stage	7 / 13 / 1993	15,000,000	15,045,275	11,249,174
33.	Kline Hawkes Pacific LP	Early Stage	8 / 30 / 2000	15,000,000	14,574,282	3,676,068
34.	Knightbridge Venture Capital VI, L.P.	Fund of Funds	4 / 21 / 2004	20,000,000	2,600,000	0
35.	Lightspeed Venture Partners VII, L.P.	Early Stage	12 / 7 / 2005	18,000,000	1,332,045	0
36.	Meritech Capital Partner III, L.P.	Later Stage	7 / 13 / 2005	35,000,000	5,775,000	0
	Meritech Capital Partners II	Later Stage	10 / 25 / 2000	24,600,166	20,101,451	6,845,826
37.	Mid-Atlantic III	Early Stage	4 / 1 / 1997	20,008,308	20,111,247	4,465,817
	Mid-Atlantic Venture Fund IV L.P.	Early Stage	5 / 4 / 2000	30,000,000	26,400,000	217,297
	NEPA Venture-II	Early Stage	7 / 24 / 1992	7,500,000	7,526,234	34,796,288
38.	Morgenthaler Partners VII L.P.	Early Stage	7 / 26 / 2001	35,000,000	26,250,000	3,977,583
	Morgenthaler Partners VIII, L.P.	Diversified	4 / 27 / 2005	35,000,000	7,000,000	0
39.	New Enterprise Associates X LP	Early Stage	9 / 13 / 2000	35,000,000	30,653,000	11,587,795
	New Enterprise Associates VI	Early Stage	3 / 2 / 1994	25,000,000	25,000,000	196,734,032
	New Enterprises Associates VII	Early Stage	4 / 1 / 1997	30,000,000	30,000,000	97,217,571
	New Enterprise Associates IX	Early Stage	10 / 28 / 1999	20,000,000	19,600,000	2,330,761
	New Enterprise Associates 11	Early Stage	10 / 29 / 2003	25,000,000	16,250,000	2,665,232
	New Enterprise Associates 12	Diversified	4 / 26 / 2006	35,000,000	1,404,833	0

Investment Summary - Alternative Investments

SERS Venture Capital Committed, Drawn and Distributed (continued)

As of December 31, 2006

	Active Venture Capital Funds Limited Partnership	Financing Stage Focus	SERS Initial Funding	Capital Committed	Capital Drawn	Distributions
40.	Oak Investment Partners XI	Later Stage	6/9/2004	$35,000,000	26,610,295	2,503,779
	Oak Investment Partners XII	Early/Late Stage	7/6/2006	40,000,000	4,686,390	0
41.	PA Early Stage Partners III L.P.	Early Stage	6/6/2001	10,000,000	4,200,000	0
42.	Polaris Venture Partners	Early Stage	6/4/1996	15,000,000	14,595,000	46,501,899
	Polaris Venture Partners II	Early Stage	9/8/1998	25,000,000	24,750,000	24,859,455
	Polaris Venture Partners III L.P.	Early Stage	1/6/2000	50,000,000	46,000,000	13,041,838
	Polaris Venture Partners IV L.P.	Early Stage	7/31/2001	50,000,000	38,000,000	0
	Polaris Venture Partners V	Diversified	1/25/2006	50,000,000	1,500,000	0
43.	Quaker Bio Ventures	Early Stage	2/25/2003	20,000,000	11,922,957	1,291,707
44.	Sofinnova Venture Partners VII, L.P.	Early Stage	*	20,000,000	0	0
45.	Sprout VII	Early Stage	2/24/1995	18,000,000	18,000,000	34,604,446
46.	Summit IV	Later Stage	6/27/1995	25,000,000	24,250,000	182,561,331
	Summit Accelerator Fund L.P.	Early Stage	11/15/1999	8,000,000	7,320,000	4,061,865
	Summit V	Later Stage	3/1/1998	37,500,000	35,812,500	40,680,554
	Summit Partners VC II L.P.	Diversified	4/27/2005	15,000,000	975,000	0
47.	T.Rowe Price	Stock Distribution	1/3/2005	0	168,439,563	103,739,636
48.	TA/Advent VIII	Later Stage	2/3/1997	30,000,000	29,541,093	51,649,099
49.	TL Ventures III LP	Early Stage	1/3/1997	15,000,000	15,062,614	18,874,357
	TL Ventures IV	Early Stage	5/13/1999	35,000,000	35,000,000	7,974,759
	TL Ventures V	Early Stage	7/13/2000	40,000,000	27,648,219	2,969,489
50.	Three Arch Capital LP	Early Stage	12/20/2000	20,000,000	16,450,000	3,145,142
	Three Arch Partners IV, L.P.	Early/Late Stage	9/10/2003	20,000,000	4,500,000	465,004
51.	US Venture Partners VII LP	Early Stage	1/24/2000	13,750,000	13,087,500	638,812
	US Venture Partners VIII LP	Early Stage	12/6/2000	26,250,000	21,463,125	2,762,215
52.	Weston Presidio II	Later Stage	11/27/1995	20,000,000	17,000,000	41,383,116
	Weston Presidio III	Later Stage	3/31/1999	35,000,000	31,237,086	20,994,821
	Weston Presidio IV	Later Stage	6/21/2000	35,000,000	31,207,752	12,127,743
	Weston Presidio V	Later Stage	12/8/2004	50,000,000	9,100,000	0
53.	Worldview Technology Partners IV	Early Stage	1/31/2001	18,130,023	15,120,043	1,907,983
	Total Active VC Commitments			**$3,262,751,534**	**2,331,464,547**	**1,656,641,939**

**Not Funded as of 9/30/06*
Commitments as of 12/31/06
Cash flows as of 9/30/06

Inactive Venture Capital Funds

Limited Partnership	Capital Committed	Capital Drawn	Distributions
Total Inactive Venture Capital	**$114,700,000**	**107,276,929**	**275,431,540**

Investment Summary - Alternative Investments

SERS Private Equity Investments Committed, Drawn and Distributed

As of December 31, 2006

The Capital Committed column represents total dollars allocated from SERS to each limited partnership. Capital Drawn is the portion of SERS capital commitments drawn by the General Partner to be invested with underlying portfolio companies. The Distributions column shows the value of original capital and profits returned to SERS.

	Active Private Equity Funds Limited Partnership	Financing Stage Focus	SERS Initial Funding	Capital Committed	Capital Drawn	Distributions
1.	ABACUS Fund Partners L.P.	Hedge Fund	4/24/2000	$15,000,000	15,149,220	8,131,989
2.	ABRY Broadcast Partners III	Buyouts	4/1/1997	25,000,000	27,013,555	21,852,484
	ABRY Broadcast Partners IV LP	Buyouts	7/26/2000	35,000,000	27,603,837	28,614,628
	ABRY Mezzanine Partners	Mezzanine	12/5/2001	30,000,000	30,844,559	11,727,676
	ABRY Partners V, L.P.	Buyouts	10/27/2004	45,000,000	14,780,925	272,411
	ABRY Senior Equity II, L.P.	Mezzanine	1/25/2006	30,000,000	3,275,127	0
3.	ABS Capital Partners III L.P.	Buyouts	1/26/1999	35,000,000	29,705,650	15,910,364
	ABS Capital Partners IV L.P.	Buyouts	10/13/2000	35,000,000	31,048,249	17,129,164
	ABS Capital Partners V, L.P.	Buyouts	11/14/2005	20,000,000	4,734,049	0
4.	AG Capital Recovery Partners II LP	Distressed Debt	10/1/2001	17,600,000	17,695,470	26,494,566
	AG Capital Recovery Partners III LP	Distressed Debt	3/20/2002	20,000,000	16,000,000	24,819,042
	AG Capital Recovery Partners IV LP	Distressed Debt	1/23/2003	50,000,000	35,415,216	42,985,501
	AG Capital Recovery Partners V, L.P.	Distressed Debt	1/25/2006	20,000,000	4,600,000	0
5.	APAX Europe IV L.P.	Buyouts	3/31/1999	35,000,000	29,445,670	20,968,215
	APAX Europe V LP	Buyouts	12/6/2000	60,000,000	64,413,049	77,570,053
	APAX Europe VI, L.P.	Later Stage	10/27/2004	60,000,000	50,699,826	8,369,693
	APAX Germany II	Middle/Later Stage	7/15/1997	8,737,262	8,455,477	16,916,389
	APAX UK Ventures VI	Middle/Later Stage	12/9/1997	6,558,000	6,861,111	12,302,931
6.	AXA Secondary Fund III	Secondaries	11/19/2004	26,000,000	11,801,475	9,161,998
	AXA Secondary Fund III-2	Secondaries	11/29/2004	14,000,000	6,143,919	4,999,420
	AXA Secondary Fund IV	Secondaries	*	80,000,000	0	0
7.	Abingworth Bioventures V, L.P.	Early Stage	*	33,775,000	0	0
8.	Accel Europe L.P.	Early Stage	7/2/2001	15,000,000	7,300,000	0
9.	Alpha Private Equity Fund 4 L.P.	Mid Market Buyouts	1/23/2002	26,580,000	34,973,099	37,028,356
	Alpha Private Equity Fund 5, L.P.	Mid Market Buyouts	12/14/2005	60,194,500	7,711,625	0
10.	Apollo Investment Fund IV	Buyouts	8/3/1998	75,000,000	73,952,122	69,777,395
	Apollo Investment Fund V	Buyouts	4/18/2001	50,000,000	53,343,540	51,779,988
	Apollo Investment Fund VI, L.P.	Buyouts	9/14/2005	40,000,000	4,273,977	0
11.	Asia Pacific Growth Fund III	Global Situations	3/8/1999	15,000,000	15,171,945	4,658,746
12.	Audax Private Equity Fund II, L.P.	Mid Market Buyouts	4/27/2005	25,000,000	7,123,799	41,559
	Audax Private Equity Fund L.P.	Mid Market Buyouts	5/25/2000	35,000,000	34,732,061	35,226,888
13.	Avenue Asia Special Situations Fund IV, LP	Distressed Debt	4/26/2006	50,000,000	2,664,750	6,587
	Avenue Special Situations Fund III, L.P.	Distressed Debt	7/16/2003	50,000,000	42,428,808	46,369,581
	Avenue Special Situations Fund IV, L.P.	Distressed Debt	8/29/2005	50,000,000	34,686,804	0
14.	B III Capital Partners	Distressed Debt	8/1/1997	35,000,000	34,503,390	47,650,729
15.	BC European Capital VII LP	Buyouts	7/27/2000	37,345,000	35,046,584	38,005,838
	BC European Capital VII Top Up	Buyouts	3/14/2001	12,090,549	11,246,070	7,732,853
	BC European Capital VIII, L.P.	Buyouts	1/26/2005	97,635,000	7,044,526	0

Investment Summary - Alternative Investments

SERS Private Equity Investments Committed, Drawn and Distributed (continued)

