

HOUSE FINANCE COMMITTEE
January 31, 2025
1:34 p.m.

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CALL TO ORDER

Co-Chair Josephson called the House Finance Committee meeting to order at 1:34 p.m.

MEMBERS PRESENT

Representative Neal Foster, Co-Chair
Representative Andy Josephson, Co-Chair
Representative Calvin Schrage, Co-Chair
Representative Jeremy Bynum
Representative Alyse Galvin
Representative Sara Hannan
Representative Nellie Unangiq Jimmie
Representative DeLena Johnson
Representative Will Stapp
Representative Frank Tomaszewski

MEMBERS ABSENT

Representative Jamie Allard

ALSO PRESENT

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

SUMMARY

PRESENTATION: SAVINGS ACCOUNT/BUDGET RESERVES/INVESTMENT FUNDS BY THE DEPARTMENT OF REVENUE

Co-Chair Josephson reviewed the meeting agenda.

^PRESENTATION: SAVINGS ACCOUNT/BUDGET RESERVES/INVESTMENT FUNDS BY THE DEPARTMENT OF REVENUE

[1:35:31 PM](#)

ADAM CRUM, COMMISSIONER, DEPARTMENT OF REVENUE, introduced himself. He relayed that the presentation intended to cover a treasury investment update, the structure of funds, investment performance, and asset allocations and the risk taken on the funds. He turned the presentation over to a colleague.

PAM LEARY, DIRECTOR, TREASURY DIVISION, DEPARTMENT OF REVENUE, introduced a PowerPoint presentation titled "Treasury Investment Fund and Cash Flow Update," dated January 31, 2025 (copy on file). The presentation would address the work done by the Treasury Division, treasury investment funds, and state cash flows. She provided a review of the Treasury Division (Treasury) on slide 4. She detailed that the division had 40 experienced professionals with strong longevity working in the division's four sections. She highlighted that Treasury leadership had an average of 16 years with the division. Many of the division's staff had professional designations such as chartered financial analysts (CFA) like CIO Zach Hanna, and certified public accountants (CPA) like herself. She stated that managing \$50 billion in numerous investment funds and tracking state cash flows was as complex as it sounded. She acknowledged the Treasury team for its work.

Ms. Leary pointed to a graphic on the right side of slide 4 beginning with a red box reflecting the Portfolio Management section. The section included 16 investment staff investing assets for state fiduciaries. She highlighted that in FY 24 there were 80,000 trades made on behalf of hundreds of state accounts that rolled into over 45 investment funds, utilizing approximately 30 investment pools, and supported by over 130 investment managers and 600 private equity funds. She highlighted that about half of the assets were managed internally.

Ms. Leary moved to the green box on slide 4 reflecting the Accounting and Operations section. The section was responsible for ensuring the 80,000 trades and costs were directed and accounted for in the correct amounts and in the right funds. The purple box reflected the Compliance section, which helped protect invested assets by monitoring adherence to existing laws, rules, regulations, contracts, policies, and guidelines. The section performed more than 75 daily compliance tests on the division's trades. The performance group calculated the performance for the 45

funds daily. She pointed to the teal box reflecting the Cash Management section, which processed over 100,000 transactions annually that supported the revenue and expenditures in the accounting system. The section oversaw all of the cashflows into and out of the state and ensured that the general fund had a sufficient balance to pay the bills. The section was also responsible for ensuring that federal reimbursements came into the state.

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Representative Johnson appreciated the returns generated by the Treasury Division. She believed its returns were up there with the best.

Ms. Leary thanked Representative Johnson for her words. She continued with her presentation on slide 4. She mentioned the unclaimed property group. She noted that the following day was national unclaimed property day. She explained how to check for any unclaimed money on the department's website.

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ZACH HANNA, CHIEF INVESTMENT OFFICER, TREASURY DIVISION, DEPARTMENT OF REVENUE, introduced himself and began on slide 6 showing a summary of the process the Treasury Division used to set over 25 state investment policies and asset allocations. He detailed that the division had used a formal state investment review for five years, which involved the commissioner, staff, and an independent advisory committee in a similar process used for the Alaska Retirement Management Board (ARMB). The division reviewed financial markets and performance for each fund quarterly and at least annually it reviewed capital market assumptions and selected asset classes for investment. He stated that the division went through each fund to set the appropriate investment policy and asset allocation that consider fund objectives and fund constraints. He noted that the appendix on slide 29 included a summary example of some of the asset allocation and slide 30 showed website links to the division's investment information.

Mr. Hanna moved to slide 7 titled "Recent Capital Market Performance." He detailed that the past several years had been incredibly volatile. The timeframe included the pandemic, which led to high surplus and near zero interest rates followed by significant inflationary pressure with inflation peaking at over 9 percent annualized in June of 2022. The Federal Reserve responded with short-term interest rates increasing to over 5 percent, which was challenging for stocks and bonds in 2022. Inflation had come down to more reasonable levels and capital markets had a strong rebound in 2023 and 2024. He highlighted a chart on slide 7 illustrating that performance was positive for all asset classes in 2024. The positive returns were led by a 24 percent return for U.S. equities and down the list through 5 percent returns for cash equivalents and more modest fixed income returns.

Representative Galvin asked about the chart on slide 7. She thought it looked like most of the security returns were also in the negative in 2018. She asked if it was a similar situation to 2022.

Mr. Hanna replied that it was not a similar situation. He explained that in 2018 there had not been nearly the extreme movement in interest rates and inflation that caused what occurred in 2022. The situation in 2022 was a result of the interplay of inflation, interest rates, and worries about economic growth. He relayed that the declines in 2018 were more about concerns over economic growth and the drop was not nearly as severe.

Mr. Hanna turned to slide 8 titled "Treasury Asset Class Performance." The slide showed the performance of the asset classes the Treasury Division managed for non-retirement state portfolios through December of 2024. The investments were all commingled that were used in different proportions to construct portfolios that were diversified, low cost, and with high liquidity. The division managed over 80 percent of the investments internally and focused on delivering market returns with consistent upside. The top section of the table on the right included the total performance for each asset class state funds invested in, followed by a section showing benchmark performance, and a section showing performance relative to the benchmark.

