

H B

580

FISCAL NOTE

REQUEST:

Revision Date: 5/3/90
 Title: An Act relating to management and investment of certain State funds
 Sponsor: Finance Committee
 Requestor: State Affairs

Agency Affected: Administration
 BRU: Centralized Administrative Services

Components: Finance

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY91	FY 92	FY 93	FY 94	FY 95	FY 96
PERSONAL SERVICES	0	0	0	0	0	0
TRAVEL	0	0	0	0	0	0
CONTRACTUAL	0	0	0	0	0	0
SUPPLIES	0	0	0	0	0	0
EQUIPMENT	0	0	0	0	0	0
LAND & STRUCTURES	0	0	0	0	0	0
GRANTS, CLAIMS	0	0	0	0	0	0
MISCELLANEOUS	0	0	0	0	0	0
TOTAL OPERATING	0	0	0	0	0	0

CAPITAL	0	0	0	0	0	0
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REVENUE	0	0	0	0	0	0
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FUNDING: (Thousands of Dollars)

GENERAL FUND	0	0	0	0	0	0
FEDERAL FUNDS	0	0	0	0	0	0
OTHER	0	0	0	0	0	0
TOTAL	0	0	0	0	0	0

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

ANALYSIS : (Attach a separate page if necessary)

See attached page. No change from previous fiscal year

Prepared by: Keith Busch, Director
 Division: Finance

Phone: 465-2240

Date: 5-2-90

Approved by Commissioner: Frank S. Baxter

Date: 5/3/90

Agency: Department of Administration

Distribution (by preparer) :

Legislative Finance
 Legislative Sponsor
 Requestor
 Office of Management and Budget
 Impacted Agency(ies)

HB 580 does not appear to have any impact on the Division of Finance in its present form. The primary changes appear to be wherever in the Statutes it formerly had "Commissioner of Revenue" it will now have "State Investment Board" and a new section of the statutes has been added to establish a State Investment Board in the Department of Revenue. The Board is to manage and invest State funds with the assistance of the Department of Revenue. From discussions with the Department of Revenue, they will be preparing a fiscal note for the impact to them.

HOUSE COMMITTEE ON STATE AFFAIRS

**RECAP OF
HB 580**

Investment of State Funds

Received March 12, 1990
by the Finance Committee

Heard March 20, 1990
Heard March 29, 1990

Passed Out of Committee March 29, 1990
1 Do Pass
4 No Recommendation

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FISCAL NOTE

REQUEST:

Revision Date: _____ Agency Affected: Administration
 Title: An Act relating to management and investment of certain State funds BRU: Centralized Administrative Services
 Sponsor: Finance Committee Components: Finance
 Requestor: State Affairs

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 91	FY 92	FY 93	FY 94	FY 95	FY 96
PERSONAL SERVICES	0	0	0	0	0	0
TRAVEL	0	0	0	0	0	0
CONTRACTUAL	0	0	0	0	0	0
SUPPLIES	0	0	0	0	0	0
EQUIPMENT	0	0	0	0	0	0
LAND & STRUCTURES	0	0	0	0	0	0
GRANTS, CLAIMS	0	0	0	0	0	0
MISCELLANEOUS	0	0	0	0	0	0
TOTAL OPERATING	0	0	0	0	0	0
CAPITAL	0	0	0	0	0	0
REVENUE	0	0	0	0	0	0

FUNDING: (Thousands of Dollars)

GENERAL FUND	0	0	0	0	0	0
FEDERAL FUNDS	0	0	0	0	0	0
OTHER	0	0	0	0	0	0
TOTAL	0	0	0	0	0	0

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

ANALYSIS: (Attach a separate page if necessary)

HB 580 does not appear to have any impact on the Division of Finance in its present form. The primary changes appear to be wherever in the Statutes it formerly had "Commissioner of Revenue" it will now have "State Investment Board" and a new section of the statutes has been added to establish a State Investment Board in the Department of Revenue. The board is to manage and invest State funds with the assistance of the Department of Revenue. From discussions with the Department of Revenue, they will be preparing a fiscal note for the impact to them.

Prepared by: Keith Busch, Director *John Thomas State Act* Phone: 465-2240
 Division: Finance Date: _____
 Approved by Commissioner: Frank S. Baxter Date: 3/15/90
 Agency: Department of Administration

Distribution (by preparer):
 Legislative Finance
 Legislative Sponsor
 Requestor
 Office of Management and Budget
 Impacted Agency(ies)

Item 2

STATE OF ALASKA
1990 LEGISLATIVE SESSION

Bill Version: HB 580
Publish Date: _____

FISCAL NOTE

REQUEST:

Revision Date: _____	Agency Affected: <u>Department of Revenue</u>
Title: <u>Management and Investment of certain State funds</u>	BRU: <u>Treasury</u>
Sponsor: <u>House Finance</u>	Components: _____
Requestor: <u>House State Affairs</u>	

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 91	FY 92	FY 93	FY 94	FY 95	FY 96
OPERATING						
PERSONAL SERVICES	0	0	0	0	0	0
TRAVEL	0	0	0	0	0	0
CONTRACTUAL	120.7	313.9	502.3	733.7	1028.8	1285.3
SUPPLIES	0	0	0	0	0	0
EQUIPMENT	0	0	0	0	0	0
LANDS & STRUCTURES	0	0	0	0	0	0
GRANTS, CLAIMS	0	0	0	0	0	0
MISCELLANEOUS	0	0	0	0	0	0
TOTAL OPERATING	120.7	313.9	502.3	733.7	1028.8	1285.3
CAPITAL	0	0	0	0	0	0
REVENUE	0	0	0	0	0	0

FUNDING: (Thousands of Dollars)

GENERAL FUND	0	0	0	0	0	0
FEDERAL FUNDS	0	0	0	0	0	0
OTHER (SBS)	120.7	313.9	502.3	733.7	1028.8	1285.3
TOTAL	120.7	313.9	502.3	733.7	1028.8	1285.3

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

ANALYSIS: Fiscal year 1990 effect is zero.

See attached analysis

Prepared By: Milt Barker MB
 Division: Treasury
 Approved by Commissioner: [Signature]
 Agency: Department of Revenue

Phone: 465-2350
 Date: March 20, 1990
 Date: 3/20/90

Distribution (by preparer):
 Legislative Finance
 Legislative Sponsor
 Requestor
 Office of Management and Budget
 Impacted Agency(ies)

HB 580
SBS Investment Management Costs

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
	(\$ Millions)					(\$000)					
Fiscal Year	Beginning Liquid Balance	GIC Maturities	Net Contributions	Average Balance	Investment Earnings	Ending Liquid Balance	Stock Management Fees	Custodian Fees	Audit Fees	Performance Measurement Fees	Total Fees
FY91	0	151.1	50.0	100.5	9.0	210.1	93.5	5.2	10.0	12.0	120.7
FY92	210.1	118.9	55.0	297.1	26.7	410.7	276.3	15.6	10.0	12.0	313.9
FY93	410.7	96.3	60.0	488.8	44.0	610.9	454.6	25.7	10.0	12.0	502.3
FY94	610.9	202.9	65.0	744.8	67.0	945.8	692.6	39.1	10.0	12.0	733.7
FY95	945.8	128.7	70.0	1045.1	94.1	1238.6	971.9	54.9	10.0	12.0	1028.8
FY96	1238.6	60.0	75.0	1306.1	117.5	1491.1	1214.7	68.6	10.0	12.0	1285.3

Notes:

1. Column 6, prior year
2. From Division of Retirement & Benefits
3. Treasury Division estimate based on FY 89 contributions
4. Column 1 + (Column 2 + Column 3)/2
5. 9% x Column 4
6. Column 1 + Column 2 + Column 3 + Column 5
7. Column 4 x .31% per contract x 30% asset allocation to common stocks
8. Column 4 x 5.25¢/\$1000 per contract
9. Per contract
10. Treasury Division estimate
11. Columns 7 + 8 + 9 + 10.

Comparison of Pending Legislation
relating to
INVESTMENT OF PUBLIC FUNDS

March 2, 1990
Department of Revenue

<u>PROVISION</u>	<u>Current Law</u>	<u>SB 509</u>	<u>SB 417</u>	<u>SB 197</u>
FUND & MANAGER				
Retirement trust funds University of Alaska Trust Fund Public School Trust Fund General Fund SBS and deferred compensation Permanent Fund	Commissioner of Revenue Commissioner of Revenue Commissioner of Revenue Department of Administration Alaska Permanent Fund Corp.	Alaska State Trust Company Alaska State Trust Company Alaska State Trust Company Alaska State Trust Company Department of Administration Alaska Permanent Fund Corp.	State Investment Board State Investment Board State Investment Board State Investment Board State Investment Board Alaska Permanent Fund Corp.	Alaska Permanent Fund Corp. Commissioner of Revenue Alaska Permanent Fund Corp. Commissioner of Revenue Department of Administration Alaska Permanent Fund Corp.
BOARD REPLACES SINGLE PERSON IN CHARGE OF TRUST FUNDS	NO	YES (SBS & deferred compensation at Commissioner of Administration's discretion)	YES	YES except SBS, deferred compensation, & University of Alaska Trust Fund
BOARD REPLACES SINGLE PERSON IN CHARGE OF GENERAL FUND	NO	Commissioner of Revenue's discretion	YES	NO
PROFESSIONAL INVESTORS ON BOARD	NO	YES	NOT REQUIRED	NOT REQUIRED
BENEFICIARY REPRESENTATIVES ON BOARD	NO	YES	YES	NO
SEPARATE CORPORATION FOR TRUST & GENERAL FUND INVESTMENTS	NO	YES (SBS & deferred compensation at Commissioner of Administration's discretion, General Fund at Commissioner of Revenue's discretion)	NO	YES except for SBS, deferred compensation, University of Alaska Trust Fund, & general fund
ACCESS TO FEDERAL RESERVE SERVICES	NO	YES	NO	NO
TRUST & GENERAL FUND INVESTMENTS SUBJECT TO:				
State Procurement Code	Delegations excepted	NO	Delegations excepted	Delegations excepted
Executive Budget Act	YES	NO	YES	YES
Administrative Procedures Act	YES	NO	YES	YES
Public Meetings Law	YES	YES with exceptions	YES	YES
Public Records Law	YES	YES with exceptions	YES	YES
Executive Branch Ethics Act	YES	NO	YES	YES
Personnel Code	NO except SBS & deferred compensation	NO	NO	NO except SBS & deferred compensation
		(SBS & deferred compensation at Commissioner of Administration's discretion)		

STATE OF ALASKA

THE LEGISLATURE

BUDGET AND AUDIT COMMITTEE

AUDIT DIVISION
P.O. BOX W
JUNEAU, ALASKA 99811-3300

Item 4

M E M O R A N D U M

DATE: January 3, 1990

TO: Chairman Jalmar Kerttula and Members
of the Legislative Budget and Audit Committee

FROM: Randy Welker *Randy Welker*
Legislative Auditor

RE: Supplemental Benefits System Investment Management

We recently inquired into the Department of Administration, Division of Retirement and Benefits' (DRB) investment strategy for the supplemental benefits systems (SBS) funds. We noted that present investment procedures include investing SBS funds exclusively in guaranteed investment contracts (GICs) with insurance companies. Currently, the SBS investment portfolio consists of GICs with seven carriers amounting to approximately \$540 million.

Apparently, this investment strategy was developed during the infancy of the SBS program by DRB and their actuary. No legal conditions or guidance for investing exist in law or regulation. For the most part, GIC's are not backed by federal insurance or other guarantees but are supported by the financial strength and quality of assets of the insurer.

In reviewing the details of the portfolio it was noted that Executive Life Insurance Company holds about 28% (\$152 million) of total SBS assets and that two companies hold over 50% of total assets. Of some concern is Executive Life's own investment strategy. They are known in the investment community as a major purchaser of high yield fixed-income instruments also known as "junk" bonds. A November 14, 1989 article in the Wall Street Journal indicated that 44% of Executive Life's cash and invested assets were made up of junk bonds while the average insurance company holds only 4% to 5% of their assets in high yield instruments.

We requested the Treasury Division in the Department of Revenue to provide us with an analysis of current DRB investment practices. This review is attached and expresses some concerns over the lack of a basic investment plan. It also notes that as a result of the recent fall in the junk bond market, that although Executive Life has held high ratings from Moody's, Best's, and Standard and Poor's insurance rating services, Moody's has placed the insurance company's claims-paying rating on review.

January 3, 1990

According to DRB, they have included in their FY 90 management plan an investigation of their current investment practices. We were told they have contracted with a consultant to review current SBS program investing strategy.

We would recommend that, on a short-term basis, DRB consider the diversification aspects of allowing too few insurance companies to hold large amounts of SBS funds. Also, as pointed out in the Treasury Division's analysis, Executive Life should be monitored in the event their financial condition should deteriorate. Future GIC purchases should involve more scrutiny of the quality of the bidder's assets and financial dealings in the investment markets.