As of December 31, 2006

	Active Private Equity Funds Limited Partnership	Financing Stage Focus	SERS Initial Funding	Capital Committed	Capital Drawn	Distributions
16.	Bain Capital Fund IX, L.P.	Buyouts	3 / 15 / 2006	$75,000,000	21,375,000	0
	Bain Capital Fund VII	Buyouts	7 / 6 / 2000	25,000,000	24,062,500	21,321,757
	Bain Capital Fund VIII-E, L.P.	Buyouts	9 / 15 / 2004	13,405,000	6,912,043	477,177
	Bain Capital IX Coinvestment Fund	Buyouts	3 / 15 / 2006	15,000,000	2,325,000	0
17.	Berkshire Fund VI LP	Mid Market Buyouts	9 / 28 / 2001	20,000,000	13,976,251	9,322,844
	Berkshire Fund VII	Mid Market Buyouts	*	32,000,000	0	0
18.	Blackstone Capital II	Buyouts	8 / 26 / 1994	40,000,000	42,827,676	92,799,317
	Blackstone Capital III	Buyouts	11 / 3 / 1997	75,000,000	74,178,299	91,205,625
	Blackstone Capital IV	Buyouts	10 / 31 / 2001	75,000,000	70,870,100	57,435,480
	Blackstone Capital Partners V, L.P.	Buyouts	9 / 14 / 2005	150,000,000	25,391,527	8,722
	Blackstone Communications Partners I LP	Buyouts	8 / 29 / 2000	25,000,000	26,330,314	14,764,341
19.	Brait IV, L.P.	Buyouts	*	25,000,000	0	0
20.	Brynwood Partners V, L.P.	Mid Market Buyouts	7 / 31 / 2005	10,000,000	4,856,219	0
21.	Centerbridge Capital Partners I, L.P.	Buyouts	9 / 26 / 2006	50,000,000	598,054	0
22.	Cerberus Institutional Partners L.P.	Distressed Debt	3 / 5 / 1999	35,000,000	35,000,000	63,510,332
	Cerberus Institutional Partners Series Three	Distressed Debt	9 / 10 / 2003	35,000,000	13,921,354	1,697,911
	Cerberus Institutional Partners Series Two	Distressed Debt	10 / 9 / 2001	35,000,000	30,100,793	45,330,256
	Cerberus Institutional Partners Series Four	Distressed Debt	*	75,000,000	0	0
23.	Charterhouse Capital Partners VII	Buyouts	12 / 4 / 2002	50,000,000	50,373,671	28,358,807
	Charterhouse Capital Partners VIII	Diversified	1 / 26 / 2006	72,161,102	10,745,511	0
24.	Charterhouse Equity Partners II	Buyouts	3 / 30 / 1994	40,000,000	43,849,172	100,462,834
	Charterhouse Equity Partners III	Buyouts	11 / 19 / 1997	50,000,000	55,395,586	42,613,033
25.	Chequers Capital XV, L.P.	Buyouts	3 / 15 / 2006	42,315,000	3,631,883	0
26.	Chrysalis Capital Partners, L.P.	Distressed Debt	3 / 16 / 2005	20,000,000	3,000,000	519,632
	LLR Equity Partners II, L.P.	Buyouts	1 / 29 / 2004	25,000,000	9,237,377	2,013,889
	LLR Equity Partners LP	Mid Market Buyouts	1 / 24 / 2000	25,000,000	24,341,235	27,665,873
27.	Clayton Dubilier & Rice V	Buyouts	5 / 3 / 1995	50,000,000	49,601,504	49,826,483
	Clayton Dubilier & Rice VI	Buyouts	1 / 4 / 1999	50,000,000	37,673,182	17,741,863
28.	Code Hennessy & Simmons	Buyouts	9 / 28 / 1989	10,000,000	9,650,000	27,208,717
	Code Hennessy & Simmons II	Buyouts	7 / 12 / 1994	20,000,000	20,000,000	50,245,995
	Code Hennessy & Simmons III	Buyouts	8 / 1 / 1997	40,000,000	38,724,000	53,983,600
	Code Hennessy & Simmons IV	Mid Market Buyouts	8 / 31 / 1999	100,000,000	96,270,000	77,348,153
	Code Hennessy & Simmons Equity V, L.P.	Mid Market Buyouts	9 / 15 / 2004	50,000,000	16,716,110	0
29.	Cognetas Fund II, L.P.	Buyouts	1 / 26 / 2005	52,072,000	13,850,442	0
30.	DLJ Merchant Banking Fund II	Buyouts	5 / 22 / 1997	75,000,000	80,615,348	90,041,814
	DLJ Merchant Banking Fund III	Buyouts	6 / 6 / 2001	85,000,000	91,501,061	87,789,940
31.	Elevation Partners, L.P.	Private Equity	10 / 27 / 2004	35,000,000	10,705,973	0
32.	Energy Spectrum Partners IV, L.P.	Mid Market Buyouts	11 / 15 / 2004	50,000,000	25,821,022	0
33.	Eureka II, L.P.	Mid Market Buyouts	9 / 14 / 2005	20,000,000	6,056,425	0

Investment Summary - Alternative Investments

SERS Private Equity Investments Committed, Drawn and Distributed (continued)

As of December 31, 2006

	Active Private Equity Funds Limited Partnership	Financing Stage Focus	SERS Initial Funding	Capital Committed	Capital Drawn	Distributions
34.	Excelsior Capital Asia Partners III, L.P.	Middle / Later Stage	3 / 15 / 2006	$25,000,000	535,139	0
35.	First Reserve Fund X, L.P.	Buyouts	1 / 15 / 2004	30,000,000	21,737,555	10,293,701
	First Reserve Fund XI	Buyouts	*	60,000,000	0	0
36.	Francisco Partners II, L.P.	Buyouts	3 / 15 / 2006	30,000,000	1,725,000	0
	Francisco Partners LP	Buyouts	5 / 8 / 2000	50,000,000	45,734,586	16,137,883
37.	Frontenac VII	Buyouts	8 / 1 / 1997	40,000,000	40,000,000	54,428,513
38.	GTC&R V	Buyouts	4 / 25 / 1997	11,400,000	11,400,000	17,085,761
	GTC&R VI	Buyouts	6 / 25 / 1998	50,000,000	50,854,013	41,095,935
	GTC&R VII	Buyouts	3 / 15 / 2000	55,000,000	47,427,796	57,747,464
	GTCR VIII	Buyouts	5 / 12 / 2003	75,000,000	57,750,000	29,845,283
	GTCR IX, L.P.	Early Stage	*	50,000,000	0	0
39.	Great Hill Equity Partners	Buyouts	4 / 12 / 1999	30,000,000	29,775,000	24,612,347
	Great Hill Equity Partners II LP	Buyouts	7 / 26 / 2000	35,000,000	33,425,000	42,681,832
	Great Hill Equity Partners III, L.P.	Mid Market Buyouts	1 / 25 / 2006	35,000,000	7,612,500	0
40.	Gryphon Partners II LP	Buyouts	8 / 6 / 1999	35,000,000	35,881,393	27,582,490
	Gryphon Partners III, LP	Buyouts	6 / 9 / 2004	30,000,000	8,437,050	1,484,758
41.	Hancock IPEP II (Harbourvest II)	Fund of Funds	4 / 1 / 1997	25,000,000	24,357,775	29,592,145
	HarbourVest Inter lll	Fund of Funds	6 / 22 / 1998	40,000,000	37,200,000	25,068,683
	Harbourvest Intl' Private Equity Partners IV	Fund of Funds	12 / 6 / 2000	40,000,000	27,600,000	10,728,585
	HIPEP V-Asia Pacifc & Rest of World Ptr. Fund	Buyouts	4 / 26 / 2006	30,000,000	2,745,316	0
42.	Hellman & Friedman II	Global Situations	1 / 7 / 1992	21,130,323	23,218,222	39,807,943
	Hellman Friedman III	Global Situations	6 / 14 / 1995	50,000,000	40,308,123	91,378,863
	Hellman Friedman IV	Global Situations	8 / 3 / 1999	75,000,000	66,540,777	78,466,964
	Hellman Friedman V	Diversified	8 / 1 / 2004	80,000,000	51,117,717	2,537,894
	Hellman & Friedman VI	Buyouts	*	125,000,000	0	0
43.	InterMedia Partners VII, LP	Diversified	*	15,000,000	0	0
44.	Invemed Catalyst Fund L.P.	Mid Market Buyouts	9 / 30 / 1999	25,000,000	13,216,624	1,407,460
45.	J.H. Whitney V LP	Later Stage	9 / 13 / 2000	20,000,000	19,298,665	14,858,105
	J.H. Whitney VI, L.P.	Buyouts	1 / 26 / 2005	50,000,000	13,694,245	0
46.	J.W. Childs Equity Partners III L.P.	Mid Market Buyouts	1 / 23 / 2002	40,000,000	33,370,036	9,250,905
47.	JP Morgan US Corp Finance Investors II	Fund of Funds	7 / 24 / 2002	50,000,000	26,883,802	5,850,769
48.	Kelso Investment Associates V	Buyouts	1 / 26 / 1994	40,000,000	54,411,479	144,929,426
	Kelso VI	Buyouts	7 / 7 / 1998	75,000,000	69,057,922	71,914,227
	Kelso VII	Buyouts	2 / 11 / 2004	40,000,000	18,072,390	2,078,471
49.	Landmark Equity IV	Secondaries	2 / 28 / 1995	14,923,291	12,880,353	17,992,121
	Landmark Equity Partners V	Secondaries	1 / 27 / 1996	19,624,113	19,434,947	22,954,499
50.	Leeds Weld Equity Partners IV, L.P.	Mid Market Buyouts	7 / 30 / 2004	20,000,000	11,144,645	0
51.	Lexington Capital Partners II	Secondaries	4 / 1 / 1998	40,000,000	39,538,000	38,889,029
	Lexington Capital Partners III L.P.	Secondaries	1 / 26 / 1999	35,000,000	34,010,028	32,827,205
	Lexington Capital Partners V	Secondaries	7 / 25 / 2001	75,000,000	65,790,788	45,578,578
	Lexington Capital Partners VI, L.P.	Secondaries	8 / 12 / 2005	50,000,000	5,307,628	4,560

Investment Summary - Alternative Investments

SERS Private Equity Investments Committed, Drawn and Distributed (continued)

As of December 31, 2006

	Active Private Equity Funds Limited Partnership	Financing Stage Focus	SERS Initial Funding	Capital Committed	Capital Drawn	Distributions
52.	Lime Rock Partners III, L.P.	Growth Equity	10/27/2004	$15,000,000	7,559,921	0
	Lime Rock Partners IV, L.P.	Growth Equity	*	25,000,000	0	0
	Lime Rock Resources, L.P.	Diversified	12/7/2005	20,000,000	4,583,591	0
53.	Madison Dearborn Capital Partners	Buyouts	2/23/1993	15,000,000	14,538,849	41,226,794
	Madison Dearborn Capital Partners IV	Buyouts	10/27/2000	90,000,000	76,869,714	25,525,602
	Madison Dearborn Capital Partners V	Buyouts	2/16/2006	75,000,000	281,250	0
	Madison Dearborn Capital Partners II	Buyouts	1/3/1997	40,000,000	40,152,017	84,292,693
	Madison Dearborn III	Buyouts	4/6/1999	75,000,000	76,194,907	75,225,652
54.	Matlin Patterson Global Opportunities II	Distressed Debt	12/3/2003	30,000,000	22,629,233	3,492,128
	MatlinPatterson Global Opportunities Partners	Distressed Debt	5/4/2001	35,000,000	33,613,973	32,681,917
55.	Media/Communication III	Buyouts	6/2/1997	25,000,000	24,131,061	25,539,613
	Media/Communications IV	Buyouts	2/5/1999	25,000,000	23,125,000	3,333,333
	Media/Communications Ventures Fund V LP	Buyouts	7/26/2000	35,000,000	30,829,565	10,435,283
56.	Meridian Venture Partners II, L.P.	Buyouts	1/26/2005	10,000,000	8,750,000	823,344
57.	New York Life Capital Partners III, L.P.	Secondaries	5/31/2006	50,000,000	5,415,733	0
58.	Newbridge Asia II L.P.	Buyouts	9/3/1999	15,000,000	15,199,629	13,250,716
	Newbridge Asia III LP	Buyouts	7/6/2000	15,000,000	15,015,979	4,526,177
	Newbridge Asia IV LP	Buyouts	6/1/2005	40,000,000	16,321,973	79,575
59.	Nordic Capital V L.P.	Buyouts	12/4/2002	40,000,000	40,787,212	15,251,232
	Nordic Capital VI, L.P.	Buyouts	10/26/2005	72,588,000	3,852,343	0
60.	OCM Opportunities Fund	Distressed Debt	1/12/1996	24,000,000	24,534,457	34,577,066
	OCM Opportunities Fund II	Distressed Debt	2/5/1998	40,000,000	40,099,999	54,580,932
	OCM Opportunities Fund III	Distressed Debt	1/20/2000	60,000,000	60,007,890	83,101,369
	OCM Opportunities Fund IV	Distressed Debt	12/31/2001	70,000,000	68,250,000	114,041,812
	OCM Opportunities Fund V	Distressed Debt	7/14/2004	40,000,000	40,003,507	43,836
	OCM Opportunities Fund VI, L.P.	Distressed Debt	9/14/2005	40,000,000	30,000,000	0
	OCM Principal Opportunities	Distressed Debt	11/12/1996	25,000,000	25,057,879	28,026,126
	OCM Principal Opportunities II	Distressed Debt	3/14/2001	25,000,000	25,000,000	30,050,243
	OCM/GFI Power Opportunities Fund II, L.P.	Buyouts	4/27/2005	25,000,000	3,777,862	29,205
	Oaktree Capital Management LLC	Diversified	5/28/2004	20,000,000	20,577,053	2,995,368
61.	Oakhill Capital Partners	Buyouts	5/17/1999	50,000,000	52,236,073	42,965,636
62.	Palamon European Equity II, L.P.	Diversified	6/14/2005	40,114,200	5,369,178	0
	Palamon European Equity L.P.	Buyouts	7/23/1999	30,000,000	32,265,087	25,358,926
63.	Parthenon Investors II	Mid Market Buyouts	9/25/2001	20,000,000	18,322,527	13,440,054
64.	Permira European Fund	Buyouts	7/1/1997	36,000,000	32,159,947	70,324,495
	Permira European Fund II	Buyouts	6/7/2000	50,000,000	43,846,362	59,807,717
	Permira European Fund III, L.P.	Buyouts	10/3/2003	112,640,170	64,752,241	23,852,391
	Permira IV, L.P.	Buyouts	*	126,870,000	0	0
	Permira UK Venture Fund III	Middle/Later Stage	8/29/1989	9,063,438	8,946,988	26,106,191
	Permira UK Venture Fund IV	Middle/Later Stage	4/2/1996	15,000,000	15,993,572	22,367,105

