MINNESOTA STATE BOARD OF INVESTMENT

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

Representative Gene Pelowski, Jr., Chair, House Committee on State and Local Government 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.

Please note that the Post Fund will be merged into the active member funds at the close of business June 30, 2009. According to the provisions of Laws of Minnesota 2008, Chapter 349, Articles 2 and 3, the Post Fund must be merged when its funding ratio falls below 80 percent. The funding ratio was 79.7 percent as of June 30, 2008.

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, 2008 compared to the long-term asset allocation of the fund was:

	Actual	Long-Term
Domestic Stocks	46.7%	45.0%
International Stocks	15.5	15.0
Bonds	25.0	25.0
Alternative Assets	11.3	12.0
Cash	1.5	3.0

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

The Post Fund generated a total rate of return of -5.2 percent for fiscal year 2008. This return underperformed by 1.2 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 2008 was -13.1 percent compared to -12.7 percent return on the equity asset class target. The return for the bond segment was 4.3 percent for fiscal year 2008 compared to 7.1 percent for the Lehman Aggregate bond index for the same period. The return generated from international stocks in fiscal year 2008 was -6.6 percent compared to the -6.4 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 2008, payable beginning January 1, 2009. 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, 2008 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.

Please note that with the merger of the Post Fund, the benefit increase formula will change. Post retirement increases beginning January 1, 2010 will be 2.5 percent a year.

Enclosure: Calculation of January 1, 2009 benefit increase.

Calculation of January 1, 2009 Benefit Increase

The Post Retirement Fund had a composite funded ratio of 79.7% on June 30, 2008. Under the provision of Minnesota Statutes Section 11A.181 subd. 1 (2) the Post Fund is dissolved because it fell below a 80.0% composite funded ratio. In accordance with Minnesota Statutes , Section 11A.181 Subd.3 a postretirement benefit increase of 2.5% is effective January 1, 2009, for Post Fund Participants eligible for an increase .

Calculation of June 30, 2008 Composite Funded Ratio

Total Fair Market Value of the Post Retirement Fund	$23,015,111,000
Post Retirement Fund required reserves determined by the Actuary	$28,881,890,404
Composite funded ratio	79.7%

Calculation of June 30, 2008 Fair Market Value Used in the Composite Funded Ratio

(Includes mortality gain and loss accruals no longer payable under 11A181 Subd.2 (1))

ASSETS:		
Investments (at market value):		
Common Stock	$	14,292,974
Alternative Equities		2,592,833
Fixed Income Securities		5,746,354
Short Term Securities		335,145
Short Term Securities-Lending Collateral		2,381,712
Total Investments	$	25,349,018
Cash		0
Security Sales Receivable		0
Accounts Receivable-Fee Refunds		0
Accounts Receivable-Mortality		106,285
Accounts Receivable-Participants		0
Accrued Interest		0
Accrued Dividends		0
Accrued Short Term Gain		565
Reserve Adjustment		0
TOTAL ASSETS	$	25,455,868
LIABILITIES:		
Management Fees Payable		7,134
Security Purchases Payable		0
Accounts Payable-Participants		1,744
Accounts Payable-Mortality		50,167
Reserve Adjustment		0
Securities-Lending Collateral		2,381,712
TOTAL LIABILITIES	$	2,440,757
NET ASSETS AT JUNE 30, 2008	$	23,015,111