On a long-term basis, we recommend that the Legislature and Executive Branch consider including the SBS and Deferred Compensation programs' investment activities with public employee retirement funds currently under the management of the Department of Revenue. As you recall in our June 19, 1989 report to the Legislative Budget and Audit Committee entitled, "A Special Report On The Department Of Revenue, Treasury Division, Public Employees' And Teachers' Retirement Funds," we recommended that legislation should be introduced to establish a "Board of Trustee" structure that would play an active role in management and investment oversight of the retirement funds. Statutory inclusion of the investment of SBS and Deferred Compensation funds could be incorporated into this proposed legislation.

If you have any questions or need additional information, please contact me at 465-3830.

Attachment

MEMORANDUM

STATE OF ALASKA
DEPARTMENT OF REVENUE

TO: Milt Barker
Deputy Commissioner
Treasury Division

DATE: December 18, 1989

TELEPHONE: 465-2350

FROM: Michael Cheung *M.C.*
State Investment Officer
Treasury Division

RE: GIC Investment For SBS

Per your request, I have reviewed our SBS GIC investment. To summarize, the State should thoroughly examine the overall nature and purposes of the SBS. The State should determine a plan objective that can incorporate both short-term and long-term needs of the plan. An investment strategy should then be set up for accomplishing this objective. As for our current GIC investments, the State should be cautious about the current turmoil in the high yield securities market, as Executive Life's business structure has been severely affected and will continue to be. Finally, any future ITB should require financial information that will enable the State to properly evaluate the financial structure and its soundness of a potential GIC provider.

The State of Alaska is the annuity plan sponsor and the plan is qualified as a defined contribution plan under IRS code 401(a). It is critical for any plan sponsor to understand the nature of its plan and the strategy it takes to accomplish its objectives. A fiduciary has to act like a Prudent Expert in all related matters with primary responsibilities on reducing risk and secondarily on earning a reasonable return. Basically a plan must have:

- a. Competitive rate of return;
- b. Maintain sufficient liquidity for benefit payments; and
- c. Maintain the safeguards and diversification that is prudent in order to reduce risk on portfolio return.

Here are a few major factors that will influence the nature of a plan. A fiduciary should carefully evaluate each of them in order to determine the objectives of the plan and the necessary strategy to accomplish it.

Need for Current Income: Is the plan in a net cash outflow stage? This will be largely influenced by the characteristics of the plan participants.

Inflation Protection: Analyze how the minimum investment income requirement will change over time with inflation.

Capital Risk Tolerance: What are the probable emotional reactions to an adverse outcome? How much volatility can be comfortably accepted?

Liquidity Requirements: Assess the probability of forced sale.

After evaluating the above factors, an investment strategy needs to be set up. Asset allocation decisions must be made. The main reason for having various asset classes is that portfolio return risk can be reduced and in the long run, a sustainable growth can also be achieved.

Currently, the State of Alaska has its SBS monies invested only in GIC instruments. The longest maturity GIC is six years and a weighted average life of 3.3 years for the entire portfolio. However, the nature of the SBS plan is for long-term purposes. The plan is in a positive cash contribution stage as annual contribution will exceed annual annuity payments in 1990. Assuming this trend will continue in the foreseeable future, long-term returns will be more critical to the plan than current income. This means the investment strategy should be one that has a long time horizon with diversified assets in order to provide sustainable growth.

To satisfy both the current annuity payments and long-term growth needs of the plan, the portfolio should be divided into two sections. One portion of it should be set up with high quality fixed income securities. A dedicated cashflow strategy will be employed for this sector, whereby principal payments and interest payments from the bond portfolio will be used to fund annuity payments. A dedicated cashflow strategy is one of the methods a GIC insurer employs to match their assets and liabilities. Another method for asset/liability matching is a bond immunization strategy. An immunization strategy will try to match the duration of annuity payments with the duration of the bond portfolio. This technique permits the locking in of a yield, at the same time the reinvestment rate risk is minimized. Immunization requires three conditions be met:

1. Portfolio Duration = Liability Duration
2. Portfolio Value = Present Value of the Liability Stream
3. Dispersion of portfolio cashflows is equal or slightly greater than the dispersion of the liability stream.

Milt Barker
December 18, 1989
Page 3

After evaluating the long-term objectives of the fund, another section of the portfolio should be geared for the long-term inflation protected growth and benefits, and asset allocation decisions should be made. Investment strategy should encompass a long investment horizon with various assets that should contribute to a sustainable portfolio return and growth. To have the proper assets mix, risks (variability of return), and expected rates-of-return of different asset types should be evaluated with respect to various economic scenarios. This process will determine the proper asset allocation that is necessary to accomplish the plan objectives. As the economy and the plan characteristics change, plan sponsors should review the plan objectives and investment strategy. Therefore, a fiduciary can take proper actions to ensure the safety, returns, and value of the plan assets.

Within the context of our current GIC portfolio, the State has diversified its investments among various GIC insurers and has set up a ladder maturity schedule. The ability of an insurer to live up to its contractual agreement is dictated by its financial strength and assets quality. There are two levels of comfort an insurer can provide: 1) conservative investment management, which includes lending assets to solid borrowers, diversification of loans by geography and industry, and limiting the amounts invested in any one company, industry, or area; and 2) maintenance of a substantial contingency fund to cover losses of any sour investments. If an insurer does not invest prudently and realized losses occur, all it has to fall back on is its contingency reserve fund.

At present, approximately 25% of our GIC's is provided by Executive Life, a principal subsidiary of First Executive Corporation. First Executive has been known in the investment community as a major player in high yield fixed income securities. At the end of 1988 fixed income securities investments represented over 80% of total assets as compared with the industry's 50% average. Approximately 50% of its assets were invested in speculative-grade bonds and private placements, while industry average is less than 15%.

Executive Life competes in the GIC market by offering higher yields than some of its competitors. Executive Life has this ability because of its higher proportion of below-investment grade securities. This strategy involves some long-term risk. Although the company follows a policy of diversification by issuer and industry, any problems that arise from any bond issuer can affect the whole high yield industry. Presently, we are already witnessing the current shakeout in the high yield fixed income industry. Executive Life has already felt the turmoil in the high yield securities market. At year end 1988, the market value of the bond portfolio was below book value by over \$400 million. And a trading out of problem assets may result in a reduction of capital when realized losses are added in restructuring in portfolio.

Milt Barker
December 18, 1989
Page 4

Recently, a Wall Street Journal article stated that First Executive (parent company) was involved in restructuring its bond portfolio. By setting up six non-disclosed subsidiaries, First Executive was able to transfer \$750 million of its high yield bonds to its subsidiaries. (Any investments worth at least 10% of the net worth has to be publicly disclosed, and 10% of the net worth for First Executive was \$140 million. First Executive only invested \$128 million in each of the subsidiaries.) In return, First Executive received \$770 million notes issued by the subsidiaries. The interests and principal payments on the subsidiaries' notes will be supported by the high yield bonds that First Executive has swapped out. In other words, First Executive was able to unload these high yield securities to its subsidiaries without incurring any realized losses. The new notes issued by the subsidiaries also received a more favorable rating by the insurance regulators. Thus, First Executive was able to reduce an estimated \$120 million from its reserve for investment losses. Therefore, liability or insurance claim holders should not view their claims as supported by improved asset quality, because the only benefits realized was First Executive's ability to reduce its reserve account. With the continued turmoil in the high yield securities market. First Executive will be hard pressed to change its business and investment strategy. The State should closely monitor this situation and do any necessary actions to preserve the safety of the SBS assets. Currently, Moody's has placed Executive Life's A1 claims-paying rating on review. The review will focus on the shakeout in the high-yield bond market and its affect on Executive Life.

For any future GIC investment, the State should also request audited financial statements and 10 Q's, quarterly statements and 10K's. These statements are filed with the SEC by publicly traded companies. Insurers should also furnish various types of investment quality ratios: delinquent percent, foreclosed percent, and below investment grade percent. Other ratios on financial strength and capital structure should also be provided. These ratios will indicate the management style and profitability of an insurer. The ITB or contract should also include explicit language that an insurer has to act like a prudent expert in order to prevent the insurer from any actions that will jeopardize the plan assets and its ability to generate the contractual return.

MC/mem

A SPECIAL REPORT ON THE
DEPARTMENT OF REVENUE
TREASURY DIVISION
PUBLIC EMPLOYEES' AND TEACHERS'
RETIREMENT FUNDS

June 19, 1989

Audit Control Number

04-4345-89-S

Commissioner, Department of
Revenue

Hugh Malone

Deputy Commissioner, Department
of Revenue

Milton B. Barker

STATE OF ALASKA

THE LEGISLATURE

BUDGET AND AUDIT COMMITTEE

AUDIT DIVISION,
P.O. BOX W
JUNEAU, ALASKA 99811-3300

June 19, 1989

Members of the Legislative Budget
and Audit Committee:

In accordance with a Legislative Budget and Audit Committee special request and the provisions of Title 24 of the Alaska Statutes, the attached report is submitted for your review.

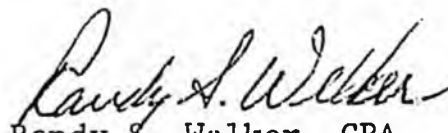
A SPECIAL REPORT ON THE
DEPARTMENT OF REVENUE
TREASURY DIVISION
PUBLIC EMPLOYEES' AND TEACHERS'
RETIREMENT FUNDS

Audit Control Number

04-4345-89-S

The purpose of this audit is to examine the accounting and oversight of the Public Employees' and Teachers' Retirement Funds administered by the Department of Revenue, Treasury Division.

The audit was conducted in accordance with generally accepted governmental performance auditing standards. The audit approach is discussed in the Report Objectives, Scope, and Methodology section of this report. The audit results may be found in the Findings and Recommendations section.



Randy S. Welker, CPA
Legislative Auditor
Division of Legislative Audit

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REPORT OBJECTIVES, SCOPE, AND METHODOLOGY

In accordance with Title 24 of the Alaska Statutes and a special request of the Legislative Budget and Audit Committee, we reviewed the Public Employees' and Teachers' Retirement Funds. The purpose was to review accounting procedures used for the retirement funds' foreign investment portfolio and to ascertain the extent of investment oversight the retirement funds are subject to.

The policy and audit approach utilized by the Division of Legislative Audit for special and performance reports can best be described as "audit by exception." This methodology focuses the audit effort on areas of an auditee's operation that have been identified by a preliminary survey as having a high degree of probability for needing improvements.

Therefore, by design, finite audit resources are used to identify where and how improvement can be made, and little time is devoted to reviewing well-run operations or programs. Consequently, this report highlights those areas needing improvement and does not emphasize those operations and programs that are properly functioning.

Discussion of the objectives, scope, and methodology of our review follows.

OBJECTIVES

In response to public allegations about mismanagement of the retirement funds and "deceptive accounting practices," the Legislative Budget and Audit Committee requested a review of certain management practices of the Public Employees' and Teachers' Retirement Funds.

The first objective of our review was to determine the type of management and investment oversight provided over the operations of the retirement funds.

The second objective was to ascertain the management and investment oversight styles applied to other similar funds.

Our third objective was to determine if proper accounting practices were applied to the funds' foreign investments.

Finally, we identified the various rates of returns earned by the retirement funds and the Permanent Fund, and we reviewed the cost of managing and investing those funds.

SCOPE AND METHODOLOGY

We met with officials of the Department of Revenue, Treasury Division, including the deputy commissioner, chief investment officer, other investment officers, and the state

comptroller; the director of the Division of Risk Management; officials of the Alaska Permanent Fund Corporation; certified public accountants under contract with the Treasury Division; and a member of the brokerage community.

We also reviewed various reference materials and publications; reports, and supporting documentation, prepared by the Senate Advisory Council; fund performance evaluation reports prepared for the retirement funds and the Alaska Permanent Fund; and, various literature provided by other states on their retirement funds.

Additionally, we prepared and distributed a questionnaire to all other states inquiring about certain aspects of their public employees retirement funds.

We also engaged a consultant, who as a former employee of Merrill Lynch had past experience in evaluating the performance of the Public Employees' and Teachers' Retirement systems, to assist us in interpreting the externally prepared performance reports on the retirement funds and the Permanent Fund.

ORGANIZATION AND FUNCTION

The Department of Revenue, Division of Treasury (Treasury) is responsible for, and has sole discretion over, the prudent investment and management of the Public Employees' Retirement Fund (PERS) and the Teachers' Retirement Fund (TRS).

Chapter 141, SLA 1988 amended PERS and TRS statutes by designating the funds as retirement trust funds and appointing the commissioner of Revenue as treasurer of the retirement systems and fiduciary of the funds. Under the amending legislation, the commissioner of Revenue shall:

1. Consider the status of the funds' investments and the system's liabilities on both a current and a probable future basis.
2. Determine the appropriate investment objectives for the funds.
3. Establish investment policies aimed at achieving the objectives.
4. Act only in regard to the best financial interests of the system's beneficiaries.

The amendments also repealed the "legal list" of investments the retirement funds were restricted to and placed upon the commissioner of Revenue, or his designee, the responsibility of fund fiduciary. Treasury also employs external investment managers who manage a substantial portion of the retirement funds.