Investment Summary - Alternative Investments

SERS Private Equity Investments Committed, Drawn and Distributed (continued)
As of December 31, 2006

	Active Private Equity Funds Limited Partnership	Financing Stage Focus	SERS Initial Funding	Capital Committed	Capital Drawn	Distributions
65.	Pitango Venture Capital Fund IV, LP	Diversified	4/21/2004	$20,000,000	8,801,534	0
66.	Providence Equity Partners IV LP	Middle/Later Stage	10/25/2000	25,000,000	27,235,356	25,955,025
	Providence Equity Partners V LP	Mid Market Buyouts	7/14/2004	50,000,000	28,961,398	188,442
	Providence Equity Partners VI, L.P.	Buyouts	*	50,000,000	0	0
67.	RRZ Private Equity	Buyouts	11/7/1996	20,000,000	20,246,562	10,848,280
68.	SCP Private Equity Partners II L.P.	Buyouts	6/15/2000	25,000,000	21,971,188	2,127,951
69.	ShoreView Capital Partners	Buyouts	4/23/2003	38,000,000	24,892,468	24,338,599
70.	Siguler Guff BRIC Opportunities Fund, L.P.	Fund of Funds	3/15/2006	10,000,000	2,058,299	103,717
71.	Sterling Capital Partners II	Buyouts	3/16/2005	30,000,000	6,754,100	0
	Sterling Capital Partners LP	Buyouts	10/15/2002	15,000,000	8,332,317	3,007,772
72.	Summit Partners Private Equity Fund VII L.P.	Buyouts	4/27/2005	97,134,500	4,856,725	0
	Summit Ventures VI LP	Later Stage	1/11/2001	62,000,000	58,912,929	27,850,577
73.	TA/Advent IX	Later Stage	9/20/2000	45,000,000	43,650,000	28,161,536
	TA/Advent X	Middle/Later Stage	1/25/2006	70,000,000	4,900,000	0
74.	TPG Partners II	Buyouts	5/2/1997	75,000,000	76,477,220	77,544,171
	TPG Partners III	Buyouts	12/15/1999	75,000,000	69,112,892	93,687,348
	TPG Partners IV	Buyouts	12/3/2003	30,000,000	23,024,120	9,347,065
	TPG Partners V	Buyouts	4/26/2006	100,000,000	1,113,009	0
75.	Thomas H. Lee Equity Fund IV LP	Buyouts	4/24/1998	70,000,000	63,844,603	47,761,305
	Thomas H Lee Equity Fund V LP	Buyouts	7/1/2000	100,000,000	101,252,737	56,575,328
	Thomas H. Lee Equity Fund VI, L.P.	Mid Market Buyouts	*	50,000,000	0	0
76.	UMS Partners Fund I, L.P.	Distressed Debt	7/14/2004	5,000,000	5,000,000	0
77.	Vestar Capital Partners III	Buyouts	5/7/1997	25,000,000	23,152,400	18,182,623
	Vestar Capital Partners IV L.P.	Mid Market Buyouts	11/22/1999	100,000,000	92,345,592	56,548,174
	Vestar Capital Partners V, L.P.	Mid Market Buyouts	9/14/2005	50,000,000	6,842,067	0
	Total Active Private Equity Commitments			**$7,727,956,448**	**4,828,658,718**	**4,198,892,282**

**Not Funded as of 9/30/06*
Commitments as of 12/31/06
Cash flows as of 9/30/06

Inactive Private Equity Funds

Limited Partnership	Capital Committed	Capital Drawn	Distributions
Total Inactive Private Equity	**$67,700,000**	**68,303,179**	**126,269,030**

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Actuarial Section

Actuary's Certification

Hay Group. Inc.
Suite 600
4301 North Fairfax Drive
Arlington, VA 22203
USA

April 25, 2007

Mr. Eric Henry
Executive Director
State Employees' Retirement System
30 North Third Street
Suite 150
Harrisburg, PA 17101-1716

HayGroup®

Dear Mr. Henry:

The purpose of this letter is to certify the actuarial adequacy of the contributions being made by the Commonwealth of Pennsylvania and other participating agencies to the Pennsylvania State Employees' Retirement System (SERS), and to discuss the approach currently being taken toward meeting the financing objectives of the plan. The results provided herein are based upon the December 31, 2006 annual actuarial valuation.

The funding objective of the plan is set forth in the SERS code. The annual employer contribution is equal to the sum of the following for the fiscal year beginning July 1, 2007:

(1) The employer share of the normal cost.
(2) The amortization of the December 31, 2001 liability for Act 2001-9 benefits over a 30-year period beginning July 1, 2002 and ending on June 30, 2032.
(3) The amortization of the remaining unfunded liabilities as of December 31, 2001 over a ten-year period beginning July 1, 2002 and ending on June 30, 2012.
(4) The amortization of all unfunded liabilities due to supplemental annuities (COLAs) after 2001, or other legislated benefit improvements after June 30, 2003, over ten-year periods beginning with the July first following the effective date of the change.
(5) The amortization of changes in liability due to actual experience differing from assumed experience after December 31, 2001 over 30-year periods beginning with the July first following the actuarial valuation determining such changes.

The amortization payments are level amounts over the applicable amortization periods. The employer cost is determined as a percent of payroll, and the employer contributes that percent of the payroll of all covered members during each fiscal year.

All costs and liabilities have been determined in conformance with generally accepted actuarial principles and procedures in accordance with the principles of practice prescribed by the American Academy of Actuaries. The calculations were performed on the basis of actuarial assumptions and methods, which are internally consistent, and reasonable (taking into account past experience under the SERS and reasonable expectations) and which in combination represent the best estimate of anticipated experience under the plan.

The actuarial valuation is based on financial and participant data, which is prepared by SERS staff. The data are reviewed for internal and year-to-year consistency as well as general reasonableness prior to their use in the actuarial valuation.

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Actuary's Certification

Mr. Eric Henry
April 25, 2007
Page 2

The actuarial valuation uses assumptions regarding future rates of investment return and rates of retirement, withdrawal, death, and disability among SERS members and their beneficiaries. The current set of assumptions used in the December 31, 2006 actuarial valuation was adopted by the Board and was based on actual experience of SERS during the years 2001 through 2005. The actuarial value of assets is developed by recognizing the difference between the expected actuarial value of assets and the market value of assets over a five-year period.

Governmental Accounting Standards Board (GASB) Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans* establishes a range of actuarial cost and amortization methods for the Unfunded Actuarial Accrued Liability. The scheduled payments since July 1, 2005 have been below the minimum amount required to meet the GASB #25 minimum. This is a temporary result of financing changes implemented by Act 2003-40 in December 2003. After June 30, 2010, we expect the SERS contribution to exceed the GASB #25 minimum.

The "Schedule of Funding Progress" and "Schedule of Employer Contributions" included in the Financial Section are provided as part of the accounting disclosure statements in accordance with GASB #25. These two schedules were derived from the December 31, 2006 actuarial valuation.

With the exception of the "Schedule of Retirees and Beneficiaries Added to and Removed from Rolls" and the "Summary of Plan Provisions", the schedules appearing in the Actuarial Section were derived from the December 31, 2006 actuarial valuation.

Based upon the valuation results, it is our opinion that the Pennsylvania State Employees' Retirement System is in sound condition in accordance with generally accepted actuarial principles and procedures. The employer contribution has been below the GASB #25 minimum since July 1, 2005 and will likely remain below the minimum through June 30, 2010. However, we project that the employer payments scheduled after that time are above the GASB minimum and that the plan is in sound condition over the long run.

Respectfully submitted,
Hay Group

By ______________________________
Edwin C. Hustead, F.S.A.
Member American Academy of Actuaries
Enrolled Actuary No. 05-1499

By ______________________________
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Summary of Actuarial Assumptions and Methods

- The investment rate of return is 8.5% per year based on an underlying rate of inflation of 3.0% per year.

- The Plan uses a five–year smoothed market approach to value plan assets for actuarial purposes.

- Actuarial methods are specified by statute. Actuarial assumptions are recommended by the plan's actuary and approved by the SERS Board of Trustees. The Board of Trustees approved assumptions based on a new experience study for the current valuation.

- For current and future non-disabled retirees, beneficiaries, and survivors, the plan uses the RP-2000 Healthy Annuitant Mortality Table projected to 2008. For current and future disabled retirees, the plan uses the RP-2000 Disabled Retiree Annuitant Mortality Table projected to 2008. For all pre-retirement active employees, the mortality is based on actual SERS experience.

- The rates for probability of retirement and the probabilities of withdrawal from active service, including death, before age and service retirements are presented in the Schedule of Active Member Valuation Data.

- The projected average salary increase is 7.1% with a range of 4.9% to 20.2%. This increase includes an underlying assumption of 3.0% for inflation. The annual rate of salary increase for promotions and longevity for members is presented in the Schedule of Active Member Valuation Data. For the current valuation, the salary increase assumptions for general employees have been modified to reflect the negotiated increases in the latest collective bargaining agreement.

- The Plan uses a variation of the entry-normal age actuarial cost method to determine the liabilities and costs related to the Plan's benefits. The method is based on the benefits and contributions for new employees rather than for all current employees from their date of entry. This variation should produce approximately the same results as the typical method over the long run. The Plan uses amortization periods of 10 years and 30 years as follows:

  (1) The amortization of the December 31, 2001 liability for Act 2001-9 benefits over a 30-year period beginning July 1, 2002 and ending on June 30, 2032.

  (2) The amortization of the remaining unfunded liabilities as of December 31, 2001 over a ten-year period beginning July 1, 2002 and ending on June 30, 2012.

  (3) The amortization of all unfunded liabilities due to supplemental annuities (COLAs) after 2001, or other legislated benefit improvements after June 30, 2003, over ten-year periods beginning with the July first following the effective date of the change.

  (4) The amortization of changes in liability due to actual experience differing from assumed experience after December 31, 2001 over 30-year periods beginning with the July first following the actuarial valuation determining such changes.

- The Plan does not use an assumption for cost-of-living adjustments in the determination of actuarial valuations.

- The Plan periodically prepares a study using actual experience in order to develop assumptions to be used in its actuarial valuations. The latest study was completed March 15, 2006, for the period January 1, 2001, through December 31, 2005.

- The most recent valuation was based on members of the Plan as of December 31, 2006. All census data was supplied by the Plan and was subject to reasonable consistency checks. Asset data was also supplied by the Plan.

- The actuarial computations were prepared by, or made under the supervision, of a Member of the American Academy of Actuaries (M.A.A.A.).

