HOUSE FINANCE COMMITTEE
January 31, 2023
1:33 p.m.

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CALL TO ORDER

Co-Chair Johnson called the House Finance Committee meeting to order at 1:33 p.m.

MEMBERS PRESENT

Representative Bryce Edgmon, Co-Chair
Representative Neal Foster, Co-Chair
Representative DeLena Johnson, Co-Chair
Representative Julie Coulombe
Representative Mike Cronk
Representative Alyse Galvin
Representative Sara Hannan
Representative Andy Josephson
Representative Dan Ortiz
Representative Will Stapp
Representative Frank Tomaszewski

MEMBERS ABSENT

None

ALSO PRESENT

Adam Crum, Commissioner, Department of Revenue; Pam Leary, Director, Treasury Division, Department of Revenue.

SUMMARY

PRESENTATION: SAVINGS ACCOUNT/BUDGET RESERVES/INVESTMENT FUNDS

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Co-Chair Johnson reviewed the meeting agenda.

^PRESENTATION: SAVINGS ACCOUNT/BUDGET RESERVES/INVESTMENT FUNDS

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ADAM CRUM, COMMISSIONER, DEPARTMENT OF REVENUE, introduced the PowerPoint Presentation "Update on the State's Cash Reserve Funds and Discussion of State Cash Flows" dated January 31, 2023 (copy on file). He introduced Director Pam Leary and explained that she would be giving the presentation.

Co-Chair Johnson asked if there were any questions before the presentation began.

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PAM LEARY, DIRECTOR, TREASURY DIVISION, DEPARTMENT OF REVENUE, introduced herself and began on slide 2 to go over the agenda for the presentation. She advanced to slide 3 briefly and relayed the four elements of the treasury: investment management, cash management, debt management, and unclaimed property. She moved to slide 4 to discuss some statistics about the treasury. The slide read as follows:

- 45 Treasury Division staff positions, most of whom touch investments in some capacity via portfolio management, accounting, operations, compliance, debt management, cash management and unclaimed property.
- $46.8 billion in assets under management (AUM) as of 12/31/22.
- Combined operating budget of $15.3 million.
- The Division is a resource to state fiduciaries, state agencies, the legislature and the general public.

Ms. Leary advanced to slide 5 to go over some investment management information. Of the $47 billion in assets held by the treasury, 47 assets were in separate accounts. There were 14 defined benefit funds and four participant direct funds under the direction of the Alaska Retirement Management Board (ARMB). Additionally, 25 funds were under the purview of the commissioner of revenue and four funds were under the direction of other state fiduciaries. She explained that accounts were managed in a pooled environment which was an efficient way to invest multiple funds.

Representative Ortiz returned to slide 4 and referred to the 45 staff treasury division positions. He asked if the

number of positions had remained stable or if it had it grown over the years.

Ms. Leary responded that the growth had been relatively flat. There was some growth about ten years ago, but the division had remained at about 40 to 45 staff on average. The division currently had about six vacancies.

Representative Ortiz asked for clarification that there were 45 positions and 39 of them were filled.

Ms. Leary replied that Representative Ortiz was correct.

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Ms. Leary continued on slide 5. She indicated that there were seven asset classes that rolled up into 23 investment pools in which retirement funds were invested. Similarly, the state had nine pools in which state funds could be invested. She advanced to slide 6 to continue to speak on investment management. The slide read as follows:

- The Chief Investment Officer and staff meet regularly with the Commissioner, ARMB or other fiduciary to discuss and determine asset allocations.
- Consideration is given to:
  - the type and use of the fund.
  - how long the fund is expected to be invested.
  - what type of risk the fund can take.
- Callan's Capital Markets Assumptions and other industry data are used to build models to generate potential asset allocation targets.
- Invest, Invest, Invest!
- State Investment Review and ARMB meetings are held quarterly to review performance, investment policy, and asset allocations with an independent investment advisory committee. Summaries and materials for the meetings are publicly available on our website.

