

SENATE FINANCE COMMITTEE
January 19, 2024
9:01 a.m.

[9:01:51 AM](#)

CALL TO ORDER

Co-Chair Stedman called the Senate Finance Committee meeting to order at 9:01 a.m.

MEMBERS PRESENT

Senator Lyman Hoffman, Co-Chair
Senator Donny Olson, Co-Chair
Senator Bert Stedman, Co-Chair
Senator Click Bishop
Senator Jesse Kiehl
Senator Kelly Merrick
Senator David Wilson

MEMBERS ABSENT

None

ALSO PRESENT

Adam Crum, Commissioner, Department of Revenue; Zach Hanna, Chief Investment Officer, Commissioner Crum; Pam Leary, Director, Treasury Division, Department of Revenue.

SUMMARY

^SAVINGS, RESERVES, and INVESTMENTS: DEPARTMENT OF REVENUE

[9:02:57 AM](#)

ADAM CRUM, COMMISSIONER, DEPARTMENT OF REVENUE, (DOR) discussed the presentation, "Update on the State's Investment Funds and Cash Flows" (copy on file). He addressed slide 2, "Agenda":

Meet the Treasury
State Investment Funds
State Cash Flows

Commissioner Crum highlighted slide 4, "Department of Revenue Treasury Division":

The Treasury Division is managed by 40 experienced professionals in portfolio management, accounting, operations, compliance, and cash management. Treasury staff average tenure is over 10 years and includes CFA's, CPA's, CTP's and other advanced degrees and designations.

Managing numerous funds and cash flows is complex and requires understanding investment management and banking systems which are highly integrated into the State accounting system.

In FY2023, there were 57,000 trades made on behalf of hundreds of state accounts that roll into 48 investment funds, utilizing 32 investment pools, supported by 150 of external and internal investment managers and 600 private equity funds.

Accounting ensures that all trades and costs are directed and accounted for in the correct accounts/funds.

The Middle office performs 160 compliance tests on trades daily and calculates daily performance for 30 state funds internally.

Cash Management processes roughly 100,000 transactions annually for departments to realize revenue and expenditures in the accounting system. There are over \$15 billion in cash inflows and cash outflows annually.

It takes a unique set of skills to manage these complex systems with strong results.

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Commissioner Crum pointed to slide 5, "Treasury Manages Complex Funds for Multiple Fiduciaries":

Treasury manages \$50 billion in assets for funds across the risk spectrum from lower risk cash-

equivalent investments through higher risk endowment and retirement funds.

Over 50 percent of 12/31/2023 assets were directed or traded internally by Treasury staff.

Staff meet with state fiduciaries regularly to review investment performance and set investment policy and asset allocations.

Quarterly Alaska Retirement Management Board (ARMB) and State Investment Review meetings include additional oversight by an independent investment advisory committee and other experts and materials are publicly available on the Treasury website.

The Treasury Division's work is mission critical, and the benefits provided in the form of excess returns, external cost savings, and error prevention are significant.

Co-Chair Stedman requested some footnotes on the slides about the background and description of the funds.

Commissioner Crum agreed to provide that information.

[9:08:10 AM](#)

ZACH HANNA, CHIEF INVESTMENT OFFICER, COMMISSIONER CRUM, displayed slide 6, "Treasury Results are Strong":

Investment returns for the State's defined benefit retirement systems have been in the top-quartile of peer performance and have exceeded benchmarks materially. This has resulted in \$2+ billion in excess returns over the past 10 years, ahead of over 80 percent of peer public pensions.

FY23 investment returns for state funds surpassed benchmarks, ranging from 4 percent to 11.6 percent and were even stronger for the 1-year period ending 12/31/23 from 5 percent to 17 percent.

Treasury uses low-cost internal investment management where appropriate.

For FY23, internal investing resulted in investment management fee savings of \$30 million and excess returns of \$90 million.

The Treasury's cost structure is materially lower than its peers. FY23 fees for the defined benefit retirement systems were 38 bps compared with a median of 56 bps for large plans -a difference of over \$50 million per year.

Professional and institutional knowledge is critical to maintaining strong results since the investment and retirement systems are complex.

Co-Chair Stedman asked for an explanation of the tables on slide 6.

Mr. Hanna replied that those were the returns as reported by Callan through September 30, 2023.

[9:10:10 AM](#)

Co-Chair Stedman wondered whether the employees, teachers, and Judiciary employees were co-mingled.

Mr. Hanna replied that the employees and teachers had the same asset allocation, and the Judiciary had a separate asset allocation.

Mr. Hanna looked to slide 8, "Capital Market Performance Update":

After a challenging 2022, calendar year 2023 performance was strong, but volatile across most asset classes.