Additionally, there are two boards which oversee the administrative aspects of the retirement systems. The Public Employees' Retirement Board is composed of five members, three of whom are members of the Department of Administration personnel board and two who are members of the system and elected by the membership of the system. The Teachers' Retirement Board consists of five members appointed by the governor. Both boards are mostly administrative in nature, being responsible for governing the regulatory aspects of the retirement systems.

The Alaska Permanent Fund is managed by an executive director, who reports to a six-member board of trustees appointed by the governor.

FUND COMPARISONS AND DISCUSSION:
PUBLIC EMPLOYEES' RETIREMENT FUND, TEACHERS'
RETIREMENT FUND, and ALASKA PERMANENT FUND

BACKGROUND

There is no validity to the statement that "a fund is a fund" as each fund has its own unique characteristics. Although funds such as those set up as trusts and endowments may have few obvious differences, there are deeper, less clearly defined differences such as fund objectives, philosophy over fund management, and investment styles. A slight difference in fund objectives and philosophy may, and usually does, result in different investment styles and, therefore, differing returns on investment. The varied fund management styles and investment philosophies create a danger in across-the-board rate of return comparisons and forming conclusions drawn from those comparisons. There are several ways of assessing investment results. It is not, for example, appropriate to compare the results of funds with very different objectives or constraints. Funds with different types and mixes of investments are also difficult to compare directly. To properly assess investment results, comparisons must reflect similar objectives, constraints, opportunities, and all things that go into the investment process.

The Alaska Permanent Fund, while not legally defined as one, is in all probability a trust fund like the Public Employees' (PERS) and Teachers' (TRS) Retirement Funds. The Alaska Permanent Fund Corporation (PFC) holds the Permanent Fund out as a "Public Trust Investing for Alaska's Future," has a Board of Trustees, and is intent on earning revenue for beneficiaries while preserving principal. The obvious similarities between PERS/TRS and the Permanent Fund end here - at considering both funds as trusts.

PFC has chosen a more cautious, less risky approach towards its investments. In an informational pamphlet dated May 1989, PFC stated:

The Fund invests its assets to earn income. To minimize the risk that Fund assets could be destroyed by bad investment decisions, the Fund is invested very conservatively. Indeed, the primary emphasis in all Fund decision-making is maintaining the safety of principal. The maximizing return on investment is the secondary consideration.

This contrasts to the Department of Revenue, Division of Treasury (Treasury) investment philosophy of the PERS/TRS which has been stated as:

The most important characteristic of the funds for investment policy purposes is their perpetual nature and, in the case of the Public Employees' Retirement System, the long number of years before it will encounter any net outflows (probably 15 to 20 years). A long time span accommodates investments which should enjoy higher returns over the long-run, although they may be slow to materialize, or be erratic in the short-run, and it allows greater use of investments which may have substantial market valuation risks. This characteristic expands the universe of investment possibilities and increases the potential for achieving higher returns on the investments.

The PERS/TRS has opted for more growth through a higher asset allocation to equities. To achieve that end, PERS/TRS follows an investment technique known as active management versus a passive management investment style. Passive management is a term used to describe an investment strategy that attempts to follow a predefined market index, such as the Standard and Poor's (S&P) 500, and fashions the portfolio to mirror the results of that index. Passive management follows a process of rebalancing the portfolio to reflect the index, not necessarily to enhance or maximize a return. Active management, on the other hand, involves portfolio management that is involved in the active investment process of buying and selling in an attempt to enhance the portfolio's performance. The active management strategy can be characterized as continually monitoring the market to determine what is the best selection of investment to produce the best returns within a predetermined set of risk parameters.

PFC is legally limited in its investment diversification by statute which defines a specific "list" of permitted investments. The Treasury did have investment limitations, but the statutory restrictions were repealed by Chapter 41, SLA 1988. This allows Treasury more investment flexibility. With this flexibility, Treasury can assume additional risk, and theoretically achieve higher returns for the PERS/TRS Funds.

ASSET ALLOCATION

An informative way to examine the assumed risk is to analyze the asset allocations of the various funds. At March 31, 1989, the various funds' holdings were (stated in percentage of portfolio at market values):

	<u>PERS</u>	<u>TRS</u>	<u>PFC</u>
Equities (1)	32.8%	34.9%	12.9%
Fixed Income	54.7%	51.3%	77.6%
Real Estate	6.4%	6.0%	5.6%
Other (2)	6.1%	7.8%	3.9%

(1) includes domestic and foreign equity holdings of the PERS and TRS. PFC does not yet invest in foreign markets.

(2) includes mortgages, cash, and interest and dividends receivable.

As can be seen, the PERS/TRS Funds hold 2.5-to-3 times more equity than does PFC. Conversely, PFC holds 1.5 times more fixed income investments than does the PERS/TRS Funds.

By their nature, equities have more risk than fixed income (debt) investments. As mentioned earlier, theoretically the riskier the investment, the higher the potential rate of return.

FUND PERFORMANCE

This section and the following section ("Other Rate of Return Data") present statistical data which show various rates of return earned not only by the PERS/TRS and Permanent Fund but other interest-bearing investments. As noted above, and throughout the report, direct comparisons between these funds and other investments are not practical for assessing how one fund "performed or out performed" another fund. This is mainly due to the differences in purpose, goals, and philosophy of each particular fund. However, the presentations provided here are done so for the benefit of interested parties who can review the returns earned by the funds and relate those to other commonly known investments.

It has been alleged that Treasury managed PERS/TRS Funds are among the worst performers within the universe of funds used for performance measurement and comparison (see Recommendation No. 2). While the allegations themselves are substantially accurate in the context they were submitted, the facts must be kept in perspective in light of the long-term nature of the retirement funds. The allegations were made from looking at just one, short period of time that the PERS/TRS funds were evaluated. One must be careful about the period of time used for measurement as investment results measured over short periods of time are very misleading. The best results today may be the worst tomorrow. What matters is consistent, long-term results.

With the above thoughts in mind, the PERS, TRS, and PFC performance can be reviewed together with returns of other, although non-comparable, commonly known investments.

Total rate of return (time-weighted) is a useful technique that is widely accepted for comparing investment results. It combines current yield plus changes in current market values for determining a portfolio's investment rate of return.

Total rate of return (time-weighted) for PERS, TRS, and PFC is shown below:

TIME-WEIGHTED TOTAL RATES OF RETURN(%)
AS OF JUNE 30, 1988 and DECEMBER 31, 1988 (a)
(unaudited)

	<u>PERS</u>	<u>TRS</u>	<u>PFC</u>
Year ending 6/30/88	3.79	3.76	5.3
Two years	7.46	7.85	6.5
Three years	13.80	13.37	11.8
Four years	15.02	14.62	(1)
Five years	(2)	(2)	13.1
Year ending 12/31/88	11.65	11.93	8.5
Two years	6.48	6.44	5.9
Three years	10.72	10.20	9.3
Four years	13.72	13.31	(1)
Five years	(2)	(2)	12.9

(a) source: PERS/TRS information obtained from Department of Revenue, Treasury Division internally calculated time-weighted rates of return. PFC information obtained from externally evaluated SEI Large Plan Report. Percentages presented are annualized time-weighted rates of return.

(1) four-year data not available for PFC from SEI external reports.

(2) five-year data not available for PERS/TRS for years ending June 30 and December 31, 1988.

As can be seen, the PERS/TRS Funds time-weighted rate of return generally exceeds that of the PFC. This is probably a reflection of the additional risk the retirement funds assume versus the more conservative approach taken by the PFC in its investments and asset allocation.

Another performance measurement would be reviewing the return of segments of the PERS/TRS and PFC portfolios; for example, reviewing PERS/TRS and PFC domestic equity investments to the J&P 500 or the fixed income investments to the Shearson Lehman Bond Index (SL-BONDS). Such an analysis would show:

PERS/TRS/PFC EQUITY AND FIXED INCOME TIME-WEIGHTED RETURNS
COMPARED TO SPECIFIC MARKET INDICES
ANNUALLY-COMPOUNDED RATES OF RETURN
FOR YEARS ENDING DECEMBER 31, 1988 (a)
(unaudited)

DOMESTIC EQUITIES

	<u>1 year</u>	<u>2 years</u>	<u>3 years</u>	<u>4 years</u>	<u>5 years</u>
PERS	18.21	9.75	12.98	17.38	(1)
TRS	18.21	10.04	12.95	17.27	(1)
PFC	15.50	11.10	13.50	(2)	15.00
S&P 500	16.80	10.90	13.40	17.80	15.30

FIXED INCOME

	<u>1 year</u>	<u>2 years</u>	<u>3 years</u>	<u>4 years</u>	<u>5 years</u>
PERS	8.73	5.14	9.37	12.33	(1)
TRS	9.10	5.01	8.58	11.71	(1)
PFC	7.20	4.30	8.10	(2)	12.10
SL-BONDS	7.60	4.90	8.40	11.50	12.20

(a) source: Dept. of Revenue, Division of Treasury internally calculated time-weighted rates of return; PFC externally evaluated SEI Large Plan Report; and, independent sources of market indices.

(1) five-year data not available for PERS/TRS.

(2) four-year data not available for PFC on SEI external reports.

The above analysis shows that for the most part PERS/TRS and PFC achieved a competitive return on its domestic equity investments compared to the S&P 500 index. PERS/TRS fixed income investments outperformed the Shearson Lehman Bond Index in each of the four years compared above. PFC also achieved a competitive return on its fixed income holdings when compared to the bond index.

Another informative comparison is reviewing the annual (each year standing on its own, unlike the cumulative returns used in the previous comparisons) rate of return and how that return fits into the universe of funds used for comparative purposes.

PERS/TRS/PFC
ANNUAL RATES OF RETURN AT MARKET VALUES
AND PERCENT RANKING IN COMPARATIVE UNIVERSE (a)

	1984		1985		1986		1987		1988	
	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank
<u>Equities</u>										
PERS	-15.1	100	28.8	63	37.5	38	17.7	96	-5.4	23
TRS	-15.1	100	28.8	63	37.5	38	18.5	90	-5.2	22
PFC	- 9.6	28	30.6	46	37.2	59	24.8	27	-6.4	55
<u>Fixed Income</u>										
PERS	1.1	55	27.9	65	22.9	3	5.0	59	7.6	51
TRS	0.8	57	28.2	61	23.4	1	4.3	79	8.8	3
PFC	4.4	56	27.2	12	20.5	25	4.3	91	7.0	71

(a) source: PERS/TRS data from SEI report for quarter ending 6/30/88. PFC data from SEI large plan report for period ending 6/30/88.

The rates of return above are based on the market value of the equity and fixed income portfolios and includes unrealized gains. PERS/TRS rankings are based on a comparison with a universe of approximately 30 large state retirement funds. PFC rankings are based on a universe comparison of 63 funds. The "rank" describes (using percentages) how the fund performed in relation to the other funds of the universe. For example, a rank of 100 indicates the fund had the lowest performance and 99% of the universe performed better. Conversely, a rank of 1 indicates the fund performed the best and 99% of the universe achieved lower returns. A rank of 55 indicates the fund performed near the median (50%), and that 45% of the universe performed worse while 54% achieved better returns.

OTHER RATE OF RETURN DATA

While not truly comparable, investment fund returns can be reviewed against other fixed income returns.

PERS/TRS/PFC ANNUAL REALIZED (NOMINAL) RATES OF RETURN
COMPARED TO OTHER FIXED RATE RETURNS (a)
(unaudited)

YEAR	Realized Rate of Return(%)			Fixed Rates of Return(%)		
	PERS	TRS	PFC	SBS(1)	DCP(1)	CD(1)
1980	9.54	10.41	11.29	10.40	n/a	12.91
1981	10.73	11.02	16.00	10.75	n/a	15.91
1982	8.52	6.98	15.10	12.35	n/a	12.04
1983	11.09	11.32	12.76	12.55	n/a	8.96
1984	10.66	9.47	10.89	12.00	n/a	10.17
1985	9.96	9.84	11.61	11.80	n/a	7.97
1986	13.16	13.12	14.36	11.87	9.30	6.62
1987	13.98	13.94	13.37	11.54	9.08	6.74
1988	8.20	8.20	9.01	11.00	9.93	7.58

(a) source: Division of Legislative Finance; Department of Administration, Division of Retirement and Benefits.

(1) SBS - State Supplemental Benefit System
DCP - State Deferred Compensation Plan
CD - Certificates of Deposit

n/a - not available

The comparisons above are not an accurate measurement of determining how PERS/TRS or PFC is performing in comparison to other funds or instruments. While it does demonstrate differing returns by different investing funds or instruments, it does not indicate nor provide a basis for comparing how similarly designed funds invested in similar securities are performing. Each of these funds or instruments, with the exception of PERS/TRS, have different objectives and goals and, therefore, have varying investment strategies and policies.

Also, the schedule above presents a different picture than the prior example. Here, annual realized (nominal) rates of return are presented. Realized rates of return do not include changes in market value and, therefore, are not usually used for comparing performance. In this schedule, PFC outperforms PERS/TRS in all but one annual period presented. This compares to the previous time weighted presentation that shows PERS/TRS outperforming PFC in all but one period presented. This exemplifies how, depending on a desired outcome, rate of returns can be used to make a point. Since PERS/TRS are pensions funds, their return

analyses should be based on a long-term view, not just how the funds performed in any one annual period.