Mr. Hanna began with the total performance section on slide 8 and highlighted that returns were strong [through

12/31/24]. He detailed that bonds and cash ranged from 2 to 5.6 percent for the year and equities ranged from 5 to 24 percent. Overall, the returns added \$575 million of income and gains to the state balance sheet in 2024, which reflected one of the best years in the past decade. Results in the bottom section showing performance relative to the benchmark were also strong. For state portfolios, most of the assets were in cash, short-term fixed income, and core fixed income, which were all managed by a Treasury investment team that had produced consistent and increasing excess returns over time. The assets had one of their best years in 2024 with excess returns from 34 to 70 basis points. He clarified that a basis point was one one-hundredth of a percent (e.g., 70 basis points was 0.7 percent). Total excess returns delivered by Treasury for internally managed portfolios across the state and the ARMB assets added \$130 million in value over the benchmark returns in 2024.

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Ms. Leary turned to slide 10 titled "Constitutional Budget Reserve Fund (CBRF)." She pointed to the blue section of a graph reflecting the fiscal year end balances of the main fund of the Constitutional Budget Reserve Fund (CBRF). The fund was created in the constitution in 1990 when voters approved adding Section 17 to Article 9 of the state constitution. All money received by the state after July 1, 1990, through resolution of disputes about the amount of certain mineral related income, was required to be deposited into the CBRF. The yellow area of the chart reflected the balance of the CBRF subaccount, which the legislature created in 2000. In accordance with statute, money in the subaccount was required to be invested to yield higher returns than in the main fund and was used for funds that would not be needed for at least five years. In 2008, \$4.1 billion was deposited into the subaccount and was managed to achieve a higher return than the main fund. In April 2015, the balance was returned to the main fund when it was determined the funds would be needed within five years. She highlighted that appropriations from the CBRF required a three-quarter vote unless certain conditions were met.

Ms. Leary stated that the green portion of the graph reflected the Statutory Budget Reserve (SBRF) created in 1986. The SBRF was a part of the General Fund and Other

Non-Segregated Investments (GeFONSI) before and after being managed as a separate fund from July 2013 to October 2015; it was included on the graph to reflect total reserve accounts. The invested balance of the CBRF was \$2.7 billion at June 30, 2024 and the SBRF contained \$240 million.

Co-Chair Schrage noted there was significant fluctuation in the state's savings over the years. He remarked that one recurring topic facing the legislature was how much was needed in savings for cashflow purposes. He had heard a wide range of numbers. He asked what was needed in the CBR to deal with revenue shortfalls or other fluctuations on an annual basis.

Commissioner Crum replied that part of the conversation involved conflating two accounts. He stated there was a consideration about the general fund, which had to do with the state's minimum cash operations. The goal was to maintain at least \$400 million in the general fund. He stated that the number for the CBRF varied across the board. He noted there were working agreements between the Office of Management and Budget (OMB), the Department of Law (DOL), and DOR.

Ms. Leary interjected that the [recommended balance] for the general fund was \$400 million to \$500 million.

Commissioner Crum clarified that there was not a formal agreement pertaining to the CBR. The goal was to make sure there was a functional amount in rainy day accounts. The department performed a consistent cashflow analysis. He relayed that earlier in the week, in response to a question about federal funds, the department analyzed state funds to determine what it would look like if the state had to cover the bill for federal funds and for how long. He added it was a recurring theme that occurred with the potential threat of [federal] government shutdowns, which had occurred annually in the past three years. He stated that having a policy number for the CBR was not for the department to set. He elaborated that it was more about looking at the overall function of government to ensure bills and matching funds could be paid.

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Co-Chair Schrage remarked that he heard Commissioner Crum not really wanting to give a number for the CBR. He asked

what the state would have to come up with if it was on the hook for the federal funds.

Commissioner Crum answered that the working agreement was to ensure the general fund would never go below \$400 million, which was used to pay the state's bills on a daily basis. He remarked on access to the CBRF and stated that from a pragmatic standpoint \$500 million was a very dangerous floor.

Co-Chair Schrage did not really hear an answer being given for what could reasonably be expected under plausible scenarios where the federal government could dramatically claw back funding to the state. He asked what the doomsday scenario was. He asked if it was \$500 million, \$1 billion, \$2 billion, etcetera.

Ms. Leary answered that the state received about \$95 million weekly in federal reimbursements. She explained that in many cases, the state paid out cash for programs and called for reimbursement. For example, Medicaid represented about half of the amount and the department had looked at how long it would take to have no cash at all if it did not receive the remaining amount. The analysis showed the state could operate its regular business through May if it only received half of the reimbursements. The presentation would further address the memorandum of agreement (MOU) with DOL, DOR, and OMB. Under the agreement there were different levels of response if things started to happen to the state's cash. She explained that some of the response may be deciding how to order the payment of the bills. She relayed that coming to the legislature for more money was at the bottom of the list of options. The department would utilize all of the tools available to ensure it had the cash needed to pay bills. The state had yet to be in a situation where the federal draws had not eventually been reimbursed. She noted that the pause [in the receipt of federal funds] had been lifted for the time being. The department would analyze the situation as things progressed.

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Representative Johnson asked for the current balance in the SBR.

Ms. Leary replied that the current balance in the SBR was about \$244 million. She noted it was a cash balance and was a line item in the second General Fund and Other Non-Segregated Investments (GeFONSI) fund. She explained that once all of the amounts in and out of the fund were determined at the end of the fiscal year, the balance may change to zero depending on how money was moved.

Representative Johnson asked if the \$244 million balance [in the SBR] had been at the end of 2024.

Ms. Leary answered that it was at the end of 2024. She clarified that the current balance, as of December 31, 2024, was \$224 million. She noted that slide 28 showed a list of the GeFONSI funds.

Co-Chair Josephson asked if the SBR funds were obligated or could be appropriated.

Ms. Leary answered that the funding could be appropriated. She stated that the question was whether the funding had been appropriated for FY 24 on paper.

Co-Chair Josephson stated that more analysis on the available funding would be needed. He referenced the pause in federal funding and Ms. Leary's statement that \$95 million came in weekly from the federal government. He asked if DOR had experienced a pause in the federal funds in its computer system. He asked if there was something different in the current week that DOR had not previously seen.