Ms. Leary advanced to slide 7 to speak on the cash management sector of the treasury. She relayed that the cash management group had an important job that generally happened under the radar and involved monitoring all of the cash coming in and out of the state. The cash management group also managed procurement, administration, and implementation of all statewide banking service contracts,

including warrant clearing contracts, primary and alternate depository services contracts, automated clearing house (ACH) origination contracts, credit card acceptance contracts, and treasury management system contracts. Additionally, the group was responsible for projecting and reconciling, on a daily basis, all incoming and outgoing cashflows to determine excess funds that could be invested by the staff.

Ms. Leary continued to slide 8 to discuss debt management as follows:

- Implement directives from the Commissioner's office and the State Bond Committee ('SBC') on policy decisions related to debt issuances, rating strategies, and potential use of debt capacity.
- Coordinate activity among various professionals for any authorized debt issuance (bond counsel, financial advisor, arbitrage, underwriter).
- Conduct meetings with Rating Agencies.
- Prepare all statutorily required reporting: - Revenue Sources Book
  - Annual Comprehensive Financial Report
  - Alaska Public Debt Book
  - Alaska Debt Affordability Analysis
- Perform all continuing disclosure undertakings for outstanding bonds.
- Provide leadership and staff for the Alaska Municipal Bond Bank Authority (AMBBA).

Ms. Leary continued on slide 9 to speak on unclaimed property. She explained that February 1 was unclaimed property day nationally. The division encouraged everyone in the state to look through the unclaimed property listed on the website [unclaimedproperty.alaska.gov] to see if their name was included in the list. The duties of the unclaimed property group included the following: providing services to reunite owners, heirs, or legal representatives with their unclaimed property; determining entitlement by analyzing statutes, court orders, legal cases, and reviewing evidence; and promoting unclaimed property reporting. There were currently 1.8 million claimable properties in the state with a value of $258 million.

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Representative Hannan asked how long the state held unclaimed property before it became a state asset. She asked if there was a legal process to arrive at the conclusion that the property would never be claimed. She wondered if the property would become an asset of the state or if it would always be a liability because an individual could return at any time and ask for the property.

Ms. Leary responded that there was always a liability that was owed and individuals could always ask for the property from the state. There was a reserve of money that would not go to the state that would always be available if an individual decided to claim the property. The beneficiary of the excess funds was the general fund and if there was ever a situation where the state needed more money to repay an individual, it would likely be sourced from the general fund. However, such an event had never happened because of the available reserve of money.

Representative Hannan asked if there was obligation from the unclaimed property division to seek out property owners or was the burden upon the legal entity.

Ms. Leary responded that the burden was on the individual, however the systems had recently been updated which allowed the group to cross-reference names with other databases to reunite the owner with the property.

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Representative Stapp asked if the $258 million in unclaimed property was kept in a liquid fund.

Ms. Leary responded that there was a database that showed everything that was held and the amount that was claimable. The value of the fund ranged depending upon the amount of unclaimed property. There had recently been a surge in unclaimed property coming through the division and it was working through the claims. The amount in the fund was just enough to cover a year's worth of anticipated unclaimed property claims.

Representative Stapp asked for clarification that there was an actual fund in existence. He asked what the point was of keeping a separate fund if it was going to be paid out of general fund dollars. He wondered if there was a legal reason.

Ms. Leary would follow up with the information.

Ms. Leary continued on slide 10 and discussed some treasury accomplishments.

- Professional Certifications:
  - Increase in professional designations: CFAs, CPAs, CIPMs & CTPs
- Delivered outstanding investment performance results:
  - In FY22, PERS and TRS performance of -4.1% resulted in an average of 9.0% during the 38-year history of the retirement systems. Over the past decade, the systems have outperformed their benchmark by 126 basis points and the median peer plan by 98 bps. This performance places the systems well into the top quartile, outperforming over 85% of peer plans.
  - State assets have grown by 9.0% in the last 12 months, largely outperforming fund benchmarks.
- ARMB Savings:
  - $35 million annual savings in management fees by reducing the amount of assets invested with external investment managers and investing those assets utilizing Treasury Investment Officers.

Representative Hannan pointed out that the retirement system was listed to be 38 years old. She thought that the retirement system was older than 38 years.