Another review of returns can be made between the retirement funds and other market indices. Like the above, the returns are not truly comparable. These market indices reflect returns for certain investments, whereas the PERS/TRS and PFC Funds results reflect a total return on a balanced portfolio of many types of investments. For example, the Standard and Poor's 500 (S&P 500) index reflects returns on equities only; the 91 day Treasury Bill index (T-BILL) reflects short-term fixed income investments; and, the Shearson Lehman bond index (SL-BONDS) reflects returns on bond investments.

PERS/TRS/PFC TIME-WEIGHTED TOTAL RATES OF RETURN
COMPARED TO MARKET INDICES ANNUALLY-COMPOUNDED
RATES OF RETURN(%)
AS OF DECEMBER 31, 1988 (a)
(unaudited)

	<u>1 Year</u>	<u>2 Years</u>	<u>3 Years</u>	<u>4 Years</u>	<u>5 Years</u>
PERS	11.6	5.5	10.7	13.7	(1)
TRS	11.9	6.4	10.2	13.3	(1)
PFC	8.5	5.9	9.3	(2)	12.9
S&P 500	16.8	10.9	13.4	17.8	15.3
T-BILL	6.7	6.0	6.0	6.5	7.1
SL-BONDS	7.6	4.9	8.4	11.5	12.2

(a) source: Department of Revenue, Division of Treasury, and independent sources of market indices. PFC data from 12/31/88 Large Plan Report.

(1) five-year data not available for PERS/TRS.

(2) four-year data not available for PFC on SEI external reports.

The misleading nature of drawing conclusions solely from this analysis must be emphasized. For example, for the three years ending December 31, 1988 the S&P 500 had achieved an annualized return of 13.4%; contrasted to PERS, TRS, and PFC returns of 10.7%, 10.2%, and 9.3% respectively. The S&P 500 is an index that measures only equities traded on the exchanges. The PERS/TRS and PFC portfolios not only contain stocks but also bonds, other fixed income securities, and real estate. Additionally, PERS/TRS holds investments in foreign equities, whereas the S&P 500 reflects only domestic equity.

PERS/TRS and PFC may have achieved a return on its equity portfolio competitive to that of the S&P 500. However, fluctuations in bond, other fixed income, and real estate

investments may have affected the overall total portfolio rate of return. Therein lies the danger of relying solely on a comparison of fund performance to any one market index.

COST OF MANAGING AND INVESTING PERS/TRS AND PFC FUNDS

It has been alleged that the cost of administering the PERS/TRS Funds are "out of control" compared to the PFC. In reviewing the cost of administering the retirement funds versus the Permanent Fund the facts must again be kept in perspective and require closer scrutiny before drawing conclusions, similar to the closer analysis needed when comparing PERS/TRS and PFC rates of return.

The Department of Revenue, Treasury Division is responsible for, among other functions, the investment and management of the State of Alaska general investment fund; AHFC pledged fund; international airports construction fund; international airports revenue fund; state mortgage insurance fund; public employees' retirement trust fund; teachers' retirement trust fund; judicial retirement trust fund; military retirement trust fund; public school trust fund; and the University of Alaska trust fund. Also, the division is responsible for state cash management, debt management, and investment accounting.

By far the largest cost centers in the management of the PERS/TRS Funds are personal services (salaries) and contractual fees.

It has been alleged that it takes between 25-to-27 positions to manage the PERS/TRS Funds as compared to the PFC requiring 16 positions to manage their portfolio.

The 25-to-27 positions referred to above represents the total staffing of the Treasury Division. These positions do many tasks, as discussed above. Not all of those positions have duties related to the PERS/TRS Funds. We examined the job descriptions of employees in the Treasury Division and verified those descriptions with some employees through personal interviews. We also identified salary and benefits costs for each of the Treasury Division employees and for the division in total.

We have calculated that Treasury utilizes a full-time equivalent (FTE) staffing of 11.3 positions to manage, invest, and account for the PERS/TRS Funds in fiscal year 1988 at a cost of \$655,273. These positions are responsible for executive management, asset accounting, portfolio management, real estate investments, and cash management as it relates to the PERS/TRS Funds. This compares to the fiscal year 1988 PFC staffing of 16 positions at a cost of \$863,000.

Contractual fees comprise the largest cost of managing the PERS/TRS and PFC Funds. These costs consist of payments made for the services of professional money managers, external performance analysis, external auditors, consultants, and custody and safekeeping fees.

PERS/TRS fiscal year 1988 contractual payments amounted to \$4,841,564 compared to PFC expenditures of \$3,428,000. PERS/TRS incurs expenses that the PFC does not. PERS/TRS, being two separate funds, has increased costs for services such as investment processing, external auditors, and the external performance analysis. The retirement funds also incur additional costs due to PERS/TRS higher asset allocation to equities which, under an active investment strategy, necessitates additional trade costs and because PERS/TRS invests in foreign equities which require higher fees than does a domestic equity. PFC does not invest in the foreign markets, has a smaller asset allocation to domestic equity, and utilizes an index equity portfolio resulting in reduced management fees. As the PFC moves into the foreign markets and reevaluates asset allocation, one would expect to see an increase in their management fees.

The industry evaluates management and funds costs on a "basis point" system. A "basis point" reflects the cost to manage \$1,000. We performed a "basis point" cost evaluation of the PERS/TRS and PFC Funds, as follows:

	<u>PERS/TRS</u>	<u>PFC</u>
Personal Services	1.90	.88
Travel	.05	.15
Contractual	14.02	3.48
Other (capital outlay, communications, rent, depreciation)	.08	.67
<u>Total "Basis Point"</u> <u>cost per \$1,000</u>	<u>16.05</u>	<u>5.18</u>

As can be seen, the cost of PERS/TRS contractual is approximately four times that of the PFC. This reflects the additional costs PERS/TRS incurs due to its higher allocation to domestic equities, investment in foreign equities, the increased costs for identical services since these are two separate funds, and the economies of scale inherent in a large fund such as the PFC.

We do not feel a simple analysis with an allegation that PERS/TRS costs three times more to manage than the PFC is justified. A closer review shows valid reasons why PERS/TRS Funds are more expensive to manage than the PFC fund.

FINDINGS AND RECOMMENDATIONS

Recommendation No. 1

A Board of Trustees concept or structure should be established that has broad powers and can exercise an active role in the management and investment oversight of the PERS and TRS Funds.

At present, the PERS and TRS boards (nor any other body) have minimal, if any, investment and management oversight responsibility over the nearly \$3.5 billion of retirement fund assets invested and managed by Treasury. What little investment oversight authority the boards may have had was eliminated by amending legislation in 1987/1988.

Currently the PERS and TRS boards are mostly administrative in nature, handling the administrative aspects of the retirement systems. The boards have no authority to direct or establish investment policy or guidance nor do they have the ability to effectively object to a direction the funds may be heading and enforce an alternative.

We believe the State and other governmental employers, fund beneficiaries, and active participants would be better served by a restructuring of the current PERS and TRS boards and the process of reporting to those boards.

We conducted a survey of all states' public employees' and teachers' retirement systems and discovered that Alaska PERS and TRS Funds investment management oversight is severely lacking when compared to other larger, older, more experienced funds.

An overwhelming number of respondents to our survey have an investment oversight function that rests with an independent body apart from the investment activity itself. This oversight authority is vested in authoritative retirement boards, boards of trustees (ranging from 3 to 4 and up to 16 members), investment committees and councils (usually a subcommittee of a board of trustees), or a statewide investment commission or board. We believe a similar structure is warranted for the PERS and TRS Funds.

The PERS and TRS statutes should be rewritten to allow, and the boards should be restructured to accept, a new, stronger investment management oversight responsibility. We recommend that:

1. The current PERS and TRS boards be consolidated into one overall board of trustees. The board of trustees should be structured so that individuals with the necessary and appropriate expertise are appointed, as well as PERS and TRS beneficiaries and active participants. Additionally, Treasury officials and, barring

constitutional prohibitions, members of the legislature should be active participants on the board.

2. Subcommittees of the board of trustees could be established to handle the respective administrative duties of the PERS and TRS Funds.
3. The board of trustees should be vested with the authority to employ outside investment advisors to review investment policies and make recommendations; to establish investment policies; to engage the independent certified public accountants for the funds' audits and have results reported directly to the board; to contract with external performance evaluators who would report directly to the board; and to review Treasury investment and asset allocation decisions.

A Board of Trustees with overlapping and staggering appointments will also provide continuity from one administration to another. Retirement funds such as the PERS and TRS are perpetual in nature. They are considered to exist forever. As such, a continuity in management is required, one that can provide the historical perspective of past actions and effects. The nature of the political environment is quite opposite. Administrations come and go, as do the political appointees that make the decisions that affect the retirement funds. Presently, the commissioner of Revenue, an appointed position, is the fiduciary of the retirement funds. A political appointment of two or four years pales in comparison to the longevity of the retirement funds. A "changing of the guard" every two-to-four years does not provide the needed continuity in fund administration. An independent board of trustees, with oversight authority, would provide the needed oversight and continuity over these funds.

It has been argued that since the PERS and TRS Funds are designated as trusts and the commissioner of Revenue is designated fiduciary of the funds, that the boards cannot and will not accept the fiduciary responsibility of managing the funds.

In our discussions with PERS and TRS board chairpersons we learned that the boards do want to assume more investment oversight responsibility over the funds but at present do not have the statutory ability to do so.

It has also been stated that the boards would not accept the liability associated with acting as a fund fiduciary. According to the Division of Risk Management of the Department of Administration, the PERS and TRS boards are currently covered by the Directors and Officials liability protection policy. This coverage, in the amount of \$100 million (with a \$5 million self-insured clause), covers any board or

commission that is created by law and that the policy coverage would extend to any actions taken by the boards or commissions that are within its official duties. At present, the commissioner of Revenue, as fiduciary, is similarly covered by this policy. Additionally, the director of Risk Management stated that if the funds incur a loss due to a breach of fiduciary duty, the Directors and Officers liability insurance policy may make funds whole, depending on the circumstances, if the payments are a legal liability. Based on the above, it is our opinion that the insurance coverage presently available to the commissioner of Revenue is likewise available to the current PERS and TRS boards and would be available to a duly created board of trustees acting in the capacity of fund fiduciary.

Therefore, we recommend that the administration and the legislature establish a board of trustees concept or structure to provide investment oversight on the Treasury investment operations, particularly the PERS and TRS Funds. Some members of the board of trustees should have the necessary professional skills. Other members should represent fund beneficiaries, active fund members, the Treasury, and, barring constitutional prohibitions, the legislature. The board of trustees should have the authority to contract for audits, external performance evaluations, and professional advice. Additionally, the board of trustees should review on an ongoing basis Treasury's implementation of investment policy and asset allocations.

Recommendation No. 2

The entire portfolio of the PERS and TRS Funds should be subjected to an external performance review. Also, the external performance reports should be presented directly to the boards and should be in a complete, understandable, and acceptable format according to industry patterns and customs.

Presently, the PERS and TRS performance evaluation analyses conducted by an independent evaluation service do not review the entire retirement funds portfolios; are not in the usual and customary format; do not contain the usual and customary presentations; and do not compare the PERS and TRS Funds with an acceptably large enough universe of other funds.

We found it difficult to glean information on the PERS and TRS Funds operating results from the performance evaluation reports prepared by the external fund performance contractors. To assist us in understanding those performance reports, we contracted with the individual who had analyzed PERS and TRS Fund performance in the past.

Our contractor had similar difficulty in understanding the performance reports as presented. We subsequently discovered that the difficulty in understanding the reports and

determining fund performance lied not with the reader, but with the unconventional format that the PERS and TRS Funds results were presented.

According to representatives of SEI (Treasury's performance reporting contractor) the State's chief investment officer had instructed SEI to prepare the performance reports according to his own design. This format per our contractor causes confusion and difficulty in analyzing fund results. It is interesting that even SEI, the firm who prepared the reports according to Treasury's custom design, finds them difficult to understand. If people knowledgeable in this area find the performance reports difficult to read and analyze, we wonder how members of the PERS and TRS boards and interested beneficiaries and active participants can determine how their funds are performing.

Another area that our contractor found unique was the abbreviated form of the performance reports. The reports do not include a number of standard comparisons, analyses, and graphic presentations. These presentations assist in understanding the fund performance and how they compare to other funds. For example, the performance reports have no presentations of asset growth summaries; total plan rates of return; cumulative rates of return for market cycles (falling markets and rising markets); reward versus risk analysis; equity and bond purchases and sales turnover analysis; equity portfolio profiles (showing capitalization of investees, dividend yields, price/earning ratios, return on net worth, earnings growth rates, market/book ratios); diversification and rate of return by industry sectors; and other graphic and numerical presentations. It is argued that this type of information is of little value in establishing investment policy and asset allocation. However, all these analyses combined assist in formulating an informed judgement as to how the retirement funds are performing by interested parties other than those responsible for investment policy and asset allocation. These analyses, and many others, are used by the Permanent Fund Corporation Board of Trustees to review the performance of the Permanent Fund. These types of analyses are not report cards on a fund, but rather a presentation of how one particular fund is performing compared to other funds competing for a return on investment.