Capital markets have been focused on the interplay of inflation, interest rates, and economic growth.

To combat inflation, the Federal Reserve increased short-term interest rates 5.25 percent, which led to a decrease in annualized inflation from 9.1 percent in June of 2022 to 3.4 percent in December of 2023.

As inflation has moderated, the potential for further interest rate increases and the associated drag on economic growth has decreased.

As a result, equity markets recovered strongly from the correction of 2022 and both core U.S. fixed income and cash equivalents benefited from high yields.

Mr. Hanna pointed to slide 9, "Treasury Asset Class Performance":

State funds invest in commingled asset class investments managed by Treasury staff and external managers.

These asset class investments are used in different proportions to meet fund investment policies.

State asset class performance for calendar year 2023 was strong across asset classes.

Most asset classes also exceeded benchmark performance for the year and longer time periods adding additional value.

[9:13:29 AM](#)

PAM LEARY, DIRECTOR, TREASURY DIVISION, DEPARTMENT OF REVENUE, addressed slide 10, "Constitutional Budget Reserve Fund (CBRF) Historical Invested Assets (in billions)":

In 1990, voters of Alaska adopted an amendment to the constitution creating the CBRF.

The CBRF has been used to fund temporary cash flow expense/revenue mismatches and to cover budget revenue shortfalls through appropriation. Appropriations from the CBRF must be repaid.

In 2000, the legislature created a subaccount in the CBRF to be used for funds that will not be needed for at least 5 years.

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Co-Chair Stedman surmised that the sub-account was targeted at a longer holding period and a higher rate of return

target. He queried the level of the main account would be needed to move money into the sub-account.

Commissioner Crum replied that the statutory discretion resided within the commissioner of DOR. He stated that there was no set target. He shared that it was an item that was only recently examined to determine the appropriate levels.

Co-Chair Stedman stressed that the budget would be examined with the chance to see what was not included in the budget. He remarked that there would be revenue projections based on oil price and volume, with specific sensitivity levels. He remarked that there would be a focus on the moving the target. He stated that there would be discussions around adjusting that benchmark, with analysis on whether to call on the subaccount. He stressed that the CBR could be drained, so wanted to ensure that the exercises were run for the health of the fund.

Commissioner Crum agreed that there was not more than \$2 billion in the CBR for a few years, and agreed to run various analyses.

Co-Chair Stedman felt that there were more conservative forecasts required examination.

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Mr. Hanna highlighted slide 11, "Constitutional Budget Reserve Fund (CBRF) Fiduciary oversight: Commissioner of Revenue." He summarized the policy used for state asset allocation. He shared that there was a formal state investment review and an independent investment advisory committee.

Co-Chair Stedman wanted more information about the review committee.

Commissioner Crum stated that there were regular quarterly meetings with investment advisors to advise on public funds.

Co-Chair Stedman stated that the board gave the commissioner some counseling from professionals on complex decisions. He felt that the board was an important internal mechanism to help minimize errors.

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Ms. Leary pointed to slide 12, "General Fund and Other Non-Segregated Investments (GeFONSI) Historical Invested Assets (in billions)":

GeFONSI includes the General Fund and Other Non segregated funds invested in a pooled environment (GF proper carries a minimum balance of \$400 million to pay our bills).

Mr. Hanna looked at slide 13, "General Fund and Other Non-Segregated Investments (GeFONSI I and II) Fiduciary oversight: Commissioner of Revenue."

Co-Chair Stedman wondered whether the reason for no benchmark was because the state always beat the benchmark.

Mr. Hanna replied that there was no benchmark. He explained that the benchmarks were approved by the consultants, and were universally used for the asset classes. He stated that the long-term investor in the asset classes with an experienced team, there was a belief that producing consistent excess returns were the focus.

Commissioner Crum explained that there was internal monitoring with a benchmark that would be the request from the consultants.

Ms. Leary addressed slide 14, "Alaska Higher Education Investment Fund (AHEIF) Historical Invested Assets (in millions)":

On September 1, 2012, the AHEIF was capitalized with a \$400 million deposit from receipts of the Alaska Housing Capital Corporation for use in paying Alaska Performance Scholarship Awards and Alaska Advantage Education Grants.

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Mr. Hanna pointed to slide 15, "Alaska Higher Education Investment Fund (AHEIF) Fiduciary oversight: Commissioner of Revenue."

Ms. Leary highlighted slide 16, "Public School Trust Fund (PSTF) Historical Invested Assets (in millions)":

The PSTF was established in 1978, replacing the territorial era public school land grant originally created by congress in 1915, by a transfer of the balance from the permanent school trust.

Following passage of HB 213 in 2018, the fund is now managed as one fund, under a percentage of market value method (5 percent of the average market value for the 5 years preceding the last previous fiscal year).