Ms. Leary responded that Representative Hannan was correct. The 38-year time frame referred to the time period during which the division had investment and performance history information for the aggregate group of funds it was managing.

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Representative Josephson asked if it would suggest that it was an easy target to meet if a person was interested in a pension reform plan and the formula relied on less than 7 percent returns on average.

Ms. Leary asked him to rephrase the question. She explained that a 7.3 percent actuarial rate was currently being used by the actuaries when they looked at their calculations for the funding status of the plans. If the percentage was

under the actuarial amount, which was the case in FY 22, it would mean that there was less of a funded status when all of the actuarial math occurred. The needs were being met from an investment perspective over the lifetime of the plan.

Representative Josephson remarked that about a year prior, ARMB indicated that the revenue commissioner at the time concluded that the health commissioner at the [Alaska Mental Health Trust Authority (AMHTA)] trust did not need additional funding. The legislature and ARMB did not agree. He had been told that the medical section of the trust was the portion that resulted in the demise of the defined benefits plan, but it was now fully solvent. He asked if there was an easy explanation.

Ms. Leary replied that the topic required a longer presentation and would be better met by the Division of Retirement and Benefits (DRB). There was overfunding of the healthcare plan assets in the last two years and ARMB decided against contributing additional funds to the plans. The money from the healthcare plans could not be used for the pension plans due to legal requirements.

Representative Josephson had heard talk the previous year that the unfunded liability had been resolved; however, he had also been told that there was [a liability of]$6.9 billion. He asked if both things were true at one point and if the $30 billion on paper could be that variable depending on plan performance.

Ms. Leary responded there were many components to the funding status. Healthcare costs had gone up and gone down and had a broad impact and many components could lead to fully funded statuses, overfunded statuses, and unfunded statuses. All of the information was analyzed by actuaries each year. Every four years, an actuary did a deep dive and completed a separate analysis to ensure that the assumptions were valid.

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Co-Chair Johnson asked about the difference between the investment earnings and the Permanent Fund earnings.

Ms. Leary replied that over the 38-year period, the performance was neck-in-neck. Sometimes the performance of

the Permanent Fund was higher, sometimes the retirement plans were higher. The two targeted very different mandates and different asset allocations. She understood that the Alaska Permanent Fund Corporation (APFC) came in just under 9 percent over the 38-year period. However over 30 years, the total was 7.95 percent for APFC and 7.8 percent for the treasury.

Co-Chair Johnson asked if the numbers were broken out by internal and external investment officers.

Ms. Leary responded that she was not sure what the breakout was for APFC, but it was about half and half for all of the assets that the treasury managed for the state and for ARMB. All fixed income was done internally, and about 70 percent of management was done internally for state assets.

Ms. Leary continued to slide 11 to speak on the debt side of the treasury accomplishments. The slide read as follows:

- Increase in the State's credit rating outlook with Fitch and Standard and Poor's.
- In the past two fiscal years, the Alaska Municipal Bond Bank Authority has funded $408.1 million in loans resulting in an estimated $55.4 million in savings to Alaskans through lowered borrowing costs.
- Restructured outstanding debt of the airport system saving $81.8 million from future debt service payments.
- During FY22, Unclaimed Property returned approximately $13.5 million to current or former Alaska owners and businesses, transferred $12.0 million into the state general fund, had a 16% increase in reported holdings.
- Maintained a reduced claims backlog since transitioning to a new unclaimed property system in FY21, despite a 15% increase in claims being received.
- Since FY19, $90.9 million in cash and stock sale proceeds have been received as unclaimed property, $45.5M million was transferred into the state general fund and over $34.4 million dollars has been returned to current or former Alaska owners and businesses.

Ms. Leary continued that in the current week, the division hit the $100 million mark in terms of unclaimed property monies paid back to Alaskans since the start of the program in 1986.

Representative Hannan asked about the restructuring of the airport debt that came about due to a cash infusion. She concluded that it came from federal monies for airports that were one-time occurrences.

Ms. Leary responded that she was unsure if she had the answer. She was aware that $40 million in cash in prior debt service funds were utilized for the restructuring of the airport debt. She was not sure how it related to appropriations.