Schedules of Active Member Valuation Data

as of December 31, 2006

Withdrawal From Active Employment Before Age & Service Retirement

Annual Rate of Active Members Separating Within the Next Year

Table A[a]

Sample Age	Male Withdrawal Years of Service 0	5	9	14+	Male Death	Male Disability	Female Withdrawal Years of Service 0	5	9	14+	Female Death	Female Disability
20	11.85%	-	-	-	0.02	-	11.19%	-	-	-	0.02	-
25	11.60	1.97	1.97	-	0.02	0.03	10.24	2.68	2.12	-	0.02	0.07
30	11.11	1.97	1.48	1.54	0.03	0.09	10.24	2.68	1.88	2.03	0.02	0.17
35	10.86	1.83	1.00	1.05	0.05	0.16	10.24	2.21	1.41	1.55	0.03	0.29
40	10.86	1.28	1.00	1.05	0.06	0.25	10.01	2.21	0.85	0.61	0.05	0.38
45	10.49	1.28	0.49	0.56	0.12	0.44	9.77	1.98	0.85	0.61	0.07	0.60
50	10.24	1.14	0.49	0.56	0.21	0.61	9.77	1.98	0.47	0.61	0.12	0.91
55	10.24	1.48	1.48	1.54	0.33	0.80	9.77	1.65	1.41	1.55	0.18	1.15
60	-	-	-	-	0.48	-	-	-	-	-	0.30	-

Annual Rate of Retirement

Table B[a]

Sample Age	Full Benefits Male	Full Benefits Female
45-59	30.0%	30.0
60-61	25.0	25.0
62	33.0	33.0
63-64	22.0	22.0
65	33.0	33.0
66 - 79	22.0	22.0
80	100.0	100.0

Annual Rate of Salary Increase

Table C

Completed Years of Service	Increase
1	16.9%
2	8.3
3	5.9
4	4.6
5	4.2
6-10	3.2
11-15	2.8
16-20	2.4
21-25	1.8
26+	1.6

Reduced Benefits

Table D

Sample Age	5 - 14 Years of Service Male	5 - 14 Years of Service Female	15 or More Years of Service Male	15 or More Years of Service Female
20	-	-	-	-
25	3.0	3.9	-	-
30	2.5	3.5	-	-
35	1.9	2.8	2.6	2.7
40	1.7	1.7	2.6	2.7
45	1.1	1.6	2.6	2.7
50	1.0	1.3	2.6	2.7
55	2.3	2.3	3.9	3.9

[a] *The assumptions presented in Table A and Table B on this page were based on a review of SERS' experience from 2001 through 2005. The rates are the probabilities that an event wll occur in the year after the valuation. For instance, the male retirement rate of 33% at age 62 means that 330 of every 1,000 male employees age 62 and eligible for full benefits are expected to retire before they reach age 63.*

Schedules of Active Member Valuation Data

as of December 31, 2006

Active Members by Age and Years of Service - Male

Age Group	0 - 4	5 - 9	10 - 14	15 - 19	20 - 24	25 - 29	30 Plus	Total	Average Salary
	Years of Service								
< 20	32	-	-	-	-	-	-	32	$23,540
20 - 24	1,140	8	-	-	-	-	-	1,148	27,938
25 - 29	3,057	495	7	-	-	-	-	3,559	35,010
30 - 34	2,366	1,914	486	7	-	-	-	4,773	41,019
35 - 39	2,258	2,120	2,665	1,085	28	-	-	8,156	48,234
40 - 44	1,951	1,601	1,914	2,487	983	40	-	8,976	50,505
45 - 49	1,864	1,468	1,373	1,865	2,084	1,166	55	9,875	50,310
50 - 54	1,758	1,382	1,414	1,600	1,599	1,892	1,152	10,797	51,554
55 - 59	1,493	1,155	1,279	1,330	1,268	1,374	2,357	10,256	53,934
60 - 64	855	618	667	679	531	387	833	4,570	54,955
65 +	297	268	333	194	114	78	297	1,581	59,307
Total	**17,071**	**11,029**	**10,138**	**9,247**	**6,607**	**4,937**	**4,694**	**63,723**	**$49,455**

Average Age: 46.39

Average Service: 12.80

Active Members by Age and Years of Service - Female

Age Group	0 - 4	5 - 9	10 - 14	15 - 19	20 - 24	25 - 29	30 Plus	Total	Average Salary
	Years of Service								
<20	43	-	-	-	-	-	-	43	$23,014
20-24	1,178	31	-	-	-	-	-	1,209	25,890
25-29	2,322	631	22	-	-	-	-	2,975	32,140
30-34	1,814	1,216	385	33	-	-	-	3,448	35,876
35-39	1,819	1,294	1,066	635	64	-	-	4,878	38,392
40-44	1,784	1,219	965	1,105	748	136	-	5,957	40,712
45-49	1,901	1,322	1,115	1,194	1,135	1,225	113	8,005	42,648
50-54	1,706	1,244	1,112	1,338	1,080	1,439	1,636	9,555	45,225
55-59	1,089	929	891	1,142	963	973	1,493	7,480	46,066
60-64	414	422	476	484	406	286	355	2,843	45,234
65+	124	131	200	145	85	62	109	856	44,630
Total	**14,194**	**8,439**	**6,232**	**6,076**	**4,481**	**4,121**	**3,706**	**47,249**	**$41,616**

Average Age: 46.20

Average Service: 12.49

Aggregate Active Member Valuation Data

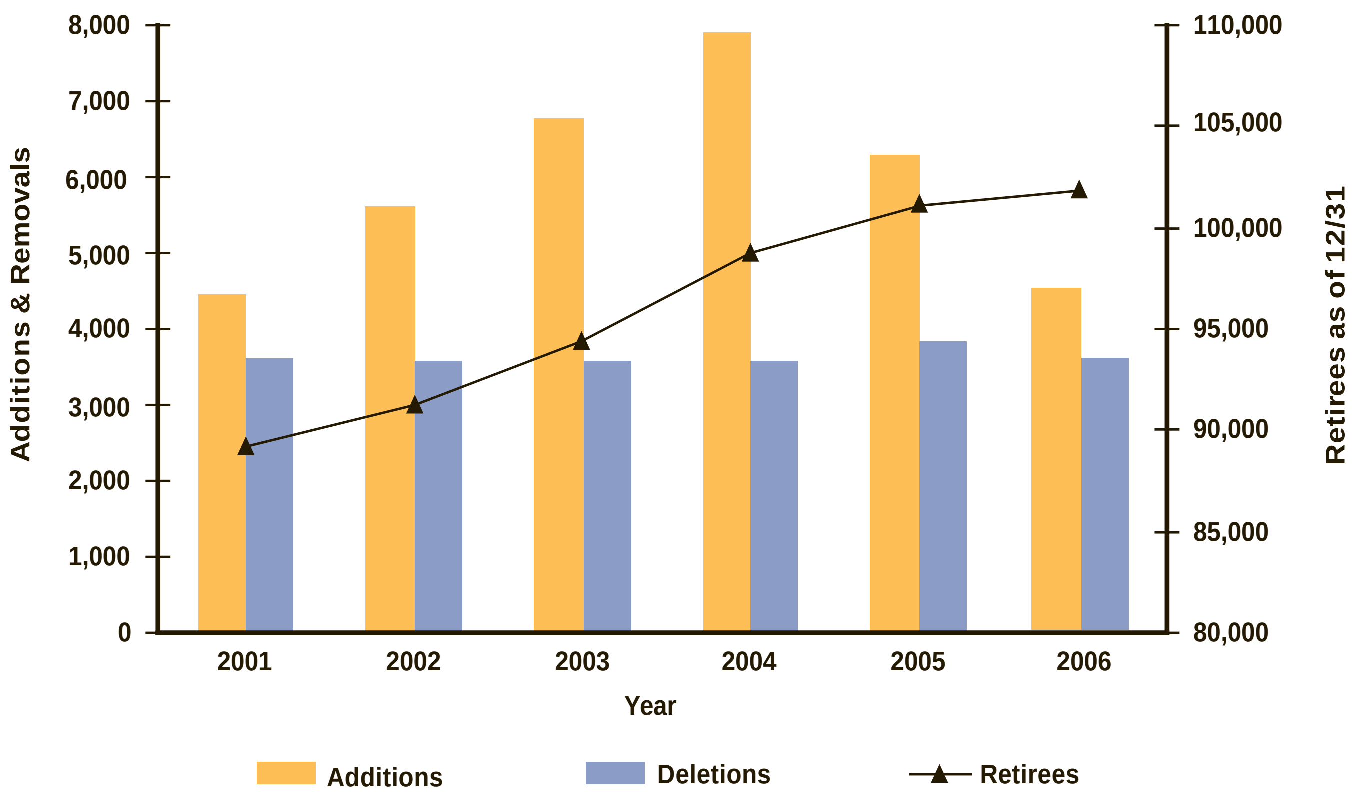
Valuation Date	Number Employers	Number Active Members	Annual Payroll	Annual Average Pay	% Increase/(Decrease) in Average Pay
31-Dec-06	108	110,972	$5,118,000,000	46,118	2.9%
31-Dec-05	108	109,981	4,929,000,000	44,815	-1.2
31-Dec-04	108	108,405	4,920,000,000	45,382	1.9
31-Dec-03	106	109,018	4,853,000,000	44,519	2.0
31-Dec-02	105	111,059	4,846,000,000	43,631	3.5
31-Dec-01	106	109,716	4,627,000,000	42,172	2.6

Schedule of Retirees and Beneficiaries Added to and Removed from Rolls

Six Years Ended December 31, 2006

	Added to Rolls		Removed from Rolls		Rolls - End of Year		Percentage Change	
Year	No.	Annual Allowances	No.	Annual Allowances	No.	Annual Allowances	No.	Annual Allowances
2006	4,514	$96,324,336	3,633	$40,351,097	102,060	$1,655,881,296	0.87%	3.44
2005	6,298	149,935,613	3,846	40,984,887	101,179	1,600,772,520	2.48	7.22
2004	7,905	198,252,778	3,590	37,279,580	98,727	1,492,913,832	4.57	12.04
2003	6,769	161,875,423	3,585	36,430,746	94,412	1,332,443,772	3.49	14.28
2002	5,605	126,087,119	3,594	31,408,470	91,228	1,165,985,640	2.25	12.92
2001	4,444	81,715,244	3,619	30,654,172	89,217	1,032,589,104	0.93	5.00

Retiree Rolls



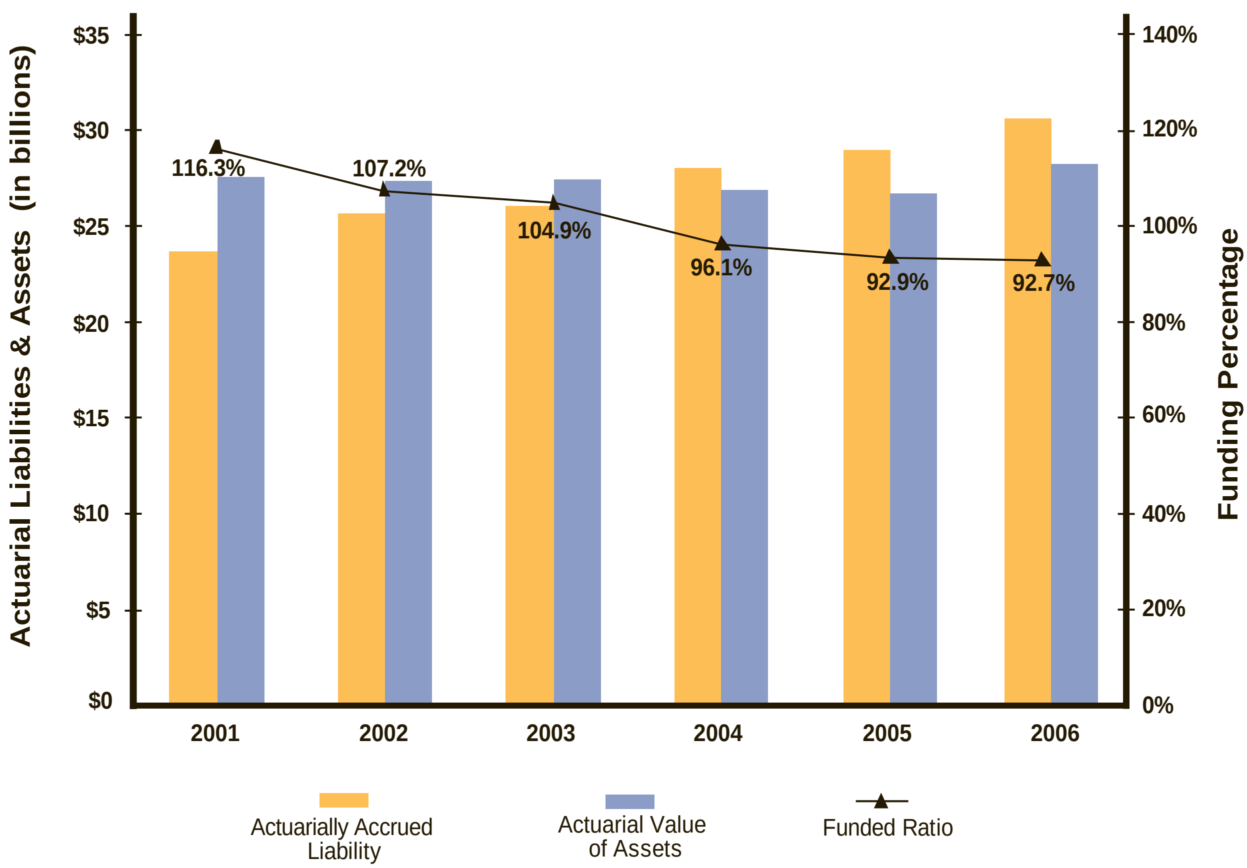
Solvency Test

Six Years Ended December 31, 2006

Dollar Amounts in Thousands

	Aggregate Accrued Liabilities For					Portion of Accrued Liabilities Covered by Reported Assets			
	(1)	(2)	(3)						
Valuation Date	Active Member Contributions	Retirees & Beneficiaries	Active Members (Employer Financed Portion)	Total Actuarial Accrued Liability (AAL)	Actuarial Valuation of Assets	(1)	(2)	(3)	Funded Ratio
31-Dec-06	$3,916,841	14,474,525	11,973,631	30,364,997	28,148,834	100.0%	100.0	81.5	92.7
31-Dec-05	3,696,477	14,000,196	11,155,043	28,851,716	26,793,782	100.0	100.0	81.6	92.9
31-Dec-04	3,593,576	12,779,570	11,625,880	27,999,026	26,900,027	100.0	100.0	90.5	96.1
31-Dec-03	3,588,664	11,296,520	11,294,577	26,179,761	27,465,615	100.0	100.0	100.0	104.9
31-Dec-02	3,498,672	10,129,669	12,022,048	25,650,389	27,497,464	100.0	100.0	100.0	107.2
31-Dec-01	3,344,107	8,684,734	11,629,916	23,658,757	27,505,494	100.0	100.0	100.0	116.3

