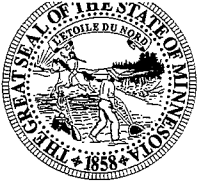


MINNESOTA
STATE
BOARD OF
INVESTMENT

07 - 0308



Board Members:

Governor
Tim Pawlenty

State Auditor
Rebecca Otto

Secretary of State
Mark Ritchie

Attorney General
Lori Swanson

Executive Director:

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

DATE: January 26, 2007

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 Steve Smith, Legislative
Commission on Pensions and Retirement

FROM: Howard J. Bicker, Executive Director

SUBJECT: Post Retirement Investment Fund Report Pursuant to
Minnesota Statutes, 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.

An Equal Opportunity
Employer

The asset allocation of the Post Fund as of June 30, 2006 compared to the long-term asset allocation of the fund was:

	Actual	Long-Term
Domestic Stocks	47.2%	45.0%
International Stocks	15.3	15.0
Bonds	23.7	25.0
Alternative Assets	8.7	12.0
Cash	5.1	3.0

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

The Post Fund generated a total rate of return of 12.0 percent for fiscal year 2006. This return outperformed by 0.2 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 2006 was 8.9 percent compared to 9.6 percent return on the equity asset class target. The return for the bond segment was -0.2 percent for fiscal year 2006 compared to -0.8 percent for the Lehman Aggregate bond index for the same period. The return generated from international stocks in fiscal year 2006 was 28.2 percent compared to the 27.9 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 2006, payable beginning January 1, 2007. 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, 2006 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, 2007 benefit increase.

Calculation of January 1, 2007 Benefit Increase

Actuarial value of required reserves at January 1, 2007	\$25,723,815,033
Less: Reserves not eligible for increase	\$773,159,119
Actuarially determined eligible reserves at January 1, 2007	<u>\$24,950,655,914</u>
CPI Inflation rate capped at 2.5%	2.5%
Dollar cost of inflationary increase	623,766,398
June 30, 2006 total required reserves	<u>\$26,088,616,786</u>
June 30, 2006 total required reserves adjusted for inflationary increase	26,712,383,184
Market value of Assets at June 30, 2006	\$22,049,700,680
Less: Inflation adjusted required reserves	26,712,383,184
Current year excess market value	<u>-4,662,682,504</u>
Negative balance carry forward	<u>-\$2,799,703,796</u>
Excess market value available for investment based benefit increase	<u>-1,862,978,708</u>
Divided by 5 year pay out period	5
Current year portion of excess market value	-372,595,742
Second year portion	-308,271,560
Third year portion	-\$95,550,756
Fourth year portion	-\$360,557,487
Fifth year portion	-\$558,850,315
Total five year excess market value	<u>-\$1,695,825,859</u>
Greater of current year excess market value or cost of transition adjustment	<u>-1,695,825,859</u>
Divided by eligible required reserves at January 1, 2007	24,950,655,914
Investment based increase for FY2006	0.0000%
Summary:	
Investment Based Benefit Increase	0.0000%
Inflation Based Benefit Increase	2.5000%
Total Benefit Increase	<u>2.5000%</u>
Total Dollar Value of January 1, 2007 Benefit Increase	<u><u>\$623,766,398</u></u>