Ms. Leary replied that there were a number of different payment systems the department used to obtain the [federal] funding. She relayed that there had been a poorly timed glitch in the system so that no one could get to the portal of the PMS [Payment Management Services] payment system. She explained that the glitch occurred in all states. The department had not expected the Medicaid payments to stop. She detailed that there were many national organizations trying to keep apprised of the situation. She relayed that eventually the payment systems opened up again on Monday or Tuesday afternoon and the department was able to draw all of the state's monies down.

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Commissioner Crum added there had been no reports from providers of any delayed payments.

Mr. Hanna discussed CBRF asset allocation on slide 11. He relayed that the CBRF had a potentially short time horizon and needed principal protection and high liquidity because it was the state's primary emergency reserve during periods of cashflow uncertainty. The fund had a stable balance close to \$3 billion for the past two years, but it was drawn down to \$1 billion the prior three years through the pandemic. The fund was currently invested in 100 percent cash equivalents, which was not typical. He elaborated that the fund was originally de-risked due to the pandemic drawdowns, but staff had intentionally left the fund positioned in shorter maturity investments due to the attractive risk-return tradeoff versus longer maturity investments. The position had been very accretive to returns over the past three years because cash equivalents had outperformed core bonds by roughly 600 basis points during the timeframe. Over the longer term the CBR main account had more typically had considerably longer bond exposure and some equity exposure over time.

Mr. Hanna relayed that Treasury would likely recommend transitioning the fund back towards a higher but still moderate risk profile as interest rates continued to normalize. From a performance perspective, 2024 was a great year for the CBRF despite the modest decreases in short-term interest rates in the second half of the year. The one-year performance was 5.59 percent in excess of the benchmark by 34 basis points, which resulted in \$150 million in gains for the CBRF in 2024.

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Co-Chair Josephson asked who could speak the best about the sweep that occurred on the night of June 30th. He noted that the sweep may not physically occur for a month or two after that date. For example, a couple of years ago, the Higher Education Investment Fund (HEIF) of over \$400 million went to zero and he assumed it was now part of the \$2.8 billion. He asked if budgets were now prepared so that the sweep did not impact the obvious goals of designated funds. He noted there were scores of funds collected from trades (e.g., a boiler fund or an elevator repair fund). He stated there was something about receiving the funds and

watching them be swept away. He asked how to operate in that world.

Ms. Leary responded that the HEIF was swept, but there was subsequent legislation that established HEIF as its own fund. The mechanism for the sweep and reverse sweep was historically done on paper so that for ease of use the state could continue to do its work. She stated that on paper the money went out, but it was still there and was put back in. She explained that when the sweep occurred without a reverse sweep, the funds were moved into the CBRF and were not reversed, but after HEIF and the Power Cost Equalization (PCE) were separated from the sweep mechanism, the amount that went into the CBRF was very small. She believed the proposed FY 26 budget included a mechanism for the use of the sweep and reverse sweep going forward. She reiterated that the amount [swept back into the CBRF] was minimal and was not building the fund up considerably.

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Co-Chair Josephson stated that historically all of the monies were returned so that they were not swept and there had been a political understanding that cooperation had to occur in order to prevent "bookkeeping nightmares" that he was told could happen with a sweep. He sensed that budgets were now built such that they were not concerns or obstacles they once were. He stated it was an issue he needed further information about. He asked for verification that Ms. Leary was saying the sweep was in the low millions of dollars now that the HEIF had been segregated.

Ms. Leary answered that she did not have the exact number but in past years it had been very small. She offered to reach out to OMB or the Division of Finance to determine the number.

Commissioner Crum added that the two highest profile items subject to the sweep were the HEIF and PCE. He believed those accounts had been rectified legislatively to where it was no longer a concern.

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Representative Galvin asked about the minimum amount that should be in an emergency fund to enable the state to get through a pandemic like COVID-19. She wondered if there was

an industry standard for a budget the size of Alaska's. She asked how much readily available cash the state should have on hand.

Commissioner Crum answered that the agreement of the \$400 million for the general fund put Alaska in a better position than almost all other states. He stated that the past couple of years as the department had gone through the cashflow analysis - he had brought the issue up with peer states in the State Financial Officers Foundation - having a consideration about where "they actually stand" in available bank accounts because "a lot of them" were anticipating revenues coming in the door through sales tax and other items. He explained that because the state had standing bank accounts it was well positioned in order to carry through. He detailed that of the \$95 million coming in [weekly], \$45 million to \$50 million went out the door for Medicaid. The other \$50 million kept the department in a position to cover the bill well into four to five months out. He explained the state was in a strong position in that way in order to cover the rest of the federal dollars needed.

Representative Galvin clarified that she was thinking about an emergency like COVID or a natural disaster. She understood there was a very small disaster fund. She thought it sounded like Alaska was in an okay position and was doing better than other states.

Commissioner Crum answered that the state had been able to access the funds during the COVID-19 crisis. He elaborated that during the first emergency disaster declaration the governor's rules around access to funds changed. He detailed that state dollars had been accessed working with the legislature through the RPL [revised program legislative] process through the Legislative Budget and Audit Committee. Additionally, the federal government had rapidly deployed Coronavirus Aid, Relief, and Economic Security (CARES) Act funds.

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Co-Chair Schrage stated his understanding that in the past the \$400 million was necessary because incoming revenue did not all match up with outflows throughout the year. He stated that if revenues came in after expenses were due, it was necessary to have cash on hand to pay expenses until

revenues came in. He asked if the \$400 million was what was needed to get through the year. He asked for verification that the department was not concerned about having some safety room in the CBR to be able to weather a downturn in oil prices, a pandemic, or a cutoff of federal funding. He had heard numbers in the past from the administration on how much should be left in savings beyond that \$400 million for cashflows to be able to ensure the state was not running into a major headache in the next year. He asked if the department was comfortable with a scenario where the CBR was spent down to zero and there was a \$400 million balance in the general fund. He clarified that was not something he was advocating for. If the answer was no, he asked how much the department wanted in savings to feel comfortable the state could get through the year in a responsible way.