FUND SOLVENCY



Analysis of Financial Experience

Four Years Ended December 31, 2006

Gains & Losses in Accrued Liabilities
Resulting from Differences Between Assumed Experience and Actual Experience
(Dollar Amounts in Thousands)

Type of Activity	2006	2005	2004	2003
Gain(Loss) from Investment Earnings	$568,176	(815,133)	(1,372,930)	(1,034,701)
Demographic Assumptions	(92,597)	4,931	15,539	9,889
Pay Increases	(213,715)	23,806	(156,133)	182,236
Other	73,112	42,858	(179,410)	(63,390)
Gain(Loss) During Year From Financial Experience	334,976	(743,538)	(1,692,934)	(905,966)
Non Recurring Items:				
Changes in Actuarial Methods and assumptions	6,546	248,873[a.]	(249,607)	564,365
Retiree COLA	-	-	-	(31,000)
Composite Gain(Loss)	**$341,522**	**(494,665)**	**(1,942,541)**	**(372,601)**

[a.] *Adoption of the assumptions from the 2005 experience study reduced the liability and employer contribution. The change in the salary increase assumptions from an age-based to service-based schedule reduced the unfunded liability by $874 million. Other experience study changes increased the unfunded liability by $536 million so the net effect of the experience study was to reduce the unfunded liability by $338 million. Changes resulting from the actuarial audit increased the unfunded liability by $89 million.*

Summary of Plan Provisions

Benefit and Contribution Provisions as of December 31, 2006

The State Employees' Retirement System makes provision for retirement, disability, and death benefits for all State employees and certain other eligible groups. The major provisions may be summarized as follows:

Eligible Employees

Class A All regular State employees and employees of certain Commissions and Authorities and employees of state-owned educational institutions and the Pennsylvania State University (unless such employees have joined the Public School Employees' Retirement System, TIAA-CREF, or Alternative Retirement Program (ARP)) hired before July 1, 2001 who did not elect into the Class AA membership as of December 31, 2001. This excludes Judges, and Magisterial District Judges who have elected Class E-1 or Class E-2.

Class AA All regular State employees who are hired after July 1, 2001, and former Class A State employees hired before July 1, 2001 who elected into Class AA as of December 31, 2001. This includes employees of certain Commissions and Authorities and employees of state-owned educational institutions and the Pennsylvania State University (unless such employees have joined the Public School Employees' Retirement System, TIAA-CREF, or ARP), but excludes State Police Troopers, Judges, Magisterial District Judges, and Legislators with Class D-3 or D-4.

Class C Liquor Law enforcement officers and other officers and certain employees of the State Police who have been members and employees continuously since prior to March 1, 1974.

Class D-3 Members of the General Assembly who have been members and employees continuously since prior to March 1, 1974.

Class D-4 Legislators who are elected after July 1, 2001, and legislators hired before July 1, 2001 who elected into this class, excluding Class D-3 members.

Class E-1 Judges

Class E-2 Magisterial District Judges

Age and Service Requirements for Superannuation (full formula benefits)

Class AA/A Age 60, with three years of service, except for members of the General Assembly, enforcement officers, correction officers, psychiatric security aids, and officers of the Delaware River Port Authority; for whom the requirement is age 50 with three years of service. Members of Class AA / A with 35 years of credited service are entitled to full formula benefits regardless of age. State Police Officers can retire on full benefits after age 50 or with 20 years of service. Capitol Police and Park Rangers can retire on full benefits at age 50 with 20 years of Capitol Police or Park Ranger service.

Class C Age 50, with three years of service.

Class D-3 Age 50, with three years of service.

Class D-4 Age 50, with three years of service.

Class E-1 Age 60, with three years of service; or 35 or more years of credited service, regardless of age.

Class E-2 Age 60, with three years of service; or 35 or more years of credited service, regardless of age.

Summary of Plan Provisions

Formula for Superannuation Annuity

The standard single-life annuity for most members is 2% of the high three-year average salary of the member multiplied by years and fractions of credited service multiplied by the Multiplier of the Class of membership. The annuity paid to a member shall not exceed the member's highest salary during any period of 12 consecutive months of creditable service.

The multipier for each of the major classes are as follows

Class	Multiplier	
A	1.00	For State Police with years of service between 20 and 25, the minimum annuity is 50% of highest annual salary. With more than 25 years of service the benefit is a minimum of 75% of highest annual salary.
AA	1.25	
C	1.00	For State Police with years of service between 20 and 25, the minimum annuity is 50% of highest annual salary. With more than 25 years of service the benefit is a minimum of 75% of highest annual salary.
D-3	3.75	
D-4	1.50	
E-1	2.00	For each of the first 10 years of judicial service dropping to 1.5 for each subsequent year of judicial service.
E-2	1.50	For each year of judicial service.

There are conditions under which long-service members or members retiring at advanced ages may receive somewhat larger benefits than those described above. Futher, benefit limitations exist for members of SERS.

Statistical Section

Statistical Section Narrative

The Statistical Section of the Commonwealth of Pennsylvania State Employees' Retirement System Comprehensive Annual Financial Report presents detailed information related to the financial statements, as well as highlights of actuarial valuations. The schedules within the Statistical Section are classified into the following four categories: Financial Trends, Revenue Capacity, Demographic and Economic Information, and Operating Information.

Financial Trends

The **Schedule of Trend Data** provides key financial, actuarial, and demographic data for ten years ending December 31, 2006. This data includes items such as employer and member contribution rates, contributions received by the System and benefits paid, fair value and actuarial value of assets, and the number of annuitants, beneficiaries, and active participants.

The **Schedule of Additions to Plan Net Assets** presents the member and employer contributions, as well as the net investment income / loss for the ten years ending December 31, 2006. The System's investment returns have the most significant impact on the additions to plan net assets.

The **Schedule of Deductions from Plan Net Assets** presents the benefits, refunds of contributions, and administrative expenses for the ten years ending December 31, 2006. The System's benefit payments have the most significant impact on the total deductions from plan nets assets.

The **Schedule of Benefit and Refund Deductions from Net Assets by Type** presents the amount of benefit payments and refunds by type for the ten years ended December 31, 2006. Most benefit types are either superannuated or early which is determined by the amount of years of service and / or age at retirement.

The **Schedule of Total Changes in Plan Net Assets** is a schedule combining the additions to and deductions from plan net assets from the Schedule of Additions to Plan Net Assets and Schedule of Deductions from Plan Net Assets to arrive at net increase / decrease of changes in plan net assets for the ten years ended December 31, 2006.

Revenue Capacity

The **Schedule of Investment Income** presents the details of the total net investment gain / loss for the ten years ended December 31, 2006. The System has two outside sources of revenue and one own-source (internal) of revenue. Employer contributions and member contributions, which information is provided for in the Schedule of Additions to Plan Net Assets and Schedule of Deductions from Plan Net Assets, are the two outside sources of revenue, and investment income is the System's own-source revenue. Since investment income is the largest source of revenue to the System, this schedule provides more detail on the major components of the investment income, which is also disclosed in total on the Schedule of Additions to Plan Net Assets.

Demographic and Economic Information

The **Schedule of Active Member Statistics** provides the total number of active members, as well as the average age, average service, and average salary by gender.

Operating Information

The **Schedule of Retired Members by Type of Benefit** presents, for given benefit ranges, the total number of retirees, total monthly benefits and total number of retirees by retirement type as of December 31, 2006.

The **Schedule of Retired Members by Option** presents, for given benefit ranges, the total number of retirees, total monthly benefits and total number of retirees by retirement option as of December 31, 2006.

The **Schedule of Average Monthly Benefit Payments** presents, in five-year increments of credited service, the average monthly benefit, average final average salary and number of retired members for the ten years ended December 31, 2006.

The **Schedule of Average Annual Benefit Payments** presents, in five-year age increments and by gender, average annual benefit for each major retirement type as of December 31, 2006.

The **Schedule of SERS Agency Participation** provides the number of covered employees and the corresponding percentage of participation for the 20 largest employers for the ten years ended December 31, 2006, as well as a listing of additional employers participating with SERS as of December 31, 2006.

Sources: Unless otherwise noted, the information of these schedules is derived from the Financial Section and Actuarial Section of the Comprehensive Annual Financial Report for the relevant year.

Schedule of Trend Data[a]
Ten Years Ended December 31, 2006

	2006	2005	2004	2003	2002	2001	2000	1999	1998	1997
Contribution Rates:										
Employer[b]	4.02%[d]	3.02[d]	2.03[d]	1.07	0.00	0.00	1.39	5.00	6.70	7.28
Member	6.25%	6.25	6.25	6.25	6.25	5.00	5.00	5.00	5.00	5.00
Contributions:										
Employer	$196,420	148,375	106,703	68,604	50,831	76,710	168,002	270,718	310,501	324,093
Member	$317,790	305,624	309,923	308,014	304,233	240,528	231,666	224,928	221,618	212,556
Average Annual Compensation	$46,118	44,815	45,382	44,519	43,631	42,172	41,110	39,698	38,898	36,926
Market Value of Assets	$32,052,830	28,751,871	26,641,399	24,535,949	20,879,559	24,706,063	27,880,467	28,093,181	24,123,358	21,311,771
Actuarial Value of Assets	$28,148,834	26,793,782	26,900,027	27,465,615	27,497,464	27,505,494	26,094,306	23,624,267	20,670,711	18,565,136
Accrued Actuarial Liability	$30,364,997	28,851,716	27,999,026	26,179,761	25,650,389	23,658,757	19,702,278	19,091,840	18,357,899	17,288,413
Funded Ratio	92.7%	92.9	96.1	104.9	107.2	116.3	132.4	123.7	112.6	107.4
Total Benefits and Refunds	$1,919,426	1,943,643	1,859,255	1,632,281	1,430,417	1,245,129	1,176,785	1,229,348	1,062,155	1,021,721
Average Pension[c]	$20,025	19,372	18,414	17,192	15,445	13,656	12,935	12,520	12,027	10,555
Annuitants and Beneficiaries	102,060	101,179	98,727	94,412	91,228	89,217	88,392	88,043	85,834	85,457
Active Participants	110,972	109,981	108,405	109,018	111,059	109,716	109,469	108,035	108,893	108,684

[a] *All dollar amounts are in thousands, except Average Pension and Average Annual Compensation*

[b] *Employer rate represents total contributions as a percent of covered payroll as of 12/31.*

[c] *Average pension amount represents average annual pension for only members who have reached superannuation through age or service credits.*

[d] *Act 40 of 2003 established a minimum employer contribution rate of 2%, 3% and 4% effective July 1, 2004, 2005 and 2006 respectively.*

