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INVESTMENT

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DATE: January 23, 2006

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, 2005 compared to the long-term asset allocation of the fund was:

	Actual	Long-Term
Domestic Stocks	50.4%	45.0%
International Stocks	15.0	15.0
Bonds	24.8	25.0
Alternative Assets	7.6	12.0
Cash	2.2	3.0

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

The Post Fund generated a total rate of return of 10.5 percent for fiscal year 2005. This return outperformed by 0.3 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 2005 was 8.6 percent compared to 8.1 percent return on the equity asset class target. The return for the bond segment was 7.1 percent for fiscal year 2005 compared to 6.8 percent for the Lehman Aggregate bond index for the same period. The return generated from international stocks in fiscal year 2005 was 15.7 percent compared to the 16.5 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 2005, 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, 2006 benefit increase.

Calculation of January 1, 2006 Benefit Increase

Actuarial value of required reserves at January 1, 2006	$23,128,919,434
Less: Reserves not eligible for increase	721,540,347
Actuarially determined eligible reserves at Janaury 1, 2006	$22,407,379,087
CPI Inflation rate capped at 2.5%	2.500%
Dollar cost of inflationary increase	560,184,477
June 30, 2005 total required reserves	23,451,363,048
June 30, 2005 total required reserves adjusted for inflationary increase	$24,011,547,525
Market value of Assets at June 30, 2005	$19,295,255,639
Less:Inflation adjusted required reserves	24,011,547,525
Current year excess market value	-4,716,291,886
Negative balance carry forward	-3,174,934,088
Excess market value available for investment based benefit increase	-1,541,357,798
Divided by 5 year pay out period	5
Current year portion of excess market value	-$308,271,560
Second year portion	-95,550,756
Third year portion	-360,557,487
Fourth year portion	-558,850,315
Fifth year portion	-593,357,973
Total five year excess market value	-$1,916,588,091
Greater of current year excess market value or cost of transition adjustment	-1,916,588,091
Divided by eligible required reserves at January 1, 2006	22,407,379,087
Investment based increase for FY2005	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, 2006 Benefit Increase	**$560,184,477**