Other areas of the PERS and TRS performance reports identified as lacking are that a total plan analysis is not performed on the entire portfolio and that the universe of funds used for performance comparison is too limited.

The major benefit of an external performance evaluation is the identification of how one particular fund is performing and how it compares to other funds (known as the "fund universe"). To have a thorough evaluation/comparison, the

entire portfolio must be externally evaluated. Presently, the PERS and TRS portfolio does not have an externally generated total plan rate of return analysis because the funds' real estate investments and foreign investments are not taken into consideration. Most respondents to our survey indicate their entire portfolios are externally evaluated. Most of those funds also have investments in equities, fixed income, some foreign investments, real estate, mortgages, leveraged buyouts, and venture capital.

The PERS and TRS Funds are compared to a fund universe consisting of only 28 other funds. This contrasts to the Permanent Fund's evaluation which compares itself to a balanced fund population (where the funds have at least 5% invested in equities and 5% in bonds) of 910 funds and a Large Plan Report of 63 funds. We believe the PERS and TRS Funds comparison is too restrictive and should be enlarged. Comparing fund performance to a larger fund universe would provide a better indication of how the PERS and TRS Retirement Funds are performing compared to other funds.

We recommend that the entire PERS and TRS Funds be externally evaluated thereby generating a total plan rate of return; that the evaluations be performed and reported in the standard informative formats with all appropriate graphic and numerical presentations; that these reports should be presented directly to the boards; and that the PERS and TRS Funds be compared against an acceptable fund universe.

The boards and/or Treasury should provide as much information as possible to the beneficiaries, active members, executive and Legislative branches, and the public that is clear and direct. By doing so, it would enhance public accountability.

Recommendation No. 3

The Department of Revenue, Treasury Division (Treasury) should follow generally accepted accounting principles in its accounting of investments for the Public Employees' Retirement System (PERS) and the Teachers' Retirement System (TRS) Funds.

Treasury does not account for PERS and TRS foreign equity investments in accordance with industry generally accepted accounting principles.

The term "generally accepted accounting principles" (GAAP) as used in reporting results of operations on the financial statements refers to a body of theory and practice developed by the accounting profession in association with industry and other organizations that may be impacted by the adoption of standards which include not only accounting principles and practices but also the methods of applying them. GAAP

is a technical accounting term encompassing a common set of accounting concepts, standards, and procedures necessary in order to render financial statements comparable between enterprises and between accounting periods. Without adherence to GAAP, users of financial statements would have no uniform standard for judging the presentation of financial position, results of operations, and changes in financial position in those financial statements.

A user of financial statements expects those statements to present fairly, clearly, and completely the economic facts of the existence and operation of an enterprise on a consistent and comparable basis. A departure from GAAP results in financial statements that may not meet the user's criteria and will generally result in a qualified auditor's opinion disclosing the departure and what effect that departure has on the financial statements. Treasury realizes the importance of an unqualified audit opinion. Treasury, in Appendix J of its General Investment Policies, requires an applicant for commercial real estate loans to submit audited financial statements that contain unqualified audit opinions. The presentation of PERS and TRS financial statements by Treasury are departures from GAAP.

Treasury does not properly account for and report investment transactions occurring in the PERS and TRS foreign investment portfolio. Treasury did properly account for and report on its foreign portfolio activities through fiscal year 1987; however, in fiscal year 1988, a departure from GAAP was made, with which we do not agree is appropriate or justifiable.

An important element of a financial statement, and a framework of modern accounting, is the presentation of the historical cost of assets, including investments.

Treasury forwards funds to its London-based foreign managers. These managers then invest in foreign equities. The amount of the funds transferred to the foreign managers is recorded as the cost of the PERS and TRS investment in foreign equities. When the foreign equities are subsequently sold by the foreign managers, the amount received from the sale, which may include a gain on the sale, is usually reinvested in foreign equities. Contrary to GAAP, the reinvestment of proceeds from the sale of the equities are not recorded in the accounting records and the cost basis of the foreign portfolio is not adjusted to properly reflect the new cost basis of the retirement funds' investments. This accounting treatment was implemented over the initial written objections of the state comptroller. The sale, gain, and reinvestment of funds should be accrued and recorded in the accounting records at the date of the transaction in accordance with generally accepted accounting principles.

This irregular accounting treatment causes a material understatement of the cost basis that PERS and TRS has invested in foreign equity holdings. The understated cost as presented in the PERS and TRS financial statements is misleading to the average reader who is not aware of the non-GAAP accounting treatment accorded these transactions by Treasury.

In their June 30, 1988 balance sheet, Treasury shows the cost and market value of PERS and TRS foreign portfolio as follows:

	<u>Cost</u>	<u>Market Value</u>
PERS	\$77,847,000	\$138,421,000
TRS	51,756,000	91,246,000

At first glance, a reader of the financial statements would think that PERS and TRS had generated a \$60,574,000 and \$39,490,000 (respectively) market gain.

However, had GAAP been applied to the accounting of the foreign portfolio, cost and market value would have been presented as follows:

	<u>Cost</u>	<u>Market Value</u>
PERS	\$134,626,000	\$138,421,000
TRS	88,711,000	91,246,000

Under GAAP, foreign portfolio market gains for the PERS and TRS Funds would have been \$3,795,000 and \$2,535,000, respectively. As reflected in the financial statements, PERS and TRS market gains are overstated by approximately 1,500 percent.

The Treasury Division, chief investment officer has stated that this accounting treatment is necessary because of "investment accounting principles," "fiduciary law," and "the IRS code." None of those references, even if they do address this issue, override GAAP and Alaska state law in these circumstances.

Alaska Statute 37.05.150 states, in part, "The accounting system must be in accordance with accepted principles of governmental (fund) accounting" Generally accepted governmental accounting principles are embodied in the Governmental Accounting, Auditing, and Financial Reporting publication prepared by the Government Finance Officers Association. In this handbook of governmental accounting, the jurisdiction of the Governmental Accounting Standards Board (GASB) is defined as "The GASB will establish standards for activities and transactions of state and local governmental entities" The handbook further defines

the hierarchy of GAAP for financial statements issued by state and local governmental units. This hierarchy is:

1. Pronouncements of the GASB are to be followed for accounting and reporting by state and local governmental units.
2. In the absence of a GASB pronouncement regarding accounting treatment, pronouncements of the Financial Accounting Standards Board (FASB) are to be followed.
3. Pronouncements of bodies composed of expert accountants that follow a due process procedure. This category includes audit and accounting guides and statements of position issued by the American Institute of Certified Public Accountants.
4. Practices or pronouncements that are widely recognized as being generally accepted because they represent prevalent practice in a particular industry or the knowledgeable application of pronouncements to specific circumstances.

Since GASB is silent regarding the treatment of foreign investments, pronouncements of the FASB must be followed. In this case, generally accepted accounting principles established by the FASB, and its predecessor the Accounting Principles Board, should be followed by the Treasury Division.

We recommend that Treasury account for and report on the PERS and TRS Funds, including its foreign portfolio activity, in accordance with generally accepted accounting principles.

STATE OF ALASKA

STEVE COWPER, GOVERNOR

DEPARTMENT OF REVENUE

TREASURY DIVISION

ELEVENTH FLOOR
STATE OFFICE BUILDING
P.O. BOX 58
JUNEAU, ALASKA 99811-0400

August 22, 1989

Randy S. Welker, CPA
Legislative Auditor
Division of Legislative Audit
P. O. Box W
Juneau, Alaska 99811-3300

RECEIVED
AUG 23 1989

LEGISLATIVE
AUDIT

Dear Mr. Welker:

I have reviewed the Division of Legislative Audit's preliminary report entitled "A Special Report on the Department of Revenue Treasury Division Public Employees' and Teachers' Retirement Funds".

At your request, I offer the following comments:

1. With regard to the discussion of realized returns on page eleven, I would like to point out:
 - a. The Financial Analysts Federation has endorsed the enclosed "Performance Presentation Standards". These standards are the first and only such standards in the industry for guidance on how to calculate and report investment performance. Section V.B. specifies that the use of total return, including income and capital appreciation, is mandatory in the presentation of investment performance data. Realized rates-of-return, as pointed out in your report, do not include unrealized capital appreciation.
 - b. Realized returns are relevant for a fund which has net cash flow requirements during the period being measured; in the case of retirement funds, a net cash flow from investments is not estimated by the funds' actuary to be required generally before FY 2005. See the enclosed "PERS and TRS Financial Projections", February 21, 1989, Mercer Meidinger Hansen. Sensitivity analyses in the projections indicate there may be some chance that a small portion of TRS investment earnings (no more than one-tenth) will be needed as cash to cover benefit payments after FY 1991;
 - c. The timing of actual realization of unrealized gains is at a fund manager's discretion and may be affected by a fund's cash flow requirements. Thus, realized returns may reflect not only investment policy, as shaped by cash flow requirements, and a portion of investment returns, but also asset liquidation decisions prompted by cash flow needs.

2. On page 12, as your report points out, there are difficulties in comparing total fund returns to market indices for individual classes of investments. The most appropriate comparison would be to an average of the relevant indices weighted by the asset allocations of a fund. This would be similar to the approach prescribed by the Financial Analysts Federation in section V.I.6.a. of their "Performance Presentation Standards" (enclosed) for comparing results of balanced accounts managed by investment advisors.
3. I am in basic agreement with Recommendation No. 1. There are obviously many issues to be considered in trying to develop the best possible structure for governance of PERS and TRS investment management. The Department of Revenue would be happy to work with Legislative members or bodies in developing legislation to reform the structure.

To address these same concerns, the Department has developed a proposal to create an independent trust company. The proposed structure would provide for the investment management of other State retirement and endowment trust funds, as well as PERS and TRS. It also would greatly improve State cash management procedures by allowing direct access to certain Federal Reserve System services, rather than through an intermediary custodian bank.

The Department's proposal has been endorsed by resolutions of the PERS and TRS boards and has been reviewed by the State's fiduciary counsel, Willkie, Farr & Gallagher.

There is one issue addressed in your report to which I should respond. The discussion of liability for fiduciary acts on page 17 does not take account of AS 37.10.071(d) and (e) which make fiduciaries personally liable and extends state indemnification of their liability only insofar as their actions are prudent, even though insurance would cover all fiduciary acts whether prudent or not. These statutory provisions were adopted to assure the most careful adherence by fiduciaries to the dictates of prudence. I do not concur with the suggestion that board members be allowed to avail themselves of the State's insurance coverage of liability for fiduciary acts when those acts fail to meet the statutory standard of professional prudence contained in AS 37.10.071(c).

4. I am in agreement with portions of Recommendation No. 2. My specific comments are:
 - a. I agree that performance reports should cover the total fund and include cumulative rates-of-return, a reward versus risk analysis, and relevant graphics. The Department has awarded a new contract for outside performance measurement services that includes such information. The first reports under the new contract will be available following the end of the first quarter of fiscal year 1990.

- b. I do not feel that other detailed analyses, mostly of individual manager portfolios, recommended in your report are useful either in establishing investment policy and asset allocations or evaluating manager or fund performance. Performance measurement data needs to be confined to comparative information that focuses on the bottom line -- rates-of-return -- and the critical policy variables -- asset allocation, bond maturity, and bond quality -- that contribute to it. The worst thing to do, if trying to ensure accountability, is to inundate fiduciaries with so much data that they can't see the forest for the trees or have time to adequately review the more critical information.
- c. If there are particular problems with the format of the report, the audit should identify them and I would be happy to consider changes. As part of the new performance measurement contract the Department will obtain any specific suggestions the contractor has for revising the format. However, the Department will not relieve the contractor of the obligation of supplying the reports in the format specified by the Department if revisions to the format decrease the report's intelligibility or appear to be for the convenience of the contractor. There is no industry standard for most of the presentations in these reports, the only possible exception being certain basic information set out in Tables I and II of the enclosed "Performance Presentation Standards" which no firm has yet adopted. Various performance measurement firms have various formats. Each has its own "standard" format and is reluctant to provide custom reports as required by the Department due to the extra time and expense involved.
- d. I agree that comparing performance to a larger universe is desirable, provided that, as your report stresses in several other places, the comparisons are meaningful. Under the circumstances it is not clear that the contractor can provide any larger universe that would be meaningful. The contractor, SEI Corporation, had the largest universes specified by the Department of the two firms responding to the RFP for these services. As part of the new contract, the Department will obtain the advice of the contractor on whether the universes can be meaningfully expanded.

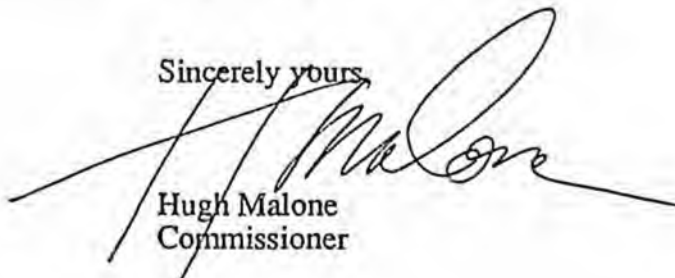
The PERS and TRS funds are compared to two universes consisting of pension funds over \$500 million -- one State pension funds, the other corporate. These universes were established to provide more meaningful comparisons than a universe including many small pension plans. Small plans for the most part operate under more restrictive constraints, have less diversification into the various asset classes represented in PERS and TRS, and are less likely to have professional management. As pointed out on page 5 of your report, similarity in objectives, constraints, opportunities, and resources are critical to achieving valid comparisons.

