MINNESOTA STATE BOARD OF INVESTMENT

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DATE: January 21, 2005

TO: Senator Linda Higgins, Chair, Senate Committee on State and Local Governmental Operations

Representative Kathy Tinglestad, Chair, House Committee on Governmental Operations and Veterans Affairs

Representative Steve Smith, Legislative Commission on Pensions and Retirement

FROM: Howard J. Bicker, Executive Director

SUBJECT: Post Retirement Investment Fund Report Pursuant to Minnesota Statues, Section 11A.041

Introduction

Pursuant to *Minnesota Statutes*, Section 11A.041, the State Board of Investment (SBI) is required to report on the investment performance activities and postretirement adjustment calculations of the Minnesota Post Retirement Investment Fund (Post Fund). This report fulfills the requirements of this legislative mandate.

Investment Objectives and Performance

Upon employee retirement, sums of money sufficient to finance fixed monthly annuities are transferred from the active members' pool of assets (i.e., Basic Retirement Funds) to the Post Fund. The Post Fund is invested to maintain current benefit levels and provide future benefit increases. The post retirement benefit increase formula is based on market value (and total rate of return) which allows the SBI to invest a greater portion of the Post Fund portfolio in stocks. Stocks are expected to provide greater investment returns over time.

The asset allocation of the Post Fund as of June 30, 2004 compared to the long-term asset allocation of the fund was:

	Actual	Long-Term
Domestic Stocks	51.4%	45.0%
International Stocks	15.5	15.0
Bonds	24.6	25.0
Alternative Assets	4.3	12.0
Cash	4.2	3.0

* Uninvested portions of the Alternative Assets allocation are held in Domestic Stocks.

The Post Fund generated a total rate of return of 16.3 percent for fiscal year 2004. This return outperformed by 0.6 percentage point the return of a composite of market indices that reflects the Fund's asset allocation policy.

The return for the domestic common stock segment for fiscal year 2004 was 20.3 percent compared to 20.6 percent return on the equity asset class target. The return for the bond segment was 1.5 percent for fiscal year 2004 compared to 0.3 percent for the Lehman Aggregate bond index for the same period. The return generated from international stocks in fiscal year 2004 was 30.9 percent compared to the 32.1 percent return for the international asset class target.

Benefit Increase Calculation

The Post Fund provided a benefit increase of 2.5 percent for fiscal year 2004, payable beginning January 1, 2004. This increase is comprised of two components:

- **Inflation adjustment** of 2.5 percent which is the maximum allowed by law. The increase in the Consumer Price Index for wage earners (CPI-W) for the twelve months ending June 30, 2004 was greater than 2.5 percent. CPI-W is also used to determine social security benefit increases.

- **Investment adjustment** of zero percent, a figure which represents a portion of the market value in excess of the amount needed to cover the Fund's actuarial assumed rate of return (6.0 percent) and the inflation adjustment (2.5 percent).

The investment adjustment was calculated according to statutory provisions. A summary of the calculation is provided on the attachment.

Enclosure: Calculation of January 1, 2005 benefit increase.

Calculation of January 1, 2005 Benefit Increase

Actuarial value of required reserves at January 1, 2005	$22,201,715,063
Less: Reserves not eligible for increase	805,298,235
Actuarially determined eligible reserves at Janaury 1, 2005	21,396,416,828
CPI Inflation rate capped at 2.5%	2.500%
Dollar cost of inflationary increase	534,910,421
June 30, 2004 total required reserves	22,549,676,868
June 30, 2004 total required reserves adjusted for inflationary increase	23,084,587,289
Market value of Assets at June 30, 2004	18,403,077,602
Less:Inflation adjusted required reserves	23,084,587,289
Current year excess market value	-4,681,509,686
Negative balance carry forward	-4,236,763,260
Excess market value available for investment based benefit increase	-444,746,426
Divided by 5 year pay out period	5
Current year portion of excess market value	-88,949,285
Second year portion	-$360,557,487
Third year portion	-$558,850,315
Fourth year portion	-$593,357,973
Fifth year portion	$68,733,579
Total five year excess market value	-$1,532,981,481
Greater of current year excess market value or cost of transition adjustment	-1,532,981,481
Divided by eligible required reserves at January 1, 2005	21,396,416,828
Investment based increase for FY2004	0.0000%

Summary:

Investment Based Benefit Increase	**0.0000%**
Inflation Based Benefit Increase	**2.5000%**
Total Benefit Increase	**2.5000%**
Total Dollar Value of January 1, 2005 Benefit Increase	**$534,910,421**