MINNESOTA STATE BOARD OF INVESTMENT

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Attorney General
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Howard J. Bicker

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

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DATE: January 8, 2004

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

Representative Jim Rhodes, 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, 2003 compared to the long-term asset allocation of the fund was:

	Actual	Long-Term
Domestic Stocks	51.9%	50.0%
International Stocks	14.7	15.0
Bonds	27.2	27.0
Alternative Assets	4.6	5.0
Cash	1.6	3.0

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

The Post Fund generated a total rate of return of 2.8 percent for fiscal year 2003. This return underperformed 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 2003 was 0.4 percent compared to 0.8 percent return on the Wilshire 5000 Investable. The return for the bond segment was 10.7 percent for fiscal year 2003 compared to 10.4 percent for the Lehman Aggregate bond index for the same period. The return generated from international stocks in fiscal year 2003 was –6.2 percent compared to the –5.4 percent return for a composite of EAFE (Europe, Australasia and Far East) and Emerging Markets indices.

Benefit Increase Calculation

The Post Fund provided a benefit increase of 2.103 percent for fiscal year 2003, payable beginning January 1, 2004. This increase is comprised of two components:

- **Inflation adjustment** of 2.103 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, 2003 was 2.103 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 (2.103 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, 2004 benefit increase.

Calculation of January 1, 2004 Benefit Increase

Actuarial value of required reserves at January 1, 2004	$21,358,541,000
Less: Reserves not eligible for increase	691,148,000
Actuarially determined eligible reserves at Janaury 1, 2004	20,667,393,000
CPI Inflation rate capped at 2.5%	2.103%
Dollar cost of inflationary increase	434,635,275
June 30, 2004 total required reserves	21,594,958,000
June 30, 2004 total required reserves adjusted for inflationary increase	22,029,593,275
Market value of Assets at June 30, 2004	16,532,934,000
Less:Inflation adjusted required reserves	
Current year excess market value	22,029,593,275
Negative balance carry forward	-5,496,659,275
	-3,693,871,840
Excess market value available for investment based benefit increase	
Divided by 5 year pay out period	-1,802,787,435
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Current year portion of excess market value	-360,557,487
Second year portion	-558,850,315
Third year portion	-593,357,973
Fourth year portion	68,733,579
Fifth year portion	184,136,183
Total five year excess market value	-1,259,896,014
Greater of current year excess market value or cost of transition adjustment	-1,259,896,014
Divided by eligible required reserves at January 1, 2004	20,667,393,000
Investment based increase for FY2003	0.0000%

Summary:

Investment Based Benefit Increase	**0.0000%**
Inflation Based Benefit Increase	**2.1030%**
Total Benefit Increase	**2.1030%**
Total Dollar Value of January 1, 2004 Benefit Increase	**$434,635,275**