Randy S. Welker, CPA
August 22, 1989
Page 4

Not unexpectedly, larger plans generally seem to have superior investment returns as indicated by the enclosed "EXHIBIT 7" prepared by SEI. The segregation of corporate and state plans is useful because their significant difference in asset allocations to equities, which results in significantly higher returns for corporate plans, focuses attention on this critical policy variable.

5. The Department will comply with Recommendation 3, beginning with its audited financial statements for fiscal year 1989. However, I would like to make three comments:
 - a. The statements on page 19 and 20 that Treasury does not account for foreign equity investments properly or in accordance with generally accepted accounting principles are overly broad. Treasury does account for foreign equity investments in accordance with generally accepted accounting principles, with the exception of its treatment of historical cost and the point of realization of foreign gains or losses. Treasury's statement of market value and total investment income for foreign equities is in accordance with generally accepted accounting principles. As stated by Ernst & Whinney in their annual audit of Treasury investments, the "differences would have no effect on total investment income".
 - b. The departure from GAAP and its effects are fully disclosed in Treasury's financial statements. Your report should acknowledge this. The statement on page 20 that "A departure from GAAP...will generally result in a qualified auditor's opinion disclosing the departure and what effect that departure has on the financial statements." may leave the reader with the impression that Treasury did not make this disclosure.
 - c. The departure from GAAP was based on consideration of a number of issues. These issues were fully discussed by Treasury staff and its independent auditors. The decision was personally reviewed by me. The issues are summarized in the enclosed memo of November 1, 1988. The report's failure to address the issues contained in the memo, which was provided to Legislative Audit, and its failure to acknowledge the Department's review of the issue may leave the reader with the impression that the departure was made arbitrarily or capriciously. In fact, the issues involved are very "close" as to what is the best accounting treatment. This is reflected in the fact that FASB-52, which is the accounting principle at issue here, was highly controversial and was adopted by the Financial Accounting Standards Board only by a 4-3 vote.

Sincerely yours,



Hugh Malone
Commissioner

HM/MBB/ph

encls.

PERFORMANCE PRESENTATION STANDARDS

Presented by the Committee for
Performance Presentation Standards

Claude Rosenberg, Jr., Chairman
R.H. Jeffrey
Robert Kirby
Dean LeBaron
John J.F. Sherrerd

Endorsed by the
Financial Analysts Federation

January 12, 1989

I. The FAF has endorsed the following standards for investment management performance presentation. Up to now, this all-important subject has been given insufficient attention; as a result, investment advisers (despite registration with the SEC) have been left to follow their own standards, which have been varied, uneven, and, in some instances, outright irresponsible and dishonest. If the investing public is to be treated fairly, and if the investment management industry is to represent the highest ethical and moral standards, a fair and understandable policy should be followed. The standards recommended earlier have been endorsed by the FAF Board of Directors after consideration of comments from its membership (which includes investment advisers, brokers, consultants, academicians and other interested parties).

II. The overall philosophy underlying these standards is the need for full disclosure of investment performance data to clients and client prospects. Certain statistics and presentation data have been delineated as requirements; but the main theme is that investment managers may present any reasonable statistics provided that their derivation, and particularly any exclusions therefrom, are highlighted and made abundantly clear.

III. Parties affected by these standards.

These standards are directed to "investment managers," which obviously includes all registered investment advisers, but the

standards also apply to other organizations and individuals, such as:

A. Stock brokers acting as "portfolio managers" for clients, particularly those who charge separate (from normal commissions) fees for their management services.

B. Mutual funds, where certain regulatory presentation practices can be deceptive (but which exist under different jurisdictions).

C. Consultants, where it is recommended that similar standards be set by a separate FAF Committee.

IV. While clients and client prospects are encouraged to make extensive qualitative judgments of investment managers, these FAF guidelines concentrate on the quantitative—on a complete, accurate and fair presentation of investment performance data.

V. Performance Calculation.

A. Time-weighted performance calculation is the mandatory methodology, since it represents the only practical method for comparing manager results over time.

B. Total return, including income and capital appreciation, is also mandatory.

V. Performance Calculation (Continued)

C. *To allow for the most efficient judgment of manager efficiency and client investment returns, results should be presented before fees so long as the manager's fee schedule is included with performance presentation.*

D. *Managers and new clients should agree in advance on the starting date for performance calculation.*

1. *This starting date should be part of the Management Agreement and calculations should conform to such agreed-to date.*

2. *Since the precise starting date for managed funds is not always definite (due to legal problems, delay of receipt of funds, etc.), it is recommended that a specified period (i.e., 30 days after funds have become available for investment) be set as inception for performance calculation. Again, the time period will vary from manager to manager, dependent on manager style or client preference; but agreement in advance between manager and new client eliminates potential confusion and sets a consistent standard.*

E. *Computational Standards.*

1. *Portfolios should be valued at least quarterly. Monthly valuation (and linking) is the preferred frequency where practical.*

2. *A time-weighted return formula which minimizes the effect of contributions and withdrawals must be utilized. Daily accounting for contributions and withdrawals is the preferred method.*

3. *When a contribution (or withdrawal) is significant (e.g., over 10%) in relation to the latest calculation of market value, a portfolio is best revalued on the date of the contribution (or withdrawal) in order to reduce possible distortion.*

4. *Investment income should be included on a full accrual basis (as opposed to cash basis).*

F. *Performance results for any one asset class (such as equities) should include cash equivalents and any other securities (e.g., convertible securities in an equity portfolio) held by the manager in place of that asset.*

V. Performance Calculation, Paragraph F.
(Continued)

1. If managers present performance results for any particular asset class excluding cash or other securities used by the manager in place of the asset class, performance with cash and the other securities should likewise be presented along with a statement that results so presented conform to FAF standards.

G. Compound annualized performance returns should be presented for all periods covered in presentation.

H. Exclusions from account performance calculations and presentation should be clearly stated.

1. Complete information on inclusions and exclusions of data should be presented, as per attached Tables I and II.

a. Managers should provide the percentages of their inclusions and exclusions to prospects. Thus, if the presented data constitutes 85% of the asset class (e.g., equities) managed, with 15% excluded, this should be so stated. If the presented data constitutes 50% of a particular type of in-

vesting within that asset class (e.g., small-to-medium capitalization equities), this should also be stated.

b. Examples of such exclusions might include:

Special category investments, such as assets not carrying full discretionary power within a manager's business in which other accounts are normally discretionary.

Client assets not being charged a fee, within a manager's business which is normally fee-based. As indicated throughout Section VIII., the performance of all fee-based accounts should be accounted for in manager measurement and presentation.

I. *Balanced accounts.*

1. *Balanced accounts, with both equity and fixed income assets, should be separated into two distinct equity and fixed income categories. Each such category should be assigned its own cash balances so that the performance of each*

V. Performance Calculation, Paragraph I.
Number 1. (Continued)

investment class will include returns specifically reflecting the use of cash equivalents and other substitutions. While managers may be able to supply sufficient risk and volatility information on each investment class to allow clients to make a reasonable judgment of results as if cash had been included, the information content from the separation of balanced portfolios into distinct asset "pots" (each with its own cash equivalent or substitute holdings) is too valuable to leave to manager choice.

2. Assuming that the balanced account manager's assignment from the client is to periodically change the asset mix, managers altering the ratios between equities and fixed income should make bookkeeping transfers of cash from one category to the other. Accounting for such transfers should, of course, be based on the specific cash transfer dates.

3. Performance results from balanced accounts should, therefore, include the following:

a. Equities, including cash or substitute securities designated for potential investment in equities.

b. Fixed income, including cash or substitute securities designated for potential investment in fixed income.

c. Total account.

4. 3.a. and 3.b. results should be compared against their respective, comparable indexes, as if they were separate equity and fixed income accounts.

5. While separating the parts of a balanced account as recommended provides valuable insights into the capabilities of managers in each distinct asset class, the most significant performance criterion is still the combined, total account results.

6. Results for the total account are best compared against equity and fixed income proportions that reflect client objectives/guidelines; these proportions should be agreed to in advance by client and manager.

a. Comparative performance should then be calculated by apportioning the returns from each of the indexes chosen to represent each asset class to the agreed-to

V. Performance Calculation, Paragraph I. Number 6. (Continued)

percentage bogey for that asset class. Assume, therefore, that client and manager have agreed to a balanced account risk posture of 60% equities and 40% fixed income. The comparative indexes used for equities (assume the S&P 500) should be weighted at 60%, while the appropriate fixed-income indexes (assume the Shearson/Lehman Corporate/ Govt. Index) should be weighted at 40%, producing a number against which the total account performance return should be compared.

J. *In addition to actual results, performance for accounts utilizing leverage should be calculated and presented as if they had been made for all-cash (no leverage).*

VI. *Indexes used for performance comparisons.*

A. *Managers should explain in advance any indexes used for performance comparisons to clients and prospects. These indexes should parallel the risk or investment styles the client account is expected to track.*

B. *Comparisons with specific measures (e.g., real returns adjusted for inflation, riskless returns from T-Bills, etc.) may be used so long as FAF standards on other factors, as presented herein, are followed.*

VII. *Treatment of convertible securities.*

A. *Convertible securities should normally be included in equity performance, unless manager and client agree in advance to their inclusion in fixed income. If convertibles are subsequently shifted from equity segments to fixed income, or vice versa, clients should be notified at the time of such shifting.*

VIII. *Formation and presentation of composite performance results by managers.*

A. *All managers should construct and present accurate composites of investment performance. Rules for such composites include:*

1. *Managers should compile and present such results for as long a period of time as accurate accounting can be accomplished, no less than 10 years if possible and up to 20 if practical.*

2. *Management organizations in business for less than 20 years should include results from the very first full calendar year since their inception.*

VIII. Formation and presentation of composite performance results by managers, Paragraph A.
(Continued)

3. Each and every year of such results should be presented to prospective clients, unless specific requests are for different periods.

4. Results presented to client prospects should be shown both for individual years and cumulative periods, as indicated in attached Table I.

5. All client accounts should be included for whatever period such accounts were under management; portions of periods under management (i.e., managers choosing inclusion of portions) is prohibited.

6. Clients' accounts no longer under management should be included in composite(s). So-called "survivor" performance results are to be avoided.

7. Changes in a manager firm's organization should not lead to an altering of composite results. Results achieved by an organization are the organization's responsibility; changes in personnel do not constitute a justifiable reason to alter composite performance results.

8. Managers are encouraged to construct separate composites where valid reasons exist for doing so. A differentiation between taxable versus nontaxable accounts; fully discretionary versus not-fully-discretionary; and other categories which entail varied investment styles, controls, or risks constitute valid reasons for separate composites. As indicated in Paragraph 9.d. below, however, managers should list all of their composites, with performance figures and other pertinent information on each, whenever performance results are presented. Any and all exclusions from any presentation of performance results should be clearly stated.

9. Composite performance calculation and presentation should be weighted by account sizes. A median of unweighted results may also be presented, but this should be accompanied by results weighted by account size, along with the statement that the latter is the recommended procedure as set by the FAF.

VIII. Formation and presentation of composite performance results by managers, Paragraph A, Number 9. (Continued)

Managers should also clearly delineate the following:

- a. The number of client relationships included in each (and all) composite(s);*
 - b. The total size of the composite for the beginning (January 1) and end of each year;*
 - c. The weighted average size of accounts constituting the composite.*
 - d. As indicated above, information on all excluded assets from any composite presentation should be presented.*
- 10. Fixed income and equity portions of balanced accounts should be included in their respective equity and fixed income composites, provided they conform to Section V., Paragraph I. above on balanced account calculations.*
 - 11. Balanced account composites should include only those accounts where the manager has*

discretion over changes from one asset to another. If the client has set balanced limits from which the manager should not deviate, the segregated assets (with their respective cash positions) should be included only with their like asset composite. (Example: Client gives Manager \$6 million for bond management and \$4 million for stock management, with no changes in mix to be made by Manager. The \$6 million should be added to the Manager's bond composite and \$4 million added to Manager's stock composite—nothing to be included in Manager's balanced account composite.)

12. Since performance results will be reported to clients along with either actual or average fee information (See Section V., Paragraph C.), composite figures should likewise contain sufficient information to enable clients and prospects to compute performance on both a pre- and post-fee basis.

13. Managers should indicate typical indexes against which any and all composites are normally judged by respective clients. Thus, a manager's equity composite which includes accounts with both large and small capitalization equities of comparable weighted size

VIII. Formation and presentation of composite performance results by managers, Paragraph A. Number 13. (Continued)

to the S&P 500 should be compared against the S&P 500, while a small-to-medium capitalization stock composite should be compared against NASDAQ, Russell 3000, etc. An account with, for example, 50% of its total in small-to-medium capitalization stocks and 50% in large capitalization stocks should be compared against similar-weighted separate indexes, rather than against either one of the two.