Co-Chair Stedman looked at the Higher Education Fund, and noted the allocation of 70/30, which was a standard balance portfolio. He, however, noted the 7 percent payout. He queried the expectation out of the balance portfolio over time.

Mr. Hanna replied that the projected return was 6.83 percent. He remarked that there was a hope that there was an emergence out of a fairly low return environment. He stressed that a 70/30 portfolio would be considered highly prudent.

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Co-Chair Stedman wondered how to protect the fund in perpetuity from purchasing power.

Mr. Hanna replied that, in the abstract, the spending rate was low at around 4 percent. He stated that there would be less than full inflation proofing if the fund was spent beyond 7 percent.

Co-Chair Stedman felt that the committee should take that into consideration.

Mr. Hanna discussed slide 17, "Public School Trust Fund (PSTF) Fiduciary oversight: Commissioner of Revenue." He stated that the fund had the same risk profile as the Higher Education Fund, and the performance was also similar to the Higher Education Fund.

Ms. Leary looked at slide 18, "Power Cost Equalization (PCE) Historical Invested Assets (in millions)":

The purpose of the PCE Endowment fund is to provide a long-term stable financing source that provides affordable levels of electric utility costs in otherwise high-cost service areas of the state.

SB 98 transferred the investment management of the fund to the Alaska Permanent Fund Corporation July 1, 2023.

Mr. Hanna addressed slide 19, "Power Cost Equalization (PCE) Fiduciary oversight: Changed from Commissioner of Revenue to APFC." He stated that the fund was liquidated to cash to transfer at the end of the fiscal year.

Co-Chair Stedman surmised that the cash was moved to APFC.

Mr. Hanna replied in the affirmative.

Commissioner Crum furthered that the fund was monitored with a strategic plan.

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Senator Wilson queried the projected 10-year return for the fund.

Mr. Hanna replied it had the same asset allocation as the prior discussed funds. He stated that 6.83 percent would have been the projected return

Senator Kiehl wondered why it was preferable to only liquidate and transfer only cash rather than securities and bonds.

Mr. Hanna replied that it was operational complex, and legally challenging to transfer securities between entities.

Co-Chair Hoffman wondered whether the decision was in compliance with the law.

Commissioner Crum replied in the affirmative.

Co-Chair Hoffman stated that the asset allocation was "very happy in its new home."

Ms. Leary discussed slide 20, "Public Employees Retirement System (PERS) and Teachers Retirement System (TRS) -Pension and Health Defined Benefit Plans Historical Invested Assets (in billions)":

The Alaska Retirement Management Board (ARMB) is a 9-person board and fiduciary of the state's pension and health systems.

Mr. Hanna highlighted slide 21, "Public Employees Retirement System and Teachers Retirement System Fiduciary oversight: Alaska Retirement Management Board."

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Co-Chair Stedman asked why the two dates were not the same.

Mr. Hanna replied that the presence of alternative investments took time to provide the returns.

Co-Chair Stedman requested an update of the data set after the returns.

Mr. Hanna agreed to provide that information.

Ms. Leary looked to slide 23, "SOA Treasury Cash Flow":

Cash Inflows

- Tax Revenues
- Oil and Gas, Excise, Other
- Federal Dollars
- Grants, Medicaid, FHWA, Education, Other
- Earnings Reserve Funds
- Agency Receipts
- Fees, Licenses, Permits, Fines, Other

Cash Outflows

- School Education Payments
- Payroll and Pension Payments
- Vendor Payments
- Medicaid Payments
- External Program Grant Payments
- Debt Service Payments

Co-Chair Stedman queried the reason why "credits" was not in the "out flow" list.

Ms. Leary replied that it would be included in the following year's presentation.

Ms. Leary pointed to slide 24, "Revenue":

Commodity Volatility

- Petroleum revenues are projected to be 37 percent of FY24 unrestricted general fund revenues.
- Uncertainty exists "in-year" for FY24 and beyond.
- Will always have in-year uncertainty because the budget is based on in-year oil collections.

Investment Return Volatility

- Investment earnings are projected to be 56 percent of FY24 unrestricted general fund revenues.
- Certainty exists today for FY24 and FY25 due to a lagging Percent of Market Value (POMV) formula.
- Uncertainty exists for FY26 and beyond.

Co-Chair Stedman looked at slide 23, and noted that the Permanent Fund Dividend (PFD) payments were not included in the slide as an expenditure.

Commissioner Crum agreed to include PFDs in the list, and stated that the list was not intended to be inclusive.

Co-Chair Stedman felt that large items should be included in the lists.

