MINNESOTA STATE BOARD OF INVESTMENT

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60 Empire Drive
Suite 355
St. Paul, MN 55103
(651) 296-3328
FAX (651) 296-9572
E-mail:
minn.sbi@state.mn.us
www.sbi.state.mn.us

DATE: January 7, 2008

TO: Senator Ann Rest, Chair, Senate Committee on State and Local Governmental Operations and Oversight

Representative Gene Pelowski, Chair, House Committee on Governmental Operations, Reform, Technology and Elections

Representative Mary Murphy, Chair, 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, 2007 compared to the long-term asset allocation of the fund was:

	Actual	**Long-Term**
Domestic Stocks	49.4%	45.0%
International Stocks	16.4	15.0
Bonds	23.4	25.0
Alternative Assets	8.5	12.0
Cash	2.3	3.0

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

The Post Fund generated a total rate of return of 18.2 percent for fiscal year 2007. This return outperformed by 0.5 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 2007 was 19.7 percent compared to 20.1 percent return on the equity asset class target. The return for the bond segment was 6.3 percent for fiscal year 2007 compared to 6.1 percent for the Lehman Aggregate bond index for the same period. The return generated from international stocks in fiscal year 2007 was 30.3 percent compared to the 29.6 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 2007, payable beginning January 1, 2008. 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, 2007 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, 2008 benefit increase.

Calculation of January 1, 2008 Benefit Increase

Actuarial value of required reserves at January 1, 2008	$27,117,131,092
Less: Reserves not eligible for increase	$916,491,502
Actuarially determined eligible reserves at Janaury 1, 2008	$26,200,639,590
CPI Inflation rate capped at 2.5%	2.5%
Dollar cost of inflationary increase	655,015,990
June 30, 2007 total required reserves	$27,498,649,353
June 30, 2007 total required reserves adjusted for inflationary increase	28,153,665,343
Market value of Assets at June 30, 2007	$25,149,112,067
Less:Inflation adjusted required reserves	28,153,665,343
Current year excess market value	-3,004,553,276
Negative balance carry forward	-$2,966,856,644
Excess market value available for investment based benefit increase	-37,696,632
Divided by 5 year pay out period	5
Current year portion of excess market value	-7,539,326
Second year portion	-372,595,742
Third year portion	-$308,271,560
Fourth year portion	-$95,550,756
Fifth year portion	-$360,557,487
Total five year excess market value	-$1,144,514,871
Greater of current year excess market value or cost of transition adjustment	-1,144,514,871
Divided by eligible required reserves at January 1, 2008	26,200,639,590
Investment based increase for FY2007	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, 2008 Benefit Increase	**$655,015,990**