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Ms. Leary advanced to slide 12 to speak on the update on cash reserve and other funds. She explained that the next set of slides would highlight six of the funds in which the treasury invested on behalf of fiduciaries. There would be two graphs for each fund: the first showed fiscal year balances and the second showed investments statistics. She noted that the prior year's market conditions were mostly not positive due to inflation and the dramatic increase in interest rates. She relayed that U.S. stocks were down by 19 percent, broad market fixed income was down by 13 percent, and international equity was down by 16 percent. Although the funds were down, all of the funds that the treasury managed had moderate performances compared to the benchmarks, with the exception of one fund.

Ms. Leary advanced to slide 13 and discussed the Constitutional Budget Reserve Fund (CBRF). The graph on the slide showed the historical invested assets of the fund since its inception in 1990. The blue section of the graph showed the main fund and the yellow section showed the sub-fund created in 2000, which referred to money that would not need to be used for five years and could therefore be invested at a slightly higher risk rate of return. The grey section was the Statutory Budget Reserve (SBR). The CBRF was funded through resolutions of disputes on mineral income. A simple majority vote for an appropriation could happen if the amount appropriated was less than the prior year, otherwise it was a three quarter vote. She emphasized that appropriations must always be repaid. The fund itself had two main purposes: funding temporary cash flow and revenue mismatches. It had also been used to appropriate for structural deficits in revenue shortfalls.

Representative Hannan stated that she had only heard the fund referred to as the Constitutional Budget Reserve (CBR), not the CBRF. She asked if the only difference was how the funds were invested. She understood that there was no difference in terms of policy but wondered if there was a difference in the legal structure and draw.

Ms. Leary responded that the sub-fund was statutorily created. It was at the discretion of the fiduciary, who was the commissioner of DOR, to determine when and if money would come out of the fund. Generally, the money being withdrawn from the sub-fund was triggered by a particular event. For example, all of the money in the sub-fund was transferred to the main fund in 2015 because it was thought at the time that the money would need to be liquidated for funding the budget due to the decreases in the balances.

Representative Hannan asked for clarification that the legislature was not making the decision of whether the money was coming from the sub-fund or the main fund. She understood that the decision was up to the commissioner of DOR.

Ms. Leary responded that the money would be coming from the main fund to support any expenditures. The sub-fund would be liquidated into the main fund and invested in a different manner.

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Representative Josephson asked for clarification that the CBRF had no creditor waiting to be repaid. He understood that the CBRF needed to be repaid, but there was a constitutional promise that the state would repay it.

Ms. Leary responded in the affirmative.

Co-Chair Johnson asked if Ms. Leary could provide the same chart that was on slide 13, but with the debt included.

Ms. Leary would provide the chart. She pointed out that the balances on the slide were the invested balances. There was a difference between the invested balances and what was being reflected either in the budget or in the Annual Comprehensive Financial Report (ACFR). The amount owed to the CBRF changed and that was reflected in the report as well. As of FY 21, the amount owed was just over $12

billion and was expected to be reduced in the ACFR for FY 22 by around $1 billion due to surpluses.

Co-Chair Edgmon added that one could also say that the deposits in the CBR were above and beyond the amounts required by law. During time periods when oil prices were high, the legislature deposited additional money into the CBR that was not required.

Ms. Leary advanced to slide 14, which showed statistics about the CBRF. The pie chart showed the target asset allocation of 100 percent cash equivalence. The fund had a short investment horizon because the money had a constant potential to be used, therefore the investment strategy was low risk and the investments were in money markets and treasury bills. The current balance was just over $1 billion as of the end of December of 2022. There were also some rolling returns for the period ending in December. The actual was a 1.6 percent return which compared favorably to the benchmark of 1.46 percent. The short-term projection for the asset allocation had a target of 2.39 percent.

Representative Stapp referred to the projected return of 2.39 percent. He asked how it was certain that the state would have a better rate of return than it had during the previous ten years.

Ms. Leary responded that it was a short-term expected rate of return and that inflation rates were currently high. She thought the projected return would be lower if a longer term view was examined.

Representative Stapp asked for a clarification of short-term.

Ms. Leary responded that short-term was essentially one year. Most of the returns later on in the presentation were closer to ten years.