Commissioner Crum responded that with the \$400 million in the general fund, \$500 million in the CBRF would be a very low floor. He stated that having \$1 billion in savings and access to that amount would probably be prudent if the state was looking to carry forward and cover many other items. He confirmed that the cashflows and inflows varied. The money the state received from the Statewide Transportation Improvement Program (STIP) and highway funds came in lump sums that the state paid and received reimbursement for. He stated, "It's making sure we have cash on hand in order to do that."

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Ms. Leary reviewed slide 12 titled "General Fund and Other Non-Segregated Investments (GeFONSI)." The general fund was the state's checking account and all incoming and outgoing cashflows went through the general fund. The fund had a minimum floor of \$400 million to ensure the department had the funds to make payments. She stated that the amount equated to a couple of days of all of the top payments needing to be paid in one day. There were about 185 other accounts and funds with assets in the two GeFONSI accounts. She explained that all of the individual funds were managed together but accounted for separately. The original GeFONSI was created in 1992 as a way to pool accounts for investment. The second GeFONSI was created in 2018 to target a higher risk return for a subset of the funds. As of the end of June [2024] there was \$3.7 billion in the two

GeFONSI funds combined. She noted the appendix on slide 28 listed the top 30 GeFONSI I and top 30 GeFONSI II funds.

Representative Galvin relayed that the previous year the legislature heard about one fund that was not used at all and it had found a way to eliminate the particular fund. She asked if there were other funds that were so rarely used that the legislature should consider closing.

Ms. Leary responded that DOR did not necessarily see all of the ins and outs of the underlying GeFONSI funds. She relayed that there had been a request to minimize the number of existing funds because some of the funds had zero balances. She was uncertain who was leading the effort, but the department had been asked for information to contribute to the analysis.

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Representative Galvin asked to see the analysis when it was complete.

Co-Chair Josephson replied affirmatively.

Mr. Hanna reviewed slide 13 titled "General Fund and Other Non-Segregated Investments (GeFONSI I and II)." He relayed that GeFONSI I and II had a short-term investment horizon with a relatively high need for principal and income protection. He detailed that GeFONSI I was 85 percent cash equivalent and 15 percent short-term bonds. He noted that GeFONSI II had a modestly higher risk with 61 percent cash equivalent, 33 percent short-term bonds, and 6 percent equities. Similar to the CBRF the two funds had fewer long-term bonds than they had historically, which was intentional and had paid off in the past three years. As rates normalized, it was expected that some additional risk would be added to the funds to increase earnings while still protecting principal and income. Performance for both funds for the year had been positive: GeFONSI I had a return of 5.44 percent and GeFONSI II had a return of 5.97 percent, both were over 35 basis points in excess of their benchmarks. Overall, the total performance resulted in \$180 million in gains during 2024.

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Ms. Leary reviewed the Alaska Higher Education Investment Fund historical balances on slide 14. The fund was capitalized with a \$400 million deposit of receipts from Alaska Housing Finance Corporation (AHFC) and was used for paying Alaska Performance Scholarship (APS) awards and the Alaska Advantage Education Grants (AEG). Up to 7 percent could be appropriated for the scholarship and grants. She detailed that two-thirds went to the APS and one-third went to AEG grants. She relayed that HB 322 established the fund as a separate fund as of June 30, 2022. Additional legislation passed in 2024 that increased the amounts of the scholarships and grants. There had been no change to the amount that could be appropriated from the fund.

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Mr. Hanna highlighted the HEIF asset allocation on slide 15. The department used a high risk profile for the fund to achieve the fund's spending objective of up to 7 percent of the prior year's balance. The risk profile for the HEIF and other similar funds was set at 70 percent equities/30 percent bonds. Performance of the past year was strong at 11.39 percent (24 basis points in excess of the benchmark), resulting in \$44 million in gains for the year. The 10-year performance was a strong 7.26 percent through a volatile period.

Co-Chair Josephson asked what had been appropriated from the account relative to the gains.

Representative Stapp answered that about \$11 million was appropriated out of the fund in 2024 in addition to the normal contribution.

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Ms. Leary confirmed that \$11 million had been appropriated and she believed the number was increasing slightly in proposed FY 26 budget to \$16 million or \$17 million. She reviewed the Public School Trust Fund (PSTF) historical assets on slide 16. The fund's balance at the end of FY 24 was \$834 million. The fund was established in 1978 and was funded by one half of one percent of state receipts from the management of state lands, mineral lease rentals and royalties. The funding was used as an offset to the K-12 formula funding. The fund contributed \$32 million to the

Public Education Fund in FY 24 and was expected to contribute \$35 million in FY 25 and FY 26.

Representative Galvin found the fund interesting because of the history she had heard from longtime Alaskans that perhaps the state did not get as much as it should have when the state had made an agreement with the federal government on lands. She asked if there were any actionable items to know about.

Ms. Leary replied that it was a historic fund and there had been calls for legal action in the past. She believed everything had been satisfied in terms of what the fund should be and is. She had not heard any recent discussion about that historical period of time.

Representative Galvin remarked that there were some strong advocates out of Seward who had sent her letters numerous times. She did not recall all of the details, but the individuals did not think she was doing enough; therefore, she was asking the question for the record. There had been some thought around mental health lands that Alaska did not receive as much as it should have at one point, and it was still yet to be determined. She stated she was putting the question out there because she did not want to lose out on it.

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Commissioner Crum answered it would be an interesting exercise to go through given the state was about 5 million acres shy from the statehood act. He believed 366,000 acres were still being conveyed to the University [of Alaska] system. He did not doubt that there was likely something missing and he thought it would require working together to figure it out.

Mr. Hanna continued to discuss the PSTF on slide 17. The PSTF had a long time horizon with the same high risk profile as the Higher Education Fund. Treasury also worked to inflation proof the fund over time through the investment policy and spending recommendations. Performance over the past year was 11.39 percent, which was 24 basis points in excess of the benchmark and resulted in \$88 million in gains, bringing the fund back to peak assets from its balance in 2021 prior to the 2022 drawdown.

Co-Chair Schrage asked for more detail about the inflation proofing mechanism.