14. *Composites should follow the same treatment of returns with and without cash as indicated in Section V., Paragraph F.*

15. *Presentation of risk measurements such as Alpha, Beta and Standard deviation for individual account returns within any composite is encouraged.*

16. *Other pertinent information for use in performance analysis should be added to composite presentations. For example, managers are encouraged to include (for each period) average market capitalization of stocks held, average quality and duration of bond holdings, etc.*

B. *Table II provides a sample recommended format for composite performance presentation to client prospects and consultants. Table II should accompany the specific performance results as presented in Table I.*

IX. Verification of composites.

A. *Audited composite and other performance figures are encouraged. At the very least, managers presenting performance data should make a positive written statement that full disclosure of assets included and excluded has been made and that calculations conform to FAF standards. Any deviations from these FAF standards should be specifically stated.*

B. *The principles of these FAF performance presentation standards should apply to all individuals and organizations serving investment management functions. Consultants are likewise encouraged to adopt similar standards and principles in reporting performance data.*

X. *Table III is a checklist for managers and clients—to assure proper conformance to the standards presented above.*

TABLE I

XYZ Capital Management: Actual and Annualized Equity Performance Versus S&P 500
 Category of Accounts: Tax-Exempt Client Portfolios
 Annualized Percentage Returns for N Years Through Year X

Year	Standard Deviation ⁽⁹⁾	Actual Return (%)	2 Yrs.	3 Yrs.	4 Yrs.	5 Yrs.	6 Yrs.	7 Yrs.	8 Yrs.	9 Yrs.	10 Yrs.	11 Yrs.	12 Yrs.	13 Yrs.	14 Yrs.	15 Yrs.	16 Yrs.	17 Yrs.
'87	1.2%	10.72 5.24	14.30 11.75	19.80 18.05	15.51 15.06	16.07 16.47	17.47 17.30	14.28 13.82	17.58 16.00	18.19 16.29	17.39 15.28	15.06 13.03	15.08 13.90	15.44 15.55	12.75 11.88	10.78 9.88	13.25 10.42	12.25 10.65
'86	3.0%	17.99 18.67	24.62 25.04	17.15 18.45	17.44 19.46	18.87 19.87	14.89 15.33	18.59 17.62	19.16 17.75	18.15 16.45	15.51 13.84	15.48 14.73	15.84 16.45	12.91 12.41	10.79 10.21	11.84 10.78	12.35 11.00	
'85	1.9%	31.61 31.75	16.73 18.34	17.26 19.72	19.09 20.18	14.28 14.66	18.70 17.45	19.32 17.61	18.17 16.18	15.23 13.32	15.24 14.34	15.64 16.25	12.50 11.90	10.25 9.59	11.41 10.24	11.99 10.50		
'84	3.0%	3.54 6.29	10.68 14.13	15.18 16.55	10.31 10.75	16.27 14.78	17.40 15.42	16.36 14.11	13.34 11.21	13.55 12.55	14.17 14.31	10.91 10.25	8.64 7.92	9.99 8.73	10.70 9.12			
'83	2.8%	18.32 22.55	21.49 22.05	12.67 12.28	19.69 17.01	20.38 17.34	18.66 15.48	14.80 11.92	14.86 13.36	15.40 15.79	11.67 10.66	9.11 8.07	10.55 8.94	11.27 9.34				
'82	6.8%	24.75 21.54	9.94 7.47	20.15 15.21	20.90 16.07	18.72 14.11	14.24 10.25	14.27 12.10	15.04 14.98	10.95 9.41	8.23 6.72	9.87 7.78	10.70 8.31					
'81	3.5%	- 3.10 - 4.97	17.92 12.18	19.65 14.29	17.26 12.32	12.24 8.12	12.74 10.61	13.72 14.06	9.34 7.98	6.54 5.19	8.48 6.49	9.51 7.18						
'80	4.4%	43.50 32.42	32.96 25.35	24.95 18.75	16.44 11.66	16.20 14.02	16.80 17.60	11.24 9.96	7.81 6.53	9.85 7.85	10.86 8.48							
'79	3.1%	23.19 18.65	16.60 12.46	8.61 5.29	10.23 9.83	12.08 14.83	6.63 6.61	3.49 3.27	6.24 5.12	7.72 6.10								
'78	2.4%	10.37 6.59	1.98 - 0.53	6.22 7.04	9.47 13.90	3.59 4.36	0.53 0.91	4.02 3.31	5.93 4.63									
'77	2.4%	- 5.77 - 7.17	4.21 7.26	9.17 16.44	1.96 3.80	-1.33 -0.19	2.99 2.78	5.31 4.35										
'76	2.5%	15.24 23.94	17.51 30.42	4.67 7.74	- 0.19 1.64	4.84 4.89	7.29 6.40											
'75	2.9%	19.82 37.23	- 0.24 0.46	- 4.85 - 4.87	2.39 0.60	5.76 3.21												
'74	3.0%	-16.94 -26.46	-15.21 -20.80	-2.83 - 9.28	2.51 - 3.89													
'73	2.7%	-13.45 -14.69	5.10 0.75	9.96 5.08														
'72	3.2%	27.62 19.00	23.94 16.62															
'71	3.1%	20.37 14.30																

XYZ CAPITAL MANAGEMENT COMPOSITE
 OF ALL CLIENTS (HOLD)

S&P 500 INDEX

Characteristic Line⁽¹⁰⁾

Beta = .89

Annual Alpha = +2.6%

R² = 90.3%

This performance presentation of XYZ Capital Management conforms to the standards set by the Financial Analysts Federation (standards dated 1988).

In addition to the information presented herein, such standards include:

- 1) Returns from all cash reserves and equivalents and/or bonds used by the manager in place of equities are included in performance calculations.
- 2) Figures include accounts under our management from their respective inception dates, including those clients no longer with the firm.
- 3) No selective periods of performance have been utilized. Results from all accounts have been continuous from their inception to the present or to the cessation of the client relationship with the firm.
- 4) The composite calculation has been appropriately weighted for the size of each account.
- 5) Results are presented before management and related custodial fees. XYZ Capital fee schedule is attached.
- 6) Convertible securities have been included in these equity results.
- 7) No alterations of composites as presented here have occurred due to changes in personnel or other reasons at any time.
- 8) The figures have been audited as of 3/3/88 (statement attached).
- 9) Approximately two-thirds of all portfolios had returns equal to the composite "actual return" +/- one standard deviation.
- 10) The characteristic line is a regression of manager composite performance versus S&P 500 over the full performance history (17 years).

VIII. Formation and presentation of composite performance results by managers, Paragraph A. Number 13. (Continued)

to the S&P 500 should be compared against the S&P 500, while a small-to-medium capitalization stock composite should be compared against NASDAQ, Russell 3000, etc. An account with, for example, 50% of its total in small-to-medium capitalization stocks and 50% in large capitalization stocks should be compared against similar-weighted separate indexes, rather than against either one of the two.

14. *Composites should follow the same treatment of returns with and without cash as indicated in Section V., Paragraph F.*

15. *Presentation of risk measurements such as Alpha, Beta and Standard deviation for individual account returns within any composite is encouraged.*

16. *Other pertinent information for use in performance analysis should be added to composite presentations. For example, managers are encouraged to include (for each period) average market capitalization of stocks held, average quality and duration of bond holdings, etc.*

B. *Table II provides a sample recommended format for composite performance presentation to client prospects and consultants. Table II should accompany the specific performance results as presented in Table I.*

IX. Verification of composites.

A. *Audited composite and other performance figures are encouraged. At the very least, managers presenting performance data should make a positive written statement that full disclosure of assets included and excluded has been made and that calculations conform to FAF standards. Any deviations from these FAF standards should be specifically stated.*

B. *The principles of these FAF performance presentation standards should apply to all individuals and organizations serving investment management functions. Consultants are likewise encouraged to adopt similar standards and principles in reporting performance data.*

X. *Table III is a checklist for managers and clients—to assure proper conformance to the standards presented above.*

TABLE II

XYZ Capital Management Equity Account Summary Category: Tax-Exempt Client Portfolios

Year	Composite Assets (\$000)		% Equiv. Equity Assets ⁽⁹⁾	% XYZ's Total Equities Managed	# of Clients	Average Account Size (\$000)	Median Account Size (\$000)
	Beg. Yr.	Yr. End					
1987	5,506,550	5,881,173	100%	96%	65	80,580	40,813
1986	4,456,012	5,506,550	100	90	62	77,557	28,726
1985	3,463,639	4,464,521	100	92	57	65,655	38,975
1984	3,253,627	3,439,790	100	93	55	52,118	25,926
1983	2,486,902	3,253,627	100	91	56	48,562	20,608
1982	1,840,726	2,480,485	100	89	52	42,042	20,933
1981	1,749,541	1,840,726	100	90	51	31,737	19,262
1980	1,133,875	1,749,541	100	91	45	35,705	26,285
1979	850,993	1,133,875	100	92	42	23,622	12,882
1978	645,561	850,993	100	90	41	18,500	11,268
1977	677,257	645,561	100	85	42	14,345	7,510
1976	540,736	677,257	100	87	44	13,822	7,588
1975	343,959	540,736	100	88	43	11,265	6,058
1974	317,764	343,959	100	90	40	8,000	4,801
1973	179,007	317,764	100	98	33	8,362	6,795
1972	78,626	179,007	100	98	21	7,459	1,997
1971	28,205	78,626	100	98	14	4,914	927

This composite presentation of XYZ Capital Management conforms to the standards set by the Financial Analysts Federation (standards dated ,19). In addition to the information presented herein, such standards include:

- 1) All cash reserves and equivalents and/or bonds used by the manager in place of equities are included in composite presentations.
- 2) Figures include accounts under our management from their respective inception dates, including those clients no longer with the firm.
- 3) No selective periods for presentation have been utilized. Data from all accounts have been continuous from their inception to the present or to the cessation of the client relationship with the firm.
- 4) The composite calculation has been appropriately weighted for the size of each account.
- 5) Results are presented before management and related custodial fees. The average fee charged for each period appears in the presentation.
- 6) Convertible securities have been included in these equity composites.
- 7) No alterations of composites as presented here have occurred due to changes in personnel or other reasons at any time.
- 8) The data have been audited as of 3/3/88 (statement attached).
- 9) Percentage of "equivalent" equity assets means the amount (%) of accounts represented which share very comparable investment guidelines and risks.

Table III

*FAF Investment Manager Performance
Presentation Standards Checklist*

Following is a checklist for investment managers, their clients and prospects, and for consultants—to assure proper conformance to the Financial Analyst Federation "Performance Presentation Standards of January 12, 1989."

I. Performance calculations.

- A. Performance results have been calculated on a time-weighted basis.*
- B. Returns combine income and current market valuations (thus, presenting so-called total returns).*
- C. Manager fee levels have been disclosed along with performance records so that after-fee results can be measured.*
- D. Performance results of broad security classes such as equities or fixed income have been calculated with cash or substitute securities included. If cash has been excluded in the calculations, returns with cash have also been presented, along with the statement that FAF standards consider performance with cash as most representative of managerial results and most representative for comparisons with other managers.*

E. All exclusions from performance calculations and presentation by manager have been disclosed.

F. The method of linking interim performance results (daily, monthly, quarterly) has been explained. (FAF standard is for monthly linking.)

G. Balanced account performance.

1. Manager has assigned cash and substitute securities to the specific asset category to which it belongs, thereby allowing a clear division of the performance record for each asset managed.

2. If cash and substitute securities are not assigned to a separate asset, comparisons should not be made against other managers' performance figures for assets where cash returns have been included.

3. Manager has supplied information on risk, volatility and/or other measures which allow for reasonable performance evaluation.

H. Convertible securities have been consistently assigned to either equities or fixed income, and have not been shifted without notice being given to clients concurrent or prior to such shift.

J. Managers have provided the indexes against which their submitted performance records have normally been compared.

K. If managers' assets have been leveraged, and performance returns calculated on this basis, results on an all-cash (unleveraged) basis have been provided.

II. Investment manager composites of performance results.

A. Manager has submitted a composite of all accounts managed for each period submitted; the composite includes results from any and all accounts no longer clients of the firm.

B. If a manager has separate composites, all have been submitted. A prospect should be able to account for the performance of all of the manager's assets managed.

C. Composites are not "survivors only" compilations; they include results of all accounts ever managed, including those of clients no longer with the firm.

D. All performance results contained in the composite include cash and substitutable securities, as per I.D. above.

E. All individual years and cumulative performance results for all periods have been supplied. The composite covers every year of the past 10 years, along with longer term results if the manager has been in business this long.