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Co-Chair Edgmon asked if there was an optimum amount that should be in the CBR. He had heard a variety of figures: $5 billion, $1 billion, and higher than $5 billion. He asked if there was a number that seemed carelessly low when it came to meeting the state's cash flow needs. He wondered if there was an optimum number.

Ms. Leary responded that the fund had seen a variety of different balances and one could use different metrics to determine what the balance should be based on possible usages. She explained that the treasury had not utilized the account in the prior year because there were available resources through the Earnings Reserve Account (ERA) that had been appropriated to the general fund. It was a policy call under the purview of the Office of Management and Budget (OMB). She noted that cash flow was different than budget, and there was a threshold of $400 million that needed to be in the general fund to pay two days' worth of high bills. The department used cash projections to determine whether cash would be needed to cover all of the expenses. The account from which the cash would be withdrawn was dependent upon the budget and appropriations. If expenses became higher than revenue, the CBR would be utilized. There was an order of operations when a deficit was not expected, and money would be withdrawn from the ERA before the CBR. When there were deficits, the money was more likely to be borrowed from the CBR first.

Co-Chair Edgmon thanked her for her answer and thought it illustrated how the topic was complicated.

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Ms. Leary advanced to slide 15 and the Power Cost Equalization (PCE) fund. The purpose was to provide for a long-term stable financing source that provided affordable levels of electric utility costs in otherwise high-cost service areas of the state. She explained that 5 percent of the monthly average market value of the fund for the previous three fiscal years could be appropriated. If prior years' earnings exceeded the amount, 70 percent of the difference could be spent on related identified programs. As of the end of FY 22, the balance of the fund was $967 million.

Ms. Leary moved to slide 16 and gave information about the PCE fund, which had a long investment horizon and tended to involve riskier asset classes such as equities. The target asset allocation was shown on the pie chart on the slide and equated to about a 70/30 percent equity to bond ratio on investments. There were four other funds that had the high risk tolerance and were invested in a similar fashion. The balances for the past five years were listed on the slide. Rolling returns for the last year were -14.95

percent, which was slightly better than the -15 percent benchmark. The projected ten-year returns were 5.6 percent.

Co-Chair Edgmon noted that the legislature passed HB 243 in 2022 which changed the investment approach from a low-risk rate of return to a strategy more on-par with that of the Permanent Fund. He recalled that the bill was signed into law in June of 2022, and he assumed it would not have had much of an impact on the losses experienced by the PCE fund. He understood that the losses were more significant than those of the Permanent Fund.

Ms. Leary responded that HB 243 changed the context of the purpose of the investments. By statute, the fiduciaries followed the prudent investor rule. The language in HB 243 gave support to targeting a greater rate of return. The investments in the PCE fund were significantly different than the Permanent Fund in that the PCE fund did not have illiquid assets such as private equity, which impacted how returns would show in a given period of time. Although there were negative returns, the PCE fund was similar to other funds that were managed with the available asset classes.

Representative Cronk asked when it was decided that the PCE fund could be used for community revenue sharing.

Ms. Leary responded that there was other legislation in which the target of expenditures was reduced from 7 percent to 5 percent. She believed the legislation was passed in 2017. The legislation included language that pointed to a waterfall effect if the earnings were plentiful, which would allow other funds to manage to have additional funding sources.

Representative Cronk thought it would be better to find other projects with reduced energy costs.

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Ms. Leary advanced to slide 17 and the Alaska Higher Education Investment Fund (AHEIF). She explained that AHEIF was established in 2012 and capitalized with a $400 million deposit from receipts of the Alaska Housing Capital Corporation (AHCC) for use in paying Alaska Performance Scholarship Awards and AlaskAdvantage Education Grants. In FY 17 and FY 18, the fund was used to assist deposits into

retirement plans for the Public Employees' Retirement System (PERS) and the Teachers' Retirement System (TRS). As of the end of FY 22, the $394.6 million balance of the fund was swept to the general fund, of which $342.6 million came directly from AHEIF and $52 million came from the CBRF due to FY 22 investment losses in AHEIF. Up to 7 percent of the fund could be appropriated for scholarships. There had been additional legislation that ensured that the fund was separate and was no longer included as a sweepable fund.