Source: State Employees' Retirement System

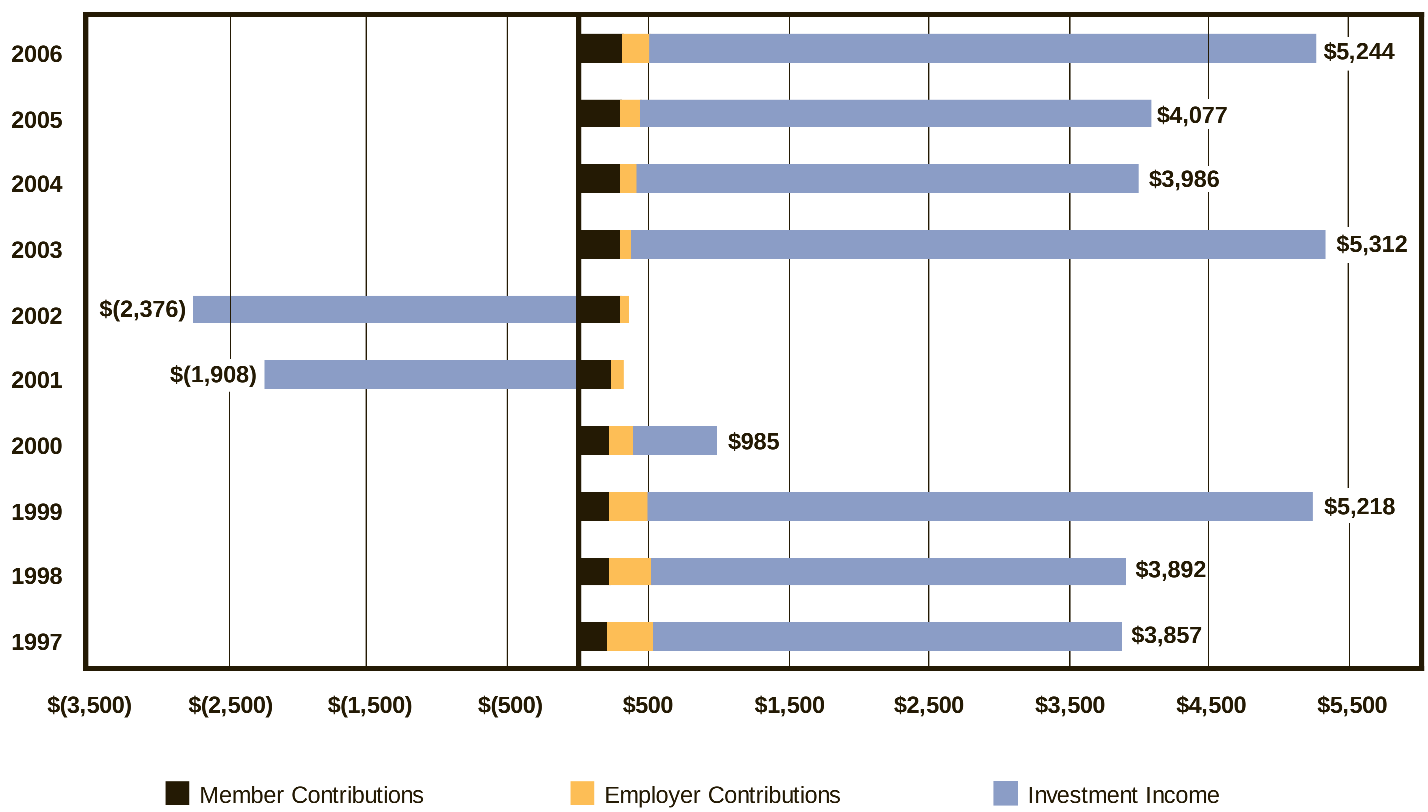
Schedule of Additions to Plan Net Assets

Ten Years Ended December 31, 2006
(Dollar Amounts in Thousands)

		Employer Contributions			
Year Ending	Member Contributions	Dollar Amount	% of Annual Covered Payroll	Net Investment Gain/(Loss)	Total
2006	$317,790	196,420	3.8%	$4,730,043	5,244,253
2005	305,624	148,375	3.0	3,622,820	4,076,819
2004	309,923	106,703	2.2	3,569,323	3,985,949
2003	308,014	68,604	1.4	4,935,699	5,312,317
2002	304,233[a]	50,831	1.0	(2,731,295)	(2,376,231)
2001	240,528	76,710	1.7	(2,225,627)	(1,908,389)
2000	231,666	168,002	3.7	585,712	985,380
1999	224,928	270,718	6.3	4,722,671	5,218,317
1998	221,618	310,501	7.3	3,359,844	3,891,963
1997	212,556	324,093	8.1	3,320,169	3,856,818

[a] *Effective January 1, 2002, most members' contributions increased to 6.25% from 5.00% of salary as a result of Act 9 of 2001.*

Additions to Plan Net Assets
(Dollar Amounts in Millions)



Source: State Employees' Retirement System

Schedule of Deductions from Plan Net Assets

Ten Years Ended December 31, 2006
(Dollar Amounts in Thousands)

Year	Benefits	Refund of Contributions	Administrative	Total
2006	$1,911,330	8,096	23,868	1,943,294
2005	1,936,428	7,215	22,704	1,966,347
2004	1,853,117	6,138	21,244	1,880,499
2003	1,627,166[a.]	5,115	23,646	1,655,927
2002	1,426,257[b.]	4,160	19,856	1,450,273
2001	1,237,953[c.]	7,176[d.]	20,887	1,266,016
2000	1,166,897	9,888	21,309	1,198,094
1999	1,218,133	11,215	19,146	1,248,494
1998	1,050,870	11,285	18,221	1,080,376
1997	1,008,648	13,073	15,542	1,037,263

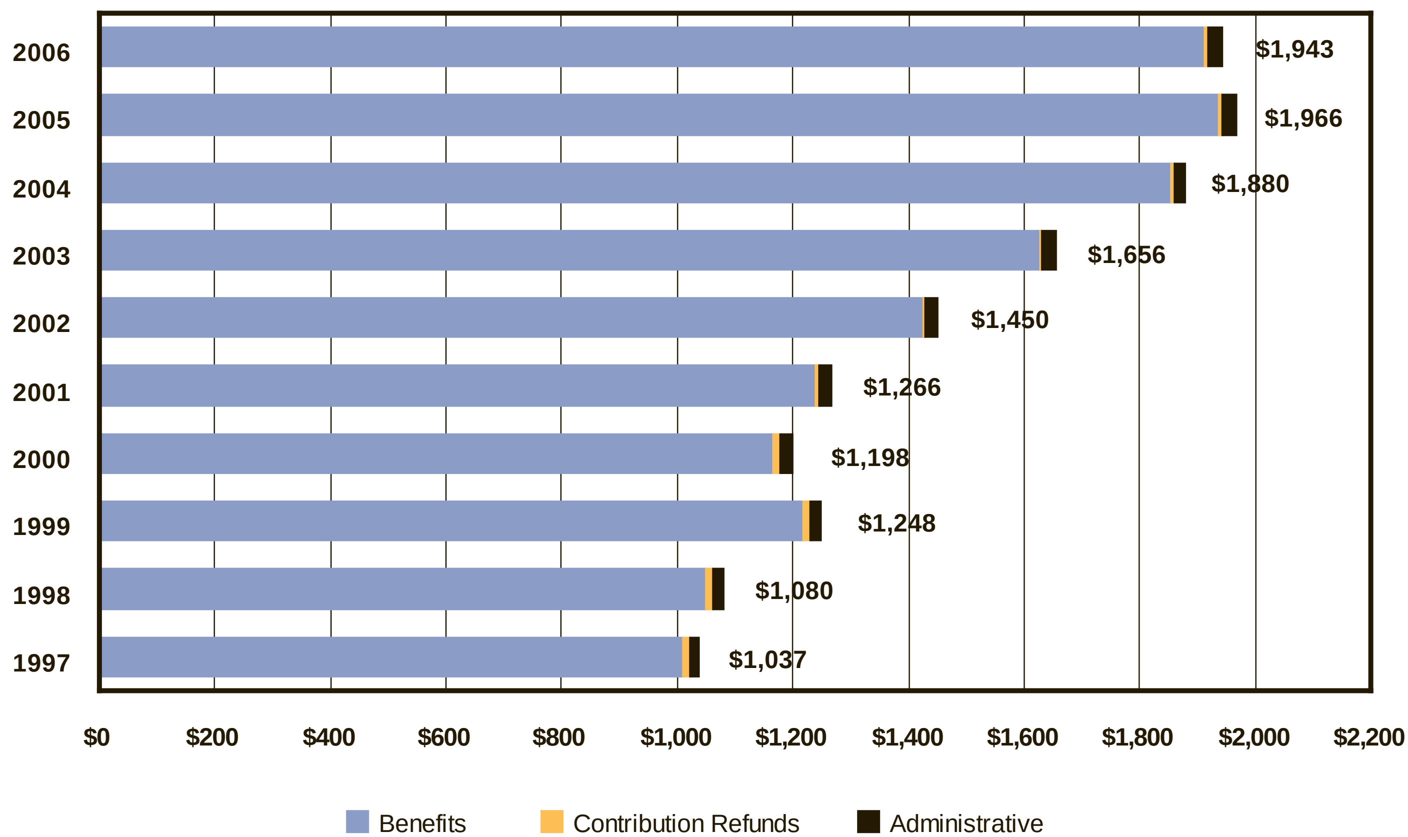
[a.] *Phase two of Cost of Living Adjustment (COLA) for members who retired between July 2, 1990 and July 1, 2002 became effective July 2, 2003.*

[b.] *Phase one of two-phase COLA for members who retired before July 2, 1990 became effective July 1, 2002.*

[c.] *For most members who retired after July 1, 2001, the benefit multiplier increased by 25% as a result of Act 9 of 2001.*

[d.] *Act 9 of 2001 also lowered the amount of years required to vest benefits from 10 years to 5 years.*

Deductions from Plan Net Assets
(Dollar Amounts in Millions)



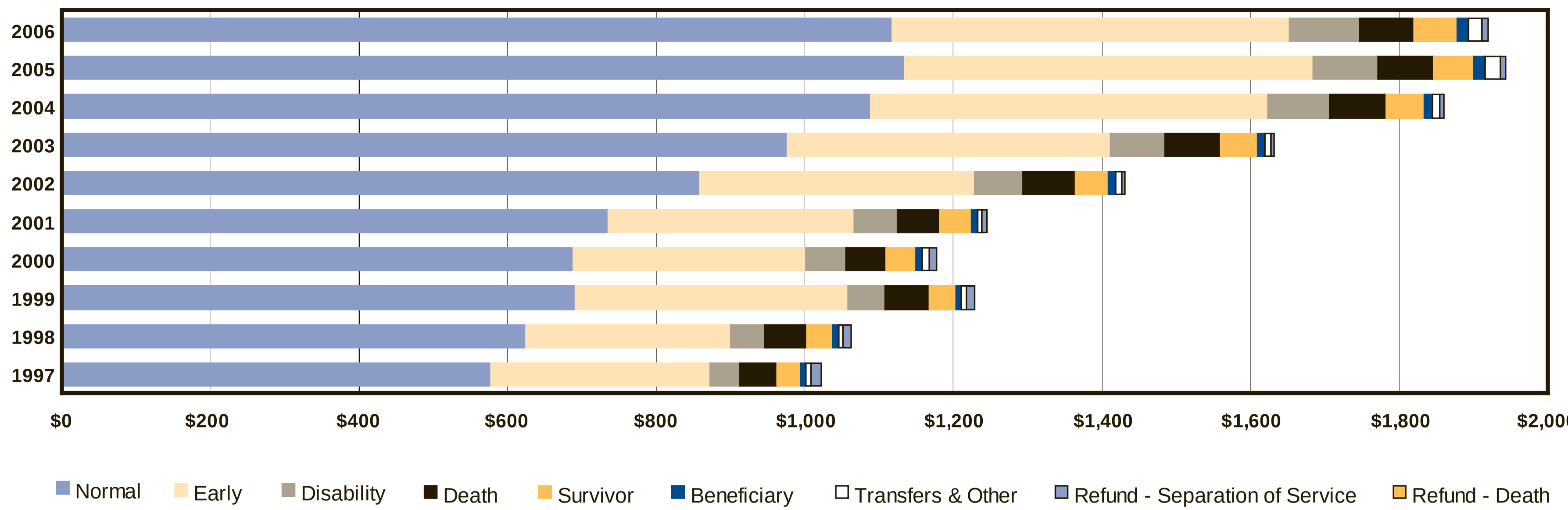
Source: State Employees' Retirement System