Mr. Hanna replied that statutory language called for increasing net income over long periods to the Treasury's income beneficiaries. It was the department's interpretation of the language as a requirement for inflation proofing. There were also some issues with how the fund was set up legally, specifying that the fund could not be cut into principal of the Children's Trust land values. The mechanism for the fund was a five-year smoothing, one year in arrears. The legislature could appropriate up to five percent of the five-year smoothed value over time. He detailed that Treasury did a projection using the state's capital market and inflation assumptions combined with what inflation had actually been. He explained that Treasury would recommend a spending level that had the fund fully inflation proofed over 20-year and 30-year forward periods. He relayed there was a memo that went to the Department of Education and Early Development annually, which outlined what the five-year average was and the amount of allowed-for spending. Treasury also had a lower recommendation to fully inflation proof, which ranged over the 20-year and 30-year period. He believed the division's recommendation was between 4.6 and 4.8 percent the previous year. He stated it was pretty close to being inflation proofed over time and if the division's recommendation was followed, the expectation was that the fund would be inflation proofed over time.

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Co-Chair Schrage stated his understanding there was a statutory limit of 5 percent and Treasury made a recommendation below the 5 percent to maintain the principal of the fund and ensure it continued to grow. He asked if the recommendation was typically followed.

Mr. Hanna answered that some years it was followed, and some years 5 percent was appropriated. He could follow up with where the number had been historically.

Co-Chair Josephson surmised the fund acted as a mini Permanent Fund where the principal could not be spent, it was inflation proofed, and a sustainable share was taken annually.

Mr. Hanna replied that the mechanism was different but there were some similarities. He explained that ultimately Treasury could recommend a spending level, whereas the Permanent Fund had limitations in terms of what could be spent and had a 5 percent draw requirement.

Representative Galvin asked about the parameters and how the 4.6 percent could be used.

Mr. Hanna replied that it went into a portion of the state's education funding formula.

Co-Chair Josephson asked for verification that it was designated funding that could be used for anything. Alternatively, he asked if it was more like a dedicated fund.

Commissioner Crum would follow up, but he believed the funds were designated. He noted it was created pre-statehood. He believed the original land grant was the argument that it was funds dedicated to that purpose.

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Ms. Leary reviewed historical assets for Public Employees' Retirement System (PERS) and Teachers' Retirement System (TRS) in the pension and health defined benefit (DB) plans on slide 18. The blue portion of the graph reflected PERS and the orange portion reflected TRS. The four funds totaled \$31 billion on June 30, 2024. She relayed that as closed funds, the DB plans currently experienced annual net withdrawals. The withdrawal in FY 24 was \$1.5 billion. The ARMB was the fiduciary of the funds and was comprised of nine trustees (two from PERS, two from TRS, two commissioners, two public representatives, and one finance officer). FY 24 Investment returns for the funds were just over 9.2 percent and the 40-year return average was 8.96 percent, which compared favorably to the current actuarial assumed rate of 7.25 percent.

Representative Johnson shared that she had heard from constituents there had been a glitch in the system related to making deposits from municipalities into individuals' retirement accounts. She noted the issue had been going on since November. She asked how to figure out benefits that were not accruing as the funds were sitting in an account

somewhere and not going into the retirement fund. She asked what the legislature could do to try to resolve the problem.

Ms. Leary answered that Treasury was very aware of the situation and the Division of Retirement and Benefits was working hard on a solution and it would take time to get the money into the accounts. She explained there was an e-reporting system where subdivisions reported through. Money came in and was sent on to Empower, the record keeper for the DB, SBS, and Deferred Compensation plans. She elaborated that e-reporting used payroll information to ensure contributions were going to the correct individuals in the right amount. She was uncertain how the analysis was done once in the accounts.

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Representative Stapp referenced Ms. Leary's statement that net outflows from the fund were a total of \$1.5 billion and the fund valuation was \$31 billion. He asked if the outflows equated to a little over 5 percent.

Ms. Leary agreed.

Representative Stapp asked how much of the fund was in liquid assets. He remarked that the cash withdraw was higher than the percent of market value (POMV) on the Permanent Fund. He asked about the asset makeup of the PERS and TRS fund. He assumed the funds had liquid assets because the cash had to go out.

Mr. Hanna answered that he would cover the issue in some detail on slide 19. He confirmed that a higher proportion of liquid assets was required for the cash outflow profile. He relayed that the fixed income allocation had gone from 19 percent three years back to 21 percent two years ago to 23 percent one year ago. He explained it was a direct reaction to liquidity needs and a reaction to a higher rate environment allowing Treasury to make the changes without sacrificing returns.

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Representative Stapp remarked that the state made additional contributions to the fund continuously. He stated that without the contributions there would be a

liquidity crisis on the fund. He asked about the chances of a fire sale if the state did not make additional contributions annually to create liquidity.

Mr. Hanna answered that the state contributions that went towards the unfunded liability were roughly 2 percent per year. The net outflows were in the 5 to 5.5 percent range annually. He explained that if the contributions did not occur, the outflows would be 2 percent higher. He reported that Treasury believed there was adequate liquidity to cover the situation if it occurred, but it would represent a challenge if it occurred for a prolonged period of time.

Representative Stapp explained he was asking the question because the pension system was backstopped by the Permanent Fund. He provided a hypothetical scenario where there were three years of 1 percent returns. He asked what type of number they would be looking at as a liquidity crisis on the fund. He reasoned that it would not be possible to sustain cash outflows on a \$30 billion fund when drawing \$1.5 billion from the fund annually. He asked what the state would have to take from the Permanent Fund to backstop the pension fund under the scenario.

Mr. Hanna replied that he would have to follow up. In rough terms, under the hypothetical scenario, it would be 6 percent of the fund corpus that was expected but now missing. He noted the other piece of the scenario was flat assets rather than increasing assets. He stated that "the other wonderful thing about managing a pension system is outflows are not really a percentage of assets, they are hard dollars." The percentage floated up and down with the asset level. He elaborated that if there was an economic or capital market environment where assets were flat rather than increasing or there was a serious inflection in the market where assets were down, there could be scenarios where the 5 to 7 percent outflow became a 10 percent outflow. He shared that Treasury's consultant conducted an asset liability study annually and liquidity was a big piece of that looking towards sufficiency in down market scenarios. He relayed that 23 percent fixed income was a marked increase from where the fund was two to ten years ago. Treasury expected it had adequate liquidity likely to survive Representative Stapp's scenario for three years, but if it went significantly beyond that timeframe there could be real issues. He stated that under the scenario, the unfunded liability would be growing. He relayed that if

the situation did not recover through capital market activity, ultimately it would be something the state would have to make up in some form.