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Representative Stapp asked if the mechanisms affected the investment performance. He noticed on slide 17 that the ten-year rate of return was projected at 5.6 percent, but the five-year average was 4.5 percent. He asked where the discrepancy was.

Ms. Leary moved to slide 18 to respond to the question. The ten-year return was based on what was currently known about the market space and expectations of the future. The actual five-year performance was 4.5 percent, which was on par with the 4.46 benchmark. The accuracy of the projections depended upon a variety of things, but most importantly it depended upon market activity.

Ms. Leary continued on slide 18. Like PCE, AHEIF had a high risk long-term investment horizon and also targeted an equity to fixed income investment ratio of 70/30. The balance as of December of 2022 was $347 million and had a negative return of -16.19. However, it was positive in the three and five-year histories that it had. It benefited from not having as much equity exposure when the asset allocation was first changed.

Ms. Leary advanced to slide 19 to speak on the General Fund and Other Non-Segregated Investments (GeFONSI). The slide showed a graph of the historical invested assets of the fund in billions. There were two types of GeFONSI funds: GeFONSI I and GeFONSI II. The GeFONSI I included the general fund proper, which was essentially the checkbook through which all money in the account flowed. Between the two GeFONSI accounts, there were 185 sub-funds. The GeFONSI II was created to target a slightly higher risk return and did not retain its monies; instead, the GeFONSI I was the beneficiary of the account.

Co-Chair Johnson referred to the internally and externally managed investment funds. She asked for clarification that Ms. Leary was speaking to GeFONSI when she mentioned 70/30 internal and external management split. She asked how the internally and externally managed accounts compared in terms of rate of returns.

Ms. Leary responded that GeFONSI I was primarily based in fixed income and cash equivalence while GeFONSI II had some equity to it. The majority of both funds were mostly managed internally by the investment staff. She would follow up with the committee on the comparison between internal and external rates of return. She suggested that the fact that many assets in the public space beat their benchmarks showed that the internal investment staff were successful in their jobs.

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Representative Josephson pointed out that the graph on slide 19 showed $9 billion in GeFONSI in 2012, which was a peak year for taxes and royalties. He asked if the money was above and beyond the CBR balance.

Ms. Leary responded in the affirmative. However, the balance did not include the SBR as it was managed as a separate account.

Representative Josephson asked about the right side of the graph showing $4.7 billion. He understood that there was close to $2 billion in the CBR and the balance was unspent for the current fiscal year. He asked if the practice was in line with general government operations and what constituted the $4.7 billion.

Ms. Leary responded that there were 185 funds in the GeFONSI, including the general fund. The balance of the general fund proper on June 30 of 2022 was approximately $3 billion and was about $1.8 billion by the end of December of 2022. The balance still included the cash value of the surpluses in the prior fiscal year and the $3 billion figure included the transfer of the ERA. There were many expenditures at the beginning of a fiscal year, which was why there was an expected reduction in the balance. The balance also included the surpluses and revenues in excess of expenses, though she expected to learn the exact figure when the ACFR was audited.

Ms. Leary moved to slide 20 and the asset allocations of the GeFONSI accounts. The GeFONSI I did not have equity and had a moderate risk objective while GeFONSI II had equity and had a moderate to high risk objective. The combined total of the funds was $4 billion as of the end of December of 2022. The six month mark showed positive returns while the one year mark showed slightly negative returns at -0.28 percent for GeFONSI I and -3 percent for GeFONSI II. The projected returns were 2.5 and 3 percent respectively.

Ms. Leary continued to slide 21 and the Public School Trust Fund (PSTF) that was funded by one half of one percent of the state receipts from the management of state lands. The PSTF was established in 1978, replacing the territorial era public school land grant originally created by congress in 1915 through a transfer of the balance from the permanent school trust. Following passage of HB 213 in 2018, the fund was now managed as one fund, under a percentage of market value (POMV) method, which was 5 percent of the average market value for the five years preceding the previous fiscal year. It was used to provide an offset for the K-12 formula funding for the schools. For FY 24, the amount of $32 million was included in the budget.