Schedule of Benefit and Refund Deductions from Plan Net Assets By Type

Schedule of Benefit and Refund Deductions from Plan Net Assets by Type
Ten Years Ended December 31, 2006
(Dollar Amounts in Thousands)

	Retirement								Refunds		
Year	Normal	Early	Death	Disability	Survivor	Beneficiary	Transfers & Other	Total Benefit Deductions	Separation of Service	Death	Total Refunds
2006	$1,117,801	535,156	73,885	93,358	58,038	14,988	18,104	1,911,330	7,971	125	8,096
2005	1,133,694	550,437	74,312	88,250	53,873	14,650	21,212	1,936,428	7,086	129	7,215
2004	1,088,129	534,674	76,216	82,515	51,946	10,818	8,819	1,853,117	6,013	125	6,138
2003	976,102	436,325	75,368	72,880	48,687	9,876	7,928	1,627,166	4,994	121	5,115
2002	859,078	368,778	70,703	64,789	45,439	8,902	8,568	1,426,257	4,024	136	4,160
2001	735,919	331,445	57,744	57,254	42,689	8,115	4,787	1,237,953	6,753	423	7,176
2000	688,410	314,014	53,785	54,112	40,037	7,948	8,591	1,166,897	9,548	340	9,888
1999	690,840	366,515	58,675	50,496	36,830	7,283	7,494	1,218,133	10,788	427	11,215
1998	623,980	276,428	57,465	45,691	34,681	7,527	5,098	1,050,870	11,034	251	11,285
1997	576,573	294,827	50,287	40,898	32,063	6,871	7,129	1,008,648	12,734	339	13,073

Benefit and Refund Deductions from Plan Net Assets by Type
(Dollar Amounts in Millions)



Source: State Employees' Retirement System

Schedule of Total Changes in Plan Net Assets

Schedule of Total Changes in Plan Net Assets
Ten Years Ended December 31, 2006
(Dollar Amounts in Thousands)

	Additions to Plan Net Assets				Deductions from Plan Net Assets				
Year Ending	Member Contributions	Employer Contributions	Net Investment Income	Total Additions	Benefits	Refund of Contributions	Administrative	Total Deductions	Net Increase/ (Decrease)
2006	$317,790	196,420	4,730,043	**5,244,253**	1,911,330	8,096	23,868	**1,943,294**	**3,300,959**
2005	305,624	148,375	3,622,820	**4,076,819**	1,936,428	7,215	22,704	**1,966,347**	**2,110,472**
2004	309,923	106,703	3,569,323	**3,985,949**	1,853,117	6,138	21,244	**1,880,499**	**2,105,450**
2003	308,014	68,604	4,935,699	**5,312,317**	1,627,166	5,115	23,646	**1,655,927**	**3,656,390**
2002	304,233	50,831	(2,731,295)	**(2,376,231)**	1,426,257	4,160	19,856	**1,450,273**	**(3,826,504)**
2001	240,528	76,710	(2,225,627)	**(1,908,389)**	1,237,953	7,176	20,887	**1,266,016**	**(3,174,405)**
2000	231,667	168,002	585,712	**985,381**	1,166,897	9,888	21,309	**1,198,094**	**(212,713)**
1999	224,928	270,718	4,722,671	**5,218,317**	1,218,133	11,215	19,146	**1,248,494**	**3,969,823**
1998	221,618	310,501	3,359,844	**3,891,963**	1,050,870	11,285	18,221	**1,080,376**	**2,811,587**
1997	212,556	324,093	3,320,169	**3,856,818**	1,008,648	13,073	15,542	**1,037,263**	**2,819,555**

Source: State Employees' Retirement System

Schedule of Investment Income
Ten Years ended December 31, 2006
(Dollar Amounts in Thousands)

	2006	2005	2004	2003	2002	2001	2000	1999	1998	1997
Investment gain (loss):										
Net appreciation / (depreciation) in fair value of investments	$3,723,160	2,811,470	2,807,290	3,423,081	(1,915,634)	(1,790,575)	774,998	2,676,745	1,212,355	1,302,080
Collective trust fund appreciation / (depreciation) and income	641,718	420,888	391,248	1,165,463	(1,310,044)	(1,014,578)	(825,600)	1,453,724	1,568,761	1,491,868
Interest	350,783	368,610	280,221	237,786	303,421	388,626	412,933	371,062	357,708	345,323
Dividends	152,690	128,480	124,099	113,634	112,015	106,253	113,293	127,330	118,502	115,749
Real estate	145,871	112,057	148,133	168,427	193,719	182,423	203,308	164,893	153,611	98,897
Miscellaneous	3,519	3,537	6,722	7,138	30,035	41,111	37,377	35,981	25,954	31,442
	5,017,741	3,845,042	3,757,713	5,115,529	(2,586,488)	(2,086,740)	716,309	4,829,735	3,436,891	3,385,359
Investment expenses	(298,204)	(234,760)	(196,859)	(187,139)	(153,211)	(148,778)	(140,526)	(115,538)	(82,369)	(72,059)
Net gain (loss) from investing activities	4,719,537	3,610,282	3,560,854	4,928,390	(2,739,699)	(2,235,518)	575,783	4,714,197	3,354,522	3,313,300
From securities lending activities:										
Securities lending income	170,675	116,477	40,854	16,163	26,696	54,813	87,874	54,530	71,736	93,672
Securities lending expenses	(160,169)	(103,939)	(32,385)	(8,854)	(18,292)	(44,922)	(77,945)	(46,056)	(66,414)	(86,803)
Net income from securities lending activities	10,506	12,538	8,469	7,309	8,404	9,891	9,929	8,474	5,322	6,869
Total net investment gain (loss)	**$4,730,043**	**3,622,820**	**3,569,323**	**4,935,699**	**(2,731,295)**	**(2,225,627)**	**585,712**	**4,722,671**	**3,359,844**	**3,320,169**

Source: State Employees' Retirement System

Schedule of Active Member Statistics

Ten Years Ended December 31, 2006

Schedule of Active Member Statistics
Ten Years ended December 31, 2006

	Male			Female			Total
	Average Age	Average Service	Average Salary	Average Age	Average Service	Average Salary	Number of Active Members
2006	46.39	12.80	$49,455	46.2	12.49	$41,616	110,972
2005	46.12	12.71	48,129	45.91	12.46	40,331	109,981
2004	46.14	13.03	48,801	46.01	12.88	40,716	108,405
2003	46.25	13.42	47,717	46.12	13.39	40,120	109,018
2002	46.16	13.55	46,857	45.98	13.48	39,198	111,059
2001	46.08	13.68	45,386	45.88	13.65	37,737	109,716
2000	45.86	13.53	44,316	45.70	13.65	36,630	109,469
1999	45.55	13.38	42,799	45.41	13.54	35,374	108,035
1998	45.42	13.42	41,853	45.28	13.56	34,757	108,893
1997	45.17	13.26	39,849	44.93	13.28	32,846	108,684

Source: State Employees' Retirement System

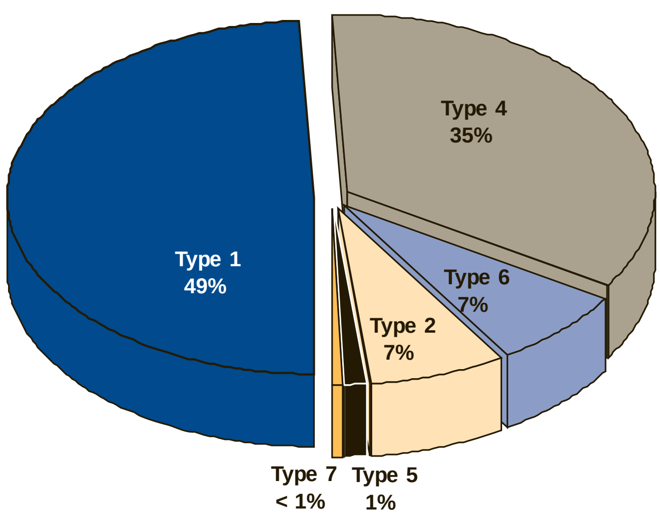
Schedule of Retired Members by Type of Benefit

Schedule of Retired Members by Type of Benefit
As of December 31, 2006

Amount of Monthly Benefit	Total Monthly Benefits	Total Number of Retirees	Type of Retirement 1	2	4	5	6	7
$1 to 500	$7,309,386	28,990	8,170	739	15,188	584	4,073	236
> 500 to 1,000	17,460,755	23,801	12,705	3,737	4,947	283	1,957	172
> 1,000 to 1,500	18,933,881	15,373	8,732	1,491	4,188	119	755	88
> 1,500 to 2,000	18,117,232	10,431	5,578	708	3,746	50	315	34
> 2,000 to 2,500	16,422,005	7,348	4,158	295	2,661	30	194	10
> 2,500 to 3,000	13,377,989	4,887	2,990	171	1,623	25	75	3
> 3,000	46,368,860	11,230	7,978	130	2,944	47	128	3
Totals	**$137,990,108**	**102,060**	**50,311**	**7,271**	**35,297**	**1,138**	**7,497**	**546**

Type of Retirement
1 - Superannuation
2 - Disabled
4 - Early
5 - Beneficiary
6 - Survivor
7 - Alternate Payee

Retired Members by Type of Benefit



Source: State Employees' Retirement System

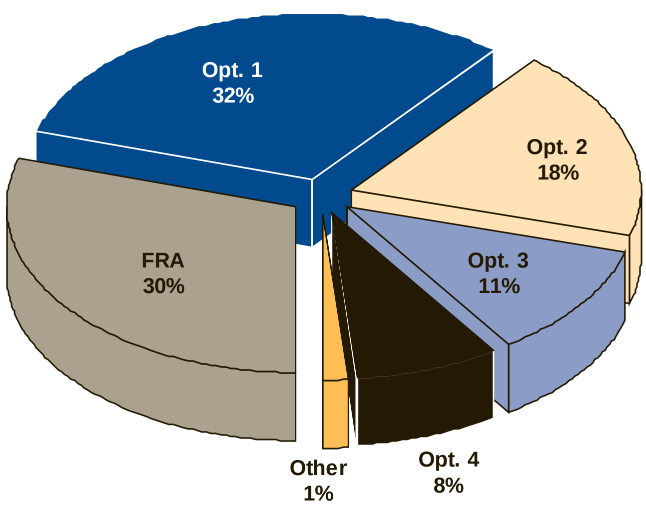
Schedule of Retired Members by Option

Schedule of Retired Members by Option
As of December 31, 2006

Amount of Monthly Benefit	Total Monthly Benefits	Total Number of Retirees	Option Selected FRA	1	2	3	4	Other
$1 to 500	$7,309,386	28,990	7,132	11,301	6,559	2,491	891	616
> 500 to 1,000	17,460,755	23,801	8,065	7,305	4,364	2,353	1,386	328
> 1,000 to 1,500	18,933,881	15,373	4,513	4,660	2,881	1,733	1,441	145
> 1,500 to 2,000	18,117,232	10,431	3,111	2,983	1,751	1,360	1,157	69
> 2,000 to 2,500	16,422,005	7,348	2,116	1,929	1,171	1,071	1,024	37
> 2,500 to 3,000	13,377,989	4,887	1,461	1,230	754	713	697	32
> 3,000	46,368,860	11,230	3,845	2,508	1,310	1,705	1,807	55
Totals	**$137,990,108**	**102,060**	**30,243**	**31,916**	**18,790**	**11,426**	**8,403**	**1,282**

Options
FRA - Full Retirement Allowance
Opt. 1 - Annuity for Life with beneficiary receiving remainder of Present Value when member dies
Opt. 2 - Annuity for Life with beneficiary receiving same annuity when member dies
Opt. 3 - Annuity for Life with beneficiary receiving one half the members annuity amount when member dies
Opt. 4 - Member designs a different plan approved by SERS not covered under the above option
Other - Death Benefit and Domestic Relation Order

Retired Members by Option



Source: State Employees' Retirement System

Schedule of Average Monthly Benefit Payments[a.]
Ten Years Ended December 31, 2006