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Representative Stapp stated that if the withdrawal had to be 6 percent due to three years of economic downturn, it was basically the entire previous year's dividend appropriation that would be needed to backstop the retirement system. He estimated the number to be between \$700 million and \$800 million. He asked if his statement was accurate.

Mr. Hanna answered that the number was probably similar in gross figures, but he was uncertain under the scenario whether there would be a point in time infusion versus paying amount back into the system over a much longer amortized period. He explained that the existing unfunded liability was being paid back into the system through 2039. Absent a liquidity crisis, the mechanism would have the new amount amortized over the 15-year period; it would be the normal mechanism for dealing with liquidity issues and lower than expected earnings.

Co-Chair Josephson asked when there had last been three consecutive years of one percent growth.

Mr. Hanna replied that he would have to look it up. He stated it had occurred in the past; there had been prolonged periods of negative capital market performance. He cited the bursting of the tech bubble as an example where there was likely negative performance over a two to three-year period. From an asset liability perspective, Treasury did a lot of modeling of down scenarios, and it was the division's expectation that the asset position into the fund could accommodate normal statistical scenarios that had occurred in the past.

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Co-Chair Schrage reviewed his takeaway from the conversation. He stated that because investments were used to drive pensions and state services through the POMV out of the Permanent Fund, when there were good years the state's financial position improved and in bad years the liabilities worsened.

Mr. Hanna agreed it was true. He pointed out that the DB pension system was a little over \$30 billion in value and the Permanent Fund was a little over \$80 billion in value. There was certainly substantial economic and equity exposure coming through both of those sources that could move in a similar direction. There was smoothing involved that would help out with some of the things. He relayed that state investment accounts were mostly much more conservative that should not have the same movement. There was an advantage of having some of those investments postured in a different fashion than some of the risk assets, which were quite large for the state.

Co-Chair Schrage thought the concern had been articulated well. He thought there were also many people looking at national trends - tech was a substantial part of GDP and market performance - and the economy could potentially be "super-heated" with some of the changes happening on the federal level. He remarked that it would improve the state's position when it came to the pensions and reduced the unfunded liability. He asked for verification that the state's position would improve significantly if the economy and stock market performed well over the next couple of years, which he believed many people expected to be the case.

Mr. Hanna agreed.

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Mr. Hanna discussed the PERS and TRS asset allocations on slide 19. The state retirement systems on slide 19 represented 83 percent of the Treasury assets under management. The systems had a more complex asset allocation because they were long-term funds with a long-term fiduciary board. As a result, the funds had allocations to less liquid alternative investments such as private equity, private debt, and real assets. The current asset allocation was 43 percent public equities, 23 percent fixed income, and 34 percent alternative investments. The returns overall had been strong. Management tended to focus on longer term returns for the funds since having the material allocations to alternatives could make the shorter-term comparisons difficult and/or misleading at times. The 10-year return through September 30, 2024 was 7.91 percent (41 basis points over the benchmark), which was in excess of the

actuarial expected return. The excess returns had resulted in over \$2 billion in additional value added to the pension systems over the 10-year period. The performance was in the top third when compared to peers (better than over 65 percent of other public pension systems). Part of the excess return could be attributed to ARMB's low cost approach. The division emphasized internal management just as it did with the state funds, which had led to costs that were 30 percent lower than the median peer and \$30 million in savings per year. Overall, there were strong returns for the ARMB, which made a meaningful contribution to retirement assets and a reduced need for higher state contributions historically.

Co-Chair Josephson commended the division on its work.

Representative Stapp asked about the difference between the PERS and TRS fund compared to other funds. He noted that the the outflows on the pension fund were not just a percentage draw, the outflows were a requirement because they went to paying retirees. He remarked that the outflows on the pension fund were indexed to something that had no bearing on anything else the state did.

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Mr. Hanna responded that the amounts were effectively hard dollar obligations of the retirement system. The actuary did a new valuation of the system annually. He received information on expected outflows in nominal dollars for almost 100 years into the future. The information showed what the outflows would be to pay for pension and health benefits. The assets of the fund may go up or down, so it was easy to think about the outflows as a percentage of the fund, but they were not. They were hard dollar outflows. From a management perspective it was what the division needed to focus on; its obligation managing the pension system was to meet benefit payments when they were due and the funds needed to be positioned in such a way that it occurred. He stated it required higher liquidity and it required the division and its consultants to do substantial modeling to understand what the systems looked like in down market scenarios or contribution issues. He stated it was a good point and something that was lost on many when they thought about retirement systems.

Commissioner Crum added that the board and investment staff worked with actuarial tables showing outgoing dollar amounts and long-term projections. The department worked with a consultant that showed projections of how markets performed throughout the tech bubble and how the current portfolio would do it if similar circumstances arose. As opposed to the 5 percent POMV draw [from the Permanent Fund], saying a percent draw for the outflows of ARMB was really just a data point in time.

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Co-Chair Josephson stated that when it came to ARMB and the PERS and TRS funds he thought more oversight and regulation had been built in post-2006. Oversight included an annual actuarial review and an intensive review every four years. The reforms had been built in while the state ended the DB program that were designed to keep a better eye on the status of the funds.

Ms. Leary agreed. She explained there were three reviews. The first was by the state's actuary, Gallagher. The second was a review actuary whose purview was an annual look at the assumptions being used. The third was an audit that occurred every four years.