Ms. Leary advanced to slide 22 and briefly explained that the PSTF fund was a high-risk account with a 70/30 asset allocation. The balance at the end of December of 2022 was $700 million and had negative returns of -16.19 percent; however, the account did beat its benchmark. The projected ten-year returns were 5.6 percent.

Ms. Leary moved to slide 24 which discussed the PERS and TRS plans. The graph on the slide showed the returns for PERS in blue and TRS in yellow. The ARMB was comprised of nine members and was the fiduciary of the state's pension and health systems. The defined benefit plans currently experienced about $1 billion per year of net outflows from the funds. The 38-year return average for PRS and TRS was 9 percent.

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Representative Stapp understood that the defined benefit plans were experiencing a net outflow of about $1 billion per year. He asked if the funds were basically exhausted.

Ms. Leary responded that there was significant actuarial work that went into defining the contribution rates that employers would put into the plans. There was money and earnings coming into the plans, but since the defined benefit plan was currently distributing money to retired individuals, the outflows were occurring. She relayed that greater detail would be provided by DRB.

Ms. Leary continued on slide 24 which showed the target asset allocation of the TRS and PERS plans. The investment objectives for the plans were high risk and had long-term investment horizons. The target allocation included private equity and real assets, which were referred to as illiquid assets. She pointed out that the total between the PERS and TRS was $28.6 billion. The returns as of September 30 of 2022 were -10 percent for both plans, beating the benchmark of about -14 percent. The official calculated returns were not yet available.

Representative Tomaszewski noted that much of the returns were not audited. He asked what the auditing schedule was and who was responsible for the auditing.

Ms. Leary responded that the auditor was Klynveld Peat Marwick Goerdeler (KPMG). She indicated that KPMG performed an audit of the invested asset balances. The audits were finalized as of June 30, which was the end of the fiscal year. The audits were published online and she would be happy to direct the committee to the website.

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Representative Josephson understood that there were routine actuarial analyses of the balances and the health of the plans overall. He asked if Ms. Leary was comfortable that the system was vigilant and protective of the asset and not cavalier about its health.

Ms. Leary responded that the changes and additions to the actuarial lineup occurred "some time ago" when there was an actuary whose assumptions were not accurate. Since then, an annual review and a deeper dive of the activity of the actuaries became procedural. She felt comfortable with the level of monitoring that was occurring and thought the risk was being taken seriously. There was a compliance group that monitored the investments to ensure they were within the appropriate parameters. Through the ARMB meetings and

state investment review board meetings, outside consultants and the investment advisory council monitored the investments, compared the investments from year to year, and ensured that there were strong internal controls. She felt confident in the team and consultants.

Representative Galvin asked about the term "some time ago." She asked for more detail on how long ago the event occurred.

Ms. Leary responded that she would have to get back to the committee with the information.

Co-Chair Johnson suggested that the committee focus on the current presentation.

2:49:30 PM

Ms. Leary advanced to slide 26 and the third portion of the presentation revolving around cash flows. She explained that the cash balance was what was held in the bank at a given point in time. The amount in the budget and the amount in the ACFR would be quite different. For example, the CBR balance was currently $1 billion in cash, but at the end of June of 2023, it was expected to reflect $2.2 billion available for appropriations.

Ms. Leary continued to slide 27 which depicted a flow chart of the state's treasury cash. Money would flow in from oil and gas, excise taxes, federal dollars, and other sources, then payments would flow out for payroll and pension payments, debt service, and other payments.

Ms. Leary moved to slide 28 and incoming revenue and relayed that there was definite volatility in the money coming in. For example, petroleum revenues were 47 percent of the FY 23 projected unrestricted general fund (UGF) revenues, but there was uncertainty about what the specific number would actually be. There would always be uncertainty because oil prices and investments could fluctuate dramatically. Investment earnings were 47 percent of the FY 23 projected unrestricted general fund revenues. There was certainty about what would be in the FY 24 budget because there was a lagging POMV formula; however, there was still uncertainty in FY 24 in terms of the amount.