[9:49:50 AM](#)

Ms. Leary looked at slide 25, "Expenditures":

Expenditures can occur prior to receipt of revenue, resulting in cash flow timing mismatches:

- Federal programs require expenditures before reimbursement.
 - i.e. Medicaid, Transportation, etc.
- Beginning of year appropriation transfers do not match incoming revenue.
 - i.e. State pension payments, transfers to sub funds for programs.
- Seasonal Cash Flow needs.

•i.e. Summer is the peak season for construction projects and seasonal workers.

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Senator Bishop wondered whether payroll for contractors was every two weeks.

Ms. Leary replied that she did not know the payment schedule.

Senator Bishop wondered who would write the checks to the contractors.

Ms. Leary replied that the money would flow through the general fund to pay contractors through the departments.

Senator Bishop wondered whether there were relationships with the departments to ensure that cash was available for checks.

Ms. Leary replied in the affirmative.

Co-Chair Stedman asked about how the Permanent Fund transfer was handled to ensure cash flow.

Ms. Leary replied that there was a transfer schedule drafted and redrafted to ensure the money was available for expected needs.

Co-Chair Stedman queried the schedule of the transfer.

Ms. Leary replied that it was about every two months, with some changes in the schedule based on need.

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Co-Chair Stedman felt that there had been improvements over time on that scheduling.

Commissioner Crum furthered that there was work with the Permanent Fund to ensure maximization of returns, before transferring the money.

Ms. Leary addressed slide 26, "Cash Flow Deficiencies":

Prior to 1985, most unrestricted revenues flowed into and stayed in the General Fund for expenditure.

Over time, the legislature established many sub-funds of the general fund to segregate cash for budgeting purposes, resulting in less cash available to pay day-to-day operating costs.

Cash Flow Deficiencies are common and managed by:

- Adjusting timing of Earnings Reserve Account transfers to the General Fund.
- Borrowing from Budget Reserves or Other Funds.
- Managing timing of expenditures.

Ms. Leary pointed to slide 27, "Revenue Shortfalls":

A revenue shortfall differs from a cash flow timing deficiency. A revenue shortfall occurs when revenue is insufficient to cover general fund appropriations in any given fiscal year.

The legislature includes language annually in the operating budget appropriating budget reserve funds for revenue shortfalls.

- Treasury has relied on this appropriation to authorize use of budget reserve funds to address both revenue shortfalls and cash flow timing mismatches.

The Constitutional Budget Reserve fund (CBR) has been used to cover revenue shortfalls historically. The CBR was fully repaid by FY2010 with no borrowing activity from the CBR until FY2015.

Co-Chair Stedman questioned the benchmarks to ensure that money was not spent more than the appropriation.

Ms. Leary replied that the state accounting system had appropriation limits.

[10:00:40 AM](#)

Ms. Leary discussed slide 28, "Cash Deficiency Memorandum of Understanding":

Developed in 1994 between DOR, DOA, OMB and LAW.

Updated as needed.

Targets \$400 million minimum cash threshold in the General Fund proper.

Outlines procedures for addressing cash flow timing mismatches:

- Develop monthly cash projections.
- Monitor daily general fund cash balances. Update forecasts based on new cash flows.
- Execute appropriated transfers from ERA, CBR, or others.
- Perform temporary fund borrowing (CBR, ERA, sub-funds) to be repaid by fiscal year end.
- In the event of forecasted revenue shortfall:
 - Seek legislative action through the Governor to access additional funds through appropriation from other Reserve Funds discussed above.
 - Prioritize disbursements, restrict expenditures.

Co-Chair Stedman wondered when the restriction of expenditure almost occurred.

Ms. Leary replied that it was in the 1990s.

Commissioner Crum stated that possible federal shutdowns were also considered shortfalls, and there was continual examinations about those possibilities.

Co-Chair Stedman agreed that it was a significant cash flow issue.

Ms. Leary looked at slide 29, "Cash Flow Summary":

Cash flow forecasting changes due to amount and timing of revenues and expenditures.

Even with balanced budgets, cash flow timing mismatches will occur.

Revenue shortfalls may occur if forecasted assumptions are wrong.

Co-Chair Stedman wanted to ensure that there was not a cash flow problem, but the presentation was an examination of

the possibilities around processing and accessibility to that cash. He stressed that the role of the committee was to ensure that DOR had ample liquidity to make the payments. He also pointed out that the credit rating would improve with timely payments.

[10:05:58 AM](#)

Commissioner Crum appreciated the discussion, and stated that there were robust processes to maintain the operations of the state. He pointed out that the threat of federal shutdown was continually analyzed, and plans around that possibility.

Co-Chair Stedman thanked the presenters and discussed housekeeping.

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ADJOURNMENT

[10:09:00 AM](#)

The meeting was adjourned at 10:08 a.m.