Mr. Hanna referenced Representative Stapp's question and explained that when looking at nominal benefit payments over time in real dollars, it was roughly \$65 billion in payments that would go out of the systems collectively over time (the information came from the prior year's experience study). He stated it left \$35 billion that needed to be made up in contributions and earnings. He believed \$12 billion of the \$35 billion that needed to be made up was coming from contributions (including the normal cost for current employees and the unfunded liability of about \$7 billion, which left \$23 billion that needed to be made up in earnings over time). He clarified it was the expectation given the current 7.25 percent expected return. Ultimately, the current expectation was that roughly \$65 billion in benefits would be paid out over time that would come from current assets, earnings, and contributions. Over time, the mix would shift depending on what happened in the capital market.

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Mr. Hanna turned to slide 20 and reviewed the Treasury investment result summary. He shared that Treasury was made up of a great team of professionals who took a lot of pride in managing the complex portfolios and generating strong results for the state. In 2024, performance for the collection of funds managed by Treasury resulted in an aggregate 9.1 percent return and \$4.5 billion in total gains for the year.

Commissioner Crum highlighted the statutory requirement and prudent investor rule of maximizing risk adjusted returns. He detailed that the outsized gains [highlighted by Mr. Hanna] came at a strong return for a low risk profile. The department was trying to make sure that it was not subject to massive swings. He noted that on some of the prior funds, when there was a decrease due to a market crash, it was not massive portions of the fund. He elaborated that compared to peer groups, Treasury had maintained a good level for the amount of risk and gains returned.

Representative Galvin asked for comment on the overall assessment of credit ratings. She thought it was important. She remarked that some individuals were wondering whether anyone would invest in Alaska. She asked if the state's ratings were anticipated to change anytime soon. She wondered if there was a fear that some of the forecasts were inaccurate.

Commissioner Crum responded that the state had received six credit rating increases over the past 1.5 years across state subdivisions. One of the reasons for the increases was stability including steady holding pattern of the budgets passed by the legislature as well as the increased demand and need for the POMV draw making up a larger portion of the unrestricted general funds. He relayed that there had been substantial gains in the amount of the funding valuation in the state's retirement system. The health side was up 140 percent and [the retirement side] was at 70 percent. He noted that the figure had grown from 60 percent a couple of years back. They had recently closed a deal on [indecipherable] in finance and had done three in the department in the past year, bringing in multiple savings to the state. He relayed that tens of millions of dollars in net present value had been saved for the deals. He explained that it kept Alaska active in the capital markets. He shared that each time one of the transactions was done, it forced the credit agencies - S&P, Moody's, and

Kroll - to rate the transaction. Recent transactions included the airport system, Goose Creek, and the Municipal Bond Bank. He continued that while the state was not at the high levels of the CBR in 2014 (when the fund was in excess of \$17 billion), the holding pattern seen in cash equivalents was recognized by credit rating groups as a nice, steady, even prospect. The massive swings up or down caused the most concern. The relatively steady approach over the past four years had mellowed out how the agencies were viewing the state. Additionally, there were items the governor had put forward that had been passed by the legislature that looked at a range of things including the bipartisan energy taskforce and looking at other options such as addressing in the carbon markets to bring future revenues to the state.

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Representative Galvin observed that because of the state's great bank accounts and some certainty there would likely not be the major problem that occurred in the past where the state had to deposit a \$3 billion cash infusion into the retirement system, the interest rate became more beneficial to the state.

Commissioner Crum replied that the better the state's credit rating, the better the cost of dollars was. The state had done no new issuances. He explained it had been outstanding debt, which based on some federal rule changes in recent years, had allowed a new financial tool. The state debt book included more information. He stated that how Alaska could use some of the public finance tools would be a valuable conversation.

Ms. Leary turned to slide 22 titled "SOA Treasury Cash Flow." She stated that the general fund had money going in and out. The slide showed a small sample of the types of inflows and outflows. She moved to slide 23 and discussed revenues/expenditures and volatility. She relayed that the state was becoming much more stable in terms of the funds coming from the ERA draw. She elaborated that it provided substantial stability because there was certainty around the money being received in the current and following year when doing the POMV formula. She stated that the situation had been in place since 2019. The 2024 investment revenue was 55 percent to the unrestricted general fund and Treasury was expecting the number to grow to 60 percent for

the current year and a bit higher in FY 26. Oil revenue had been decreasing as its percentage of the unrestricted general fund. She addressed expenditures and explained that like the federal draws, there was often money going out the door (to things like Medicaid, transportation, and education grants) before it went back into the general fund. There was often a disconnect of when money came in versus when it went out and there were some seasonal cashflow needs. For example, in the summer when construction projects started, more money went out the door early in the fiscal year.

Representative Galvin referenced the mismatching of the monies, particularly Medicaid. She asked if there were ways to tighten up the timespan between cash outflows and inflows. She wondered if additional staff resources would help with the issue.

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Commissioner Crum responded that the system was pretty well accounted for. He explained that because Centers for Medicare and Medicaid Services (CMS) was such a large portion of the federal budget, there were very tight rules around who the fiscal agents were, how states processed the funds, and the time it reached providers.

Ms. Leary addressed cash flow deficiencies versus revenue shortfalls on slide 24. She explained that cash flow deficiencies were the timing issue where Treasury did not have the money when it was needed. She elaborated there were numerous tools to address the issue and manage cashflows. One was adjusting the timing of ERA transfers to the general fund. Treasury did not take the money at the start of the fiscal year, it left the money in the Permanent Fund in order to earn greater returns, and took it as needed to help maintain the \$400 million minimum balance in the general fund. If Treasury started to see a situation where the balance may drop below \$400 million, it would call out for more money, which could be done primarily through the ERA. Funding had been borrowed from budget reserves in the past. The last time had been October 2023 when funds had been borrowed for a month in order to keep the money in the treasury and avoid having to call out an additional amount. Another method was managing timing of expenditures. For example, the public education fund drew money, which used to be done at the beginning of the fiscal

year. Over time, the division had developed a more even flow throughout the year in order to avoid impacting cashflows in one lump sum. Revenue shortfalls occurred when there was not sufficient incoming revenue to cover appropriations within a given fiscal year. The legislature typically included language in the operating budget where budget reserve funds were appropriated for revenue shortfalls. She believed the language was included in the proposed FY 26 budget. Treasury had used the CBRF historically to cover revenue shortfalls. She added that the state actually got to a point of repaying the CBRF in 2010 before it started borrowing again in FY 15.