Ms. Leary continued to slide 29 to discuss expenditures. There were sometimes situations where money needed to be laid out, particularly for federal programs, before the cash could flow in. That sometimes meant that cash needed to be called from elsewhere. There were many mismatches that occurred at the beginning of a fiscal year in which appropriations did not match incoming revenue. Seasonal cash flow needs also caused mismatches when large amounts of money were needed at a particular time.

Ms. Leary advanced to slide 30 to speak to cash flow deficiencies, which were situations in which the state did not have sufficient funds for the bills that were due. Prior to 1985, most unrestricted revenues flowed into the general fund and remained there. Over time, the legislature established many sub-funds within the general fund to segregate cash for budgeting purposes, resulting in less cash available to pay daily operating costs. The legislature typically included language in the budget bill allowing for a transfer from the CBR if unrestricted revenue was insufficient to cover the general fund appropriations in a given year.

Ms. Leary moved to slide 31 and explained the cash deficiency memorandum of understanding (MOU). In 1994, various state departments created a cash efficiency plan. The target was a $400 million minimum cash threshold in the general fund proper which would outline procedures for addressing cash flow timing mismatches. Some procedures were developing monthly cash projections, monitoring daily general fund cash balances, and executing appropriated transfers from ERA, CBR, or other accounts. The MOU also spoke to temporary fund borrowing that had to be repaid by the end of a fiscal year. The memorandum also outlined what would happen if all appropriations were exhausted and it was evident that there would not be enough money to pay the bills. In the situation, DOR would seek legislative action through the governor to access additional funds through appropriation from other cash reserve funds or other funds.

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Ms. Leary continued to slide 32 and continued to discuss cash flow deficiencies. She indicated that using budget reserve funds had been the solution for cash flow timing mismatches and revenue shortfalls. The FY 21 ACFR showed $12.8 billion owed to the CBR, but the amount was expected

to be reduced in FY 22 due to the sweep of unassigned balances and sub-funds.

Ms. Leary advanced to slide 33 to speak about volatility management techniques. Some management strategies were as follows: accessing cash reserves and other funds, managing the timing of ERA transfers to the general fund, managing the timing of expenditures, and modernizing fiscal tools to include lines of credit.

Ms. Leary moved to slide 34 and offered some cash flow takeaways. She highlighted that forecasts for cash flow were never correct and even with balanced budgets, cash flow timing mismatches would occur, and revenue shortfalls might occur if forecasted assumptions were wrong. Additionally, higher revenue volatility required greater cash reserves until volatility decreased, but volatility management techniques were available. She concluded her presentation.

Representative Stapp asked if there was a ballpark number as far as cost to the state for cash flow timing mismatches.

Ms. Leary responded that the mismatches were taken from the ERA and were now appropriations. There was no real cost to the state because the money was destined to move into the general fund regardless. She assumed Representative Stapp was referring to a situation in which money from the ERA was taken at any point in time and was not invested at the Permanent Fund to a higher risk rate of return. She was not sure a cost to the state had ever been calculated and there were lots of components that comprised it.

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Representative Hannan made a request for future information. When she first became a legislator, it became a burden for DOR to manage the physical cash for cannabis taxes. She wondered if Ms. Leary had the opportunity to look at how the cash collection process could be improved upon. She understood that additional employees needed to be brought on to physically manage and secure large amounts of cash. She wondered what the legislature could do to support change.

Mr. Crum responded to the question. The Division of Tax managed the marijuana revenues and he was working on a risk management system for DOR. He had attended a recent departmental meeting on developing a safer and more effective process. The department was looking at outsourcing some of the responsibilities to contractors. It was important to make the process safe and easy and to minimize the risk.

Representative Coulombe asked which year the fixed asset management became internally managed.

Ms. Leary responded that there was a long history of internal fixed income management. The equity aspects had been brought internally as well and almost all internal fixed income was managed within DOR.

Representative Coulombe asked if the $35 million annual savings in management fees were incurred over a long period of time.

Ms. Leary responded that it was within the last five years that management had been moved internally to identify the savings.

Co-Chair Johnson reviewed the following meeting's agenda.

3:03:33 PM

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ADJOURNMENT

The meeting was adjourned at 3:04 p.m.