	Years Credited Service						
Retirement Effective Dates	**< 5**	**5-10**	**10-15**	**15-20**	**20-25**	**25-30**	**30+**
Period 1/1/2006 to 12/31/2006							
Average monthly benefit	$174	316	690	1,171	1,878	2,487	3,489
Average final average salary	$27,898	35,283	42,358	45,225	53,513	58,031	60,582
Number of retired members	51	584	491	667	471	627	1,205
Period 1/1/2005 to 12/31/2005							
Average monthly benefit	$197	335	695	1,161	1,844	2,409	3,464
Average final average salary	$31,822	34,767	40,577	45,052	51,985	55,391	60,758
Number of retired members	57	579	544	785	588	885	2,034
Period 1/1/2004 to 12/31/2004							
Average monthly benefit	$170	355	674	1,171	1,820	2,255	3,230
Average final average salary	$26,332	34,645	39,343	44,095	49,960	53,306	56,940
Number of retired members	53	550	558	878	686	1,130	3,100
Period 1/1/2003 to 12/31/2003							
Average monthly benefit	$201	370	661	1,126	1,721	2,201	3,179
Average final average salary	$30,920	34,935	37,342	41,727	47,340	51,372	55,947
Number of retired members	33	514	538	851	701	984	2,633
Period 1/1/2002 to 12/31/2002							
Average monthly benefit	$201	355	631	1,073	1,683	2,150	3,264
Average final average salary	$25,626	33,588	37,370	41,421	45,974	49,743	56,880
Number of retired members	29	492	525	627	615	799	1,826
Period 1/1/2001 to 12/31/2001							
Average monthly benefit	$166	413	542	967	1,445	1,874	2,959
Average final average salary	$27,851	32,700	35,821	40,773	43,815	47,066	55,470
Number of retired members	25	399	476	594	536	805	1,332
Period 1/1/2000 to 12/31/2000							
Average monthly benefit	$160	469	448	771	1,205	1,645	2,487
Average final average salary	$28,373	31,567	35,508	39,153	41,765	45,709	53,923
Number of retired members	33	252	639	594	458	712	678
Period 1/1/1999 to 12/31/1999							
Average monthly benefit	$149	453	425	798	1,132	1,567	2,235
Average final average salary	$27,246	29,670	34,691	38,970	40,447	43,931	49,742
Number of retired members	55	268	618	613	517	776	2,140
Period 1/1/1998 to 12/31/1998							
Average monthly benefit	$124	424	423	762	1,110	1,690	2,410
Average final average salary	$24,114	28,296	34,841	37,288	39,524	44,937	51,200
Number of retired members	44	271	621	587	476	791	914
Period 1/1/1997 to 12/31/1997							
Average monthly benefit	$144	421	372	620	944	1,604	2,081
Average final average salary	$27,838	27,556	33,750	35,789	36,756	43,655	45,961
Number of retired members	37	265	760	832	625	869	1,471

[a.] *Includes Normal Retirement, Early Retirement and Disability Benefits for new retirees in the years listed.*

Source: State Employees' Retirement System

Schedule of Average Annual Benefit Payments
As of December 31, 2006

	Superannuation		Early Retirement		Disability		Beneficiary and Survivor	
Age	**Male**	**Female**	**Male**	**Female**	**Male**	**Female**	**Male**	**Female**
Under 25	-	-	-	379	-	-	13,111	7,071
25-29	-	-	529	555	8,175	8,748	10,621	12,889
30-34	-	-	966	939	10,257	10,369	23,999	12,343
35-39	-	-	2,170	1,610	13,170	10,652	14,167	12,965
40-44	-	-	4,502	2,222	12,752	11,136	5,477	11,129
45-49	-	-	9,685	4,664	14,791	13,527	7,645	9,043
50-54	$31,327	29,041	12,313	8,748	15,839	14,920	5,657	7,510
55-59	36,299	34,175	19,079	13,371	15,893	14,521	8,231	10,589
60-64	34,125	25,448	21,821	14,859	13,095	12,975	9,696	12,448
65-69	27,829	19,387	16,041	11,111	10,335	9,522	7,842	11,212
70-74	22,061	14,457	14,179	9,201	9,356	8,422	8,266	10,162
75-79	18,890	11,561	14,087	8,825	10,076	7,509	7,726	8,774
80-84	15,872	9,815	12,103	7,798	9,327	7,139	6,112	7,007
85-89	12,894	8,207	11,607	8,045	8,472	6,246	5,412	6,194
90 over	12,182	8,330	12,279	9,486	5,820	6,884	4,047	5,156
Total Average	**$23,760**	**15,074**	**16,546**	**10,527**	**13,220**	**12,099**	**7,975**	**8,375**

	Superannuation	**Early Retirement**	**Disability**	**Beneficiary and Survivor**
Average Pension	$20,025	13,662	12,635	8,336
Average Age: Male & Female	73.4	61.2	60.3	75.0

Source: State Employees' Retirement System

Schedule of SERS Agency Participation - Twenty Largest Employers
Ten Years Ended December 31, 2006

\# - Number of Active Employees
- Percentage of Total Active Members

	2006		2005		2004		2003		2002		2001		2000		1999		1998		1997	
Employer Name	#	%	#	%	#	%	#	%	#	%	#	%	#	%	#	%	#	%	#	%
Dept of Public Welfare	19,355	17.44%	19,781	17.99%	20,175	18.61%	20,417	18.73%	21,242	19.13%	21,507	19.60%	21,766	19.88%	22,290	20.63%	23,378	21.47%	24,194	22.26%
Dept of Corrections	15,151	13.65	15,126	13.75	14,463	13.34	14,267	13.09	14,839	13.36	14,416	13.14	14,123	12.90	13,284	12.30	12,765	11.72	12,070	11.11
Dept of Transportation	12,484	11.25	12,388	11.26	12,428	11.46	12,603	11.56	12,768	11.50	12,623	11.51	12,748	11.65	12,590	11.65	12,556	11.53	12,475	11.48
Pennsylvania State University	6,265	5.65	6,210	5.65	6,085	5.61	6,102	5.60	6,071	5.47	6,099	5.56	6,117	5.59	6,174	5.71	6,408	5.88	6,547	6.02
Pennsylvania State Police	6,172	5.56	6,127	5.57	5,885	5.43	5,803	5.32	5,807	5.23	5,650	5.15	5,632	5.14	5,597	5.18	5,406	4.96	5,313	4.89
Dept of Labor and Industry	5,692	5.13	5,608	5.10	5,648	5.21	5,823	5.34	5,938	5.35	5,416	4.94	5,467	4.99	5,624	5.21	5,762	5.29	5,826	5.36
State System of Higher Education	5,344	4.82	5,240	4.76	5,248	4.84	5,432	4.98	5,565	5.01	5,697	5.19	5,897	5.39	5,989	5.54	6,331	5.81	6,535	6.01
Liquor Control Board	4,102	3.70	3,994	3.63	3,840	3.54	3,686	3.38	3,672	3.31	3,523	3.21	3,576	3.27	3,463	3.21	3,421	3.14	3,417	3.14
Dept of Environmental Protection	2,921	2.63	2,836	2.58	2,854	2.63	2,916	2.67	2,973	2.68	3,016	2.75	3,004	2.74	2,922	2.70	2,896	2.66	2,919	2.69
Dept of Military and Veterans Affairs	2,540	2.29	2,492	2.27	2,402	2.22	2,291	2.10	2,220	2.00	2,127	1.94	2,057	1.88	1,919	1.78	1,846	1.70	1,712	1.58
PA Higher Educ. Assist Agcy	2,524	2.27	2,378	2.16	1,968	1.82	1,957	1.80	1,908	1.72	1,811	1.65	1,544	1.41	1,482	1.37	1,303	1.20	1,193	1.10
Dept of Revenue	2,319	2.09	2,322	2.11	2,238	2.06	2,312	2.12	2,462	2.22	2,493	2.27	2,431	2.22	2,326	2.15	2,301	2.11	2,344	2.16
PA Turnpike Commission	2,276	2.05	2,227	2.02	2,282	2.11	2,354	2.16	2,330	2.10	2,404	2.19	2,406	2.20	2,228	2.06	2,316	2.13	2,335	2.15
Executive Offices	2,247	2.02	2,246	2.04	2,237	2.06	2,351	2.16	2,349	2.12	2,374	2.16	2,335	2.13	2,233	2.07	2,194	2.01	2,219	2.04
Dept of Conserv & Natural Resources	2,093	1.89	1,971	1.79	1,927	1.78	2,009	1.84	2,079	1.87	2,045	1.86	2,019	1.84	1,748	1.62	1,658	1.52	1,563	1.44
Administrative Off.-PA Courts	1,989	1.79	1,953	1.78	1,957	1.81	1,884	1.73	1,883	1.70	1,834	1.67	1,836	1.68	1,621	1.50	1,630	1.50	1,545	1.42
House of Representatives	1,701	1.53	1,706	1.55	1,662	1.53	1,619	1.49	1,568	1.41	1,544	1.41	1,496	1.37	1,493	1.38	1,474	1.35	1,449	1.33
Dept of Health	1,479	1.33	1,435	1.30	1,386	1.28	1,393	1.28	1,378	1.24	1,330	1.21	1,271	1.16	1,213	1.12	1,216	1.12	1,221	1.12
Dept of General Services	1,340	1.21	1,306	1.19	1,230	1.13	1,281	1.18	1,357	1.22	1,350	1.23	1,333	1.22	1,270	1.18	1,261	1.16	1,273	1.17
Board of Probation and Parole	974	0.88	1,010	0.92	998	0.92	986	0.90	989	0.89	944	0.86	940	0.86	913	0.85	892	0.82	862	0.79
Active Employees for Twenty Largest Employers	**98,968**	**89.18%**	**98,356**	**89.43%**	**96,913**	**89.40%**	**97,486**	**89.42%**	**99,398**	**89.50%**	**98,203**	**89.51%**	**97,998**	**89.52%**	**96,379**	**89.21%**	**97,014**	**89.09%**	**97,012**	**89.26%**
Total Number of Active Employees	110,972		109,981		108,405		109,018		111,059		109,716		109,469		108,035		108,893		108,684	

Source: State Employees' Retirement System

Schedule of Additional Participating Employers

As of December 31, 2006

Bloomsburg University Community Activities
Bucks County Community College
Bucks County Health Department
Bucks County Intermediate Unit
California University Student Association
Capitol Preservation Committee
Center for Rural Pennsylvania
Central Susquehanna Intermediate Unit
Chester County Health Department
Civil Service Commission
Clarion University Student Association
Community College of Allegheny County
Community College of Philadelphia
Delaware County Community College
Delaware River Joint Toll Bridge
Delaware River Port Authority
Delaware Valley Regional Planning Commission
Department of Aging
Department of Agriculture
Department of Banking
Department of Community & Economic Development
Department of Education
Department of State
Department of the Auditor General
East Stroudsburg University Student Association
Edinboro University Services Inc.
Environmental Hearing Board
Erie County Health Department
Fish and Boat Commission
Game Commission
Governor's Office
Harrisburg Area Community College
Historical and Museum Commission
House Appropriations Committee (D)
Independent Regulatory Review Commission
Indiana University Student Co-op
Insurance Department
Intergovernmental Cooperation Authority
Joint Legislative Conservation Committee
Joint State Government Commission
Kutztown University Student Services
Lancaster-Lebanon Intermediate Unit
Legislative Budget & Finance Committee
Legislative Data Processing Center
Legislative Reference Bureau
Lehigh Carbon Community College
Lieutenant Governor's Office
Local Government Commission
Lock Haven University Student Co-op
Luzerne County Community College
Luzerne Intermediate Unit
Mansfield University Community Services
Milk Marketing Board
Millersville Student Services
Montgomery County Community College
Northampton Community College
Office of Attorney General
Office of Liquidations
Pennsylvania College of Technology
Pennsylvania Convention Center Authority
Pennsylvania Emergency Management Agency
Pennsylvania Gaming Control Board
Pennsylvania Health Care Cost Containment Council
Pennsylvania Highlands Community College
Pennsylvania Housing Finance Agency
Pennsylvania Infrastructure Investment Authority
Pennsylvania Municipal Retirement System
Pennsylvania Port Authority
Pennsylvania Public Television Network Commission
Port Authority Transit Corporation
Public School Employees' Retirement System
Public Utility Commission
Reading Area Community College
Riverview Intermediate Unit
Securities Commission
Senate of Pennsylvania
Shippensburg Student Association
Slippery Rock Student Government
State Employees' Retirement System
State Ethics Commission
State Public School Building Authority
State Tax Equalization Board
Susquehanna River Basin Commission
Thaddeus Stevens College of Technology
Treasury Department
U.S. Property & Fiscal Office for Pennsylvania
West Chester University Student Services
Westmoreland County Community College

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