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Co-Chair Josephson stated that historically the use of CBR funds had been approved by a three-quarter vote in the event Treasury was short-funded or there was a crisis. He stated the amount had been as much as \$500 million that Treasury was free to access from the CBR. He considered a scenario where the legislature did not authorize access to CBR funds. He asked for verification that Treasury was allowed to draw from the CBR in a moment of need and repay it.

Ms. Leary answered that it was part of Treasury's memorandum of understanding (MOU) she would discuss on the next slide. She explained that if Treasury knew it could repay the amount needed for a shortfall in a given year, it could take money for that purpose. She relayed that Treasury primarily used the CBR for cashflow issues.

Co-Chair Josephson was glad Treasury had that liberty. He asked about the difference between giving legislative authority in the budget for Treasury to use CBR funds versus failing to pass the language and Treasury being allowed to use the funds anyway.

Commissioner Crum responded that the benefit of legislative authority was the ability to deal with catastrophic events. For example, if the price of oil went negative for a substantial period of time and Treasury did not have enough funds and could not repay the amount by the end of a fiscal year. He stated it was the benefit of the vote from the legislature for Treasury to have access to the CBR draw. It was the division's intent that anytime it needed to pull

from the CBR for cashflow purposes, that the money would be replaced prior to the end of the fiscal year.

Co-Chair Josephson recognized that Representative Hannan had joined the meeting after attending a bill hearing.

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Ms. Leary turned to slide 25 titled "Cash Deficiency Memorandum of Understanding." The slide outlined the MOU between DOR, OMB, and DOL. She reviewed the slide:

- 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, CBRF, or others.
 - Perform temporary fund borrowing (CBRF, ERA, subfunds) 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.
 - Prioritize disbursements, restrict expenditures.

Representative Galvin asked if there had been any thought about bringing the \$400 million [minimum floor in the general fund] up to meet inflation. She observed that the slide specified the MOU had been created in 1994.

Ms. Leary responded that the MOU was updated as needed. She relayed that most recent update was at least five years back, but it had been a good number for Treasury during that time.

Commissioner Crum clarified that the original memo was developed in 1994. He did not believe it was at the \$400 million dollar mark at the time.

Ms. Leary responded affirmatively. She provided a cash flow summary on slide 26. She highlighted that cashflow forecasting changes happened on the revenue and expenditure side. Even with balanced budgets, cashflow mismatches occurred. Additionally, revenue shortfalls may occur if forecast assumptions were incorrect.

[3:05:04 PM](#)

Co-Chair Josephson asked about slide 28 in the appendix. He was trying to get a better understanding of the sweep issue. He looked at the Alaska Fisherman's Fund under GeFONSI II and asked if there were fees from fishermen that helped capitalize the \$11.6 million.

Ms. Leary replied that she was not certain about the source of revenue for the specific fund.

Co-Chair Josephson stated his understanding that some of the 60 funds [shown on slide 28] were funded by private individuals through professional licensing fees.

Ms. Leary agreed.

Co-Chair Josephson used the Agricultural Revolving Loan Fund as an example. He provided a scenario where the legislature appropriated \$8 million instead of the \$8.745 million shown on slide 28. Under the scenario, he believed the \$745,000 balance would sweep away. He asked if he was accurate.

Ms. Leary answered that many of the funds [shown on slide 28] were designated and had some requirements because funds were coming from outside the state to replenish the fund balance. She explained that the likelihood of those funds being available for draws or sweep was less than the general fund. She noted that the balances shown on the slide were at a point in time and did not necessarily reflect the amount put in by the legislature the previous year. She elaborated that it could be an aggregated fund over many years that was being developed for a specific purpose.

Co-Chair Josephson discussed his philosophical concern where Alaskans were required to contribute their own funds and a portion of that money lapsed into the general fund and was swept. If he was told he was required to contribute money to a fund and some of his resources were swept to the CBR, he would wonder if the funds he provided were merely helping the state pay back its CBR debt. He was alarmed by the fact that there used to be an understanding in the political culture that the reverse sweep would occur as a recognition that the system needed to keep track of the funds and that was no longer the case. He would talk to the Legislative Finance Division to determine whether the problem had been cured by writing a budget that dispensed with the concern.

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Commissioner Crum offered to follow up with a report showing which of the funds were sweepable. He stated that many of the funds shown on the slide that were set up by statute or settlement meant there were specific rules around how they could be used. He highlighted the Public School Trust Fund as an example and explained that the corpus of the fund could not be touched. The fund had to be invested in a certain way in order to propose a draw. He pointed out that slide 28 only showed the top 60 participants out of around 230 funds managed by Treasury. He noted that the funds had different asset allocations and risk profiles. He elaborated that Treasury did substantial work to manage the funds and put forward recommendations to whoever the governing body may be as to the appropriate draw.

Co-Chair Josephson referenced the past court case *Hickel v Cowper*. As an example, he highlighted that the case talked about the Spill Prevention and Response Fund. He explained that because the fund was needed in the event of emergency, it was deemed to be available for appropriation and not sweepable. Additionally, federal dollars could not be swept. He was alarmed to learn from the case that many things could be swept. He stated it was the reason there had been a concern with the HEIF, which the legislature had fixed. He asked about the other 229 funds and stated the legislature needed to figure it out.

Representative Stapp stated that the case also specified that the ERA account did not require legislative action to spend "and we all know how that turned out." Separately, he noted that the state insurance catastrophic reserve fund was capitalized above the statutory limit. He understood it was likely because Treasury had obligated funds that it would spend. He remarked that according to AS 37.05.289, there was not supposed to be more than \$50 million in the fund. He asked what happened when the fund balance exceeded \$50 million. He wondered where the money went.

Commissioner Crum responded that the department collected and invested the funds. He explained that the draws on the fund were the responsibility of the bodies using the program. He explained that Treasury did not measure or track the expenditure portion. He added that whatever funds the state had, Treasury tried to grow the amount.

Co-Chair Josephson thanked the department for its presentation. He reviewed the schedule for the following Monday.

ADJOURNMENT

[3:13:04 PM](#)

The meeting was adjourned at 3:13 p.m.