F. Compound annualized returns have also been provided for all periods.

G. A clear statement from manager indicates that no selectivity of account results for partial periods exists.

H. Composite or other data have not been altered for reasons of personnel changes or any other reasons.

I. Composite results are:

1. Weighted for the dollars under management (the FAF standard).

2. Presented on a median (unweighted) basis (recommended only as additional information, not as the primary disclosure).

- J. *Data includes:*
 - 1. *Number of client relationships in the composite.*
 - 2: *Assets under management for each period.*
 - 3. *Average and median size of accounts in the composite have been presented.*
 - 4. *Assets included in the composite presented are shown as a percentage of the manager's total accounts which share very comparable investment guidelines and risks; and as a percentage of the manager's total funds under management. All clients and related performance data for this asset type can be accounted for.*
- K. *Fee information is clear, so that pre- and post-fee results can be determined.*
- L. *Composites include typical indexes against which manager has been judged.*
- M. *Alpha, Beta, Standard Deviation of Returns and other measures of risk, quality, variability, etc. within the composite for each year have been indicated.*

- N. *Other information provided:*

III. *Verification of performance data.*

- A. *Results have been audited by reputable auditors.*
- B. *Results are not audited, but include statements that calculations and presentation of individual accounts and composites conform to FAF performance presentation standards.*
- C. *Neither of A. or B. above.*

PERS AND TRS FINANCIAL PROJECTIONS

FEBRUARY 21, 1989

WILLIAM M.
MERCER MEIDINGER HANSEN
INCORPORATED

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WILLIAM M.
MERCER MEIDINGER HANSEN
INCORPORATED

February 21, 1989

Mr. James R. Wilson
Statement Investment Officer
State of Alaska
Department of Revenue
Treasury Division
P.O. Box SB
Juneau, AK 99811

Re: PERS and TRS Financial Projections

Dear Jim:

Enclosed you will find our actuarial projections of financial results for both PERS and TRS for the next 15 years. As always, care should be exercised in using these long-term financial projections.

For both PERS and TRS, we provide projections based upon four different sets of actuarial assumptions. The first table for each retirement system is based upon the current actuarial assumption which assumes an investment return rate of 9% per year and salary increases of 6.5% for the first five years of employment and 5.5% for later years of employment. Then, for each retirement system, we provide three additional projections. The first one assumes a 1% higher investment return with no change in the salary increase assumption; the second one assumes no change in the investment assumption but a 1% lower rate of salary increase assumption; the last one, which provides the most optimistic scenario, bases its projections upon a 1% higher rate of investment return with the 1% lower salary increase assumption.

For both PERS and TRS, there were actuarial losses during FY88. These losses led to lower funding ratios and increases in employer contribution rates. There were three major deviations from actuarial assumptions during the year. Of greatest importance was the substantial increase in the monthly premiums for retiree medical insurance. The monthly rate is currently \$250 per month per benefit recipient. After a few years of declining retiree medical insurance premiums, the rates have once again shot skyward.

There were actuarial losses from less-than-anticipated investment return rates during the year. Even with the three-year smoothing approach used on valuation assets, the dramatic drop in equity values on October 19, 1987 still had an affect on the total investment performance for the year. Based upon valuation assets, both PERS and TRS had investment performance rates during the year which were about 3% less than our 9% interest assumption.

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Mr. James R. Wilson
February 21, 1989
Page Two

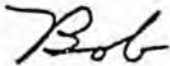
Partially dampening the affects of these two actuarial losses were the less-than-anticipated salary increases during the year. Both PERS and TRS experienced actuarial gains in this area.

The projections this year, when compared with last year's projections, all show slightly lower funding ratios and slightly higher employer contributions at all durations. More than anything else, this reflects the impact of the higher cost of post-retirement medical insurance. Also, this year's projections include additional employer contributions for the Retirement Incentive Program.

Summary

Despite actuarial gains from less-than-anticipated salary increases during FY88, actuarial losses from a dramatic rise in retiree medical insurance premiums, as well as less-than-anticipated investment performance, led to a decrease in funding ratios for both PERS and TRS. Nevertheless, both plans are still extremely well funded and are projected to remain so in the ensuring years.

Sincerely,



Robert F. Richardson, ASA, EA, MAAA
Principal

RFR:js

Table 1
State of Alaska TRS
Financial Projections ('000 omitted)

As of June 30	Investment Return 9.00% (nominal)			Salary Increases 6.04% (6.5/5.5 assumed)						Ending Asset Valuation	
	--Valuation Amounts on July 1--			-----Flow Amounts During Following 12 Months-----							
	Total Assets	Accrued Liability	Surplus* (Deficit)	Total Salaries	Employer Contribs	Employee Contribs	Total Contribs	Benefit Payments	Net Contribs	Investment Earnings	
1988	1,331,905	1,346,677	(14,772)	413,556	59,064	37,885	96,839	78,902	17,487	126,075	1,475,967
1989	1,475,967	1,482,362	(6,395)	438,535	59,519	39,723	99,242	83,548	15,694	139,521	1,631,182
1990	1,631,182	1,628,457	2,725	465,022	57,897	36,667	96,564	80,385	8,179	153,781	1,793,142
1991	1,793,142	1,784,918	8,224	493,110	57,715	37,723	95,438	93,429	2,009	168,735	1,963,887
1992	1,963,887	1,952,792	11,094	522,893	60,979	39,897	100,876	98,692	2,183	184,802	2,150,872
1993	2,150,872	2,136,494	14,378	554,476	64,418	42,196	106,614	104,192	2,421	202,398	2,355,692
1994	2,355,692	2,337,571	18,121	587,967	68,040	44,627	112,667	109,945	2,722	221,675	2,580,089
1995	2,580,089	2,557,711	22,378	623,480	71,855	47,197	119,052	114,812	4,240	242,848	2,827,177
1996	2,827,177	2,799,971	27,206	661,138	75,870	49,916	125,786	125,013	773	265,931	3,093,880
1997	3,093,880	3,061,206	32,675	701,071	80,095	52,791	132,886	129,756	3,130	291,120	3,388,130
1998	3,388,130	3,349,291	38,839	743,415	84,542	55,830	140,372	138,434	1,938	318,741	3,708,810
1999	3,708,810	3,663,024	45,786	788,318	89,218	59,124	148,342	146,321	2,021	348,904	4,059,735
2000	4,059,735	4,006,144	53,591	835,932	94,136	62,695	156,831	151,330	5,501	382,066	4,447,302
2001	4,447,302	4,384,959	62,343	886,422	99,307	66,482	165,789	155,844	9,944	418,716	4,875,962
2002	4,875,962	4,803,804	72,158	939,962	104,740	70,497	175,237	165,218	10,019	459,035	5,345,017
2003	5,345,017	5,261,848	83,169	996,736	110,445	74,755	185,200	172,835	12,366	503,255	5,860,638

* Surpluses reduce employer contributions over 5 years
 * Deficits increase employer contributions over 25 years

PERCENTAGE RATIO RELATIONSHIPS OF ABOVE DATA

As of June 30	Funding Ratio	-----As % of Salaries-----				--As % of Assets--	
		Employer Contribs	Employee Contribs	Total Contribs	Benefit Payments	Net Contribs	Investment Earnings
1988	98.8	14.27%	9.16%	23.43%	19.08%	1.28%	9.00%
1989	99.6	13.57%	9.06%	22.63%	19.05%	1.01%	9.00%
1990	100.2	12.45%	8.32%	20.77%	19.01%	0.48%	9.00%
1991	100.5	11.70%	7.65%	19.35%	18.95%	0.11%	9.00%
1992	100.6	11.66%	7.63%	19.29%	18.87%	0.11%	9.00%
1993	100.7	11.62%	7.61%	19.23%	18.79%	0.11%	9.00%
1994	100.8	11.57%	7.59%	19.16%	18.70%	0.11%	9.00%
1995	100.9	11.52%	7.57%	19.09%	18.41%	0.16%	9.00%
1996	101.0	11.48%	7.55%	19.03%	18.91%	0.03%	9.00%
1997	101.1	11.42%	7.53%	18.95%	18.51%	0.10%	9.00%
1998	101.2	11.37%	7.51%	18.88%	18.62%	0.05%	9.00%
1999	101.2	11.32%	7.50%	18.82%	18.56%	0.05%	9.00%
2000	101.3	11.26%	7.50%	18.76%	18.10%	0.13%	9.00%
2001	101.4	11.20%	7.50%	18.70%	17.58%	0.21%	9.00%
2002	101.5	11.14%	7.50%	18.64%	17.58%	0.20%	9.00%
2003	101.6	11.08%	7.50%	18.58%	17.34%	0.22%	9.00%

Table 2
State of Alaska IRS
Financial Projections ('000 omitted)

As of June 30	Investment Return 10.00% (nominal)			Salary Increases 6.04% (6.5/5.5 assumed)							
	--Valuation Amounts on July 1--			-----Flow Amounts During Following 12 Months-----							Ending
	Total Assets	Accrued Liability	Surplus* (Deficit)	Total Salaries	Employer Contribs	Employee Contribs	Total Contribs	Benefit Payments	Net Contribs	Investment Earnings	Asset Valuation
1988	1,331,905	1,348,677	(16,772)	413,556	59,004	37,885	96,889	78,902	17,987	140,749	1,490,641
1989	1,490,641	1,482,362	8,279	438,535	57,237	39,723	96,960	83,548	13,413	157,188	1,661,242
1990	1,661,242	1,628,457	32,785	465,022	55,090	38,667	93,757	88,385	5,372	174,699	1,841,313
1991	1,841,313	1,704,918	56,394	493,110	53,216	37,723	90,939	93,429	(2,490)	193,213	2,032,036
1992	2,032,036	1,952,792	79,244	522,893	54,614	39,897	94,511	98,692	(4,181)	213,155	2,241,009
1993	2,241,009	2,136,494	104,515	554,476	56,000	42,196	98,195	104,192	(5,997)	235,006	2,470,018
1994	2,470,018	2,337,371	132,448	587,967	57,363	44,627	101,989	109,945	(7,956)	258,954	2,721,016
1995	2,721,016	2,557,711	163,306	623,480	58,692	47,197	105,890	114,812	(8,922)	285,261	2,997,355
1996	2,997,355	2,799,771	197,384	661,138	59,976	49,916	109,892	125,013	(15,122)	313,966	3,296,199
1997	3,296,199	3,061,206	234,994	701,071	61,199	52,791	113,990	129,756	(15,766)	345,313	3,625,746
1998	3,625,746	3,349,291	276,455	743,415	62,349	55,830	118,180	138,434	(20,254)	379,691	3,985,182
1999	3,985,182	3,663,024	322,159	789,318	63,466	59,124	122,530	146,321	(23,791)	417,255	4,378,648
2000	4,378,646	4,006,144	372,501	835,932	64,351	62,695	127,046	151,330	(24,284)	458,544	4,812,905
2001	4,812,905	4,384,759	427,946	886,422	65,161	66,482	131,643	155,844	(24,202)	504,145	5,292,848
2002	5,292,848	4,803,804	489,044	939,962	65,804	70,497	136,302	165,218	(28,917)	554,303	5,818,235
2003	5,818,235	5,261,848	556,386	996,736	66,248	74,755	141,003	172,835	(31,831)	609,323	6,395,726

- * Surpluses reduce employer contributions over 5 years
- * Deficits increase employer contributions over 25 years

PERCENTAGE RATIO RELATIONSHIPS OF ABOVE DATA

As of June 30	Funding Ratio	-----As % of Salaries-----				--As % of Assets--	
		Employer Contribs	Employee Contribs	Total Contribs	Benefit Payments	Net Contribs	Investment Earnings
1988	98.8	14.27%	9.16%	23.43%	19.08%	1.28%	10.00%
1989	100.6	13.05%	9.06%	22.11%	19.05%	0.85%	10.00%
1990	102.0	11.85%	8.32%	20.16%	19.01%	0.31%	10.00%
1991	103.2	10.79%	7.65%	18.44%	18.95%	-0.13%	10.00%
1992	104.1	10.44%	7.63%	18.07%	18.87%	-0.20%	10.00%
1993	104.9	10.10%	7.61%	17.71%	18.79%	-0.26%	10.00%
1994	105.7	9.76%	7.59%	17.35%	18.70%	-0.31%	10.00%
1995	106.4	9.41%	7.57%	16.99%	18.41%	-0.31%	10.00%
1996	107.0	9.07%	7.55%	16.62%	18.91%	-0.48%	10.00%
1997	107.7	8.75%	7.53%	16.26%	18.51%	-0.46%	10.00%
1998	108.3	8.35%	7.51%	15.90%	18.62%	-0.53%	10.00%
1999	108.8	8.04%	7.50%	15.54%	18.56%	-0.57%	10.00%
2000	109.3	7.70%	7.50%	15.20%	18.10%	-0.53%	10.00%
2001	109.8	7.35%	7.50%	14.85%	17.58%	-0.48%	10.00%
2002	110.2	7.00%	7.50%	14.50%	17.58%	-0.52%	10.00%
2003	110.6	6.65%	7.50%	14.15%	17.34%	-0.52%	10.00%

Table 3
State of Alaska TRS
Financial Projections ('000 omitted)

As of June 30	Investment Return 9.00% (nominal)			Salary Increases			5.04% (5.5/4.5 assumed)			Ending Asset Valuation	
	Valuation Total Assets	Amounts on July 1 Accrued Liability	Surplus* (Deficit)	Flow Total Salaries	Employer Contribs	Employee Contribs	During Following 12 Months Total Contribs	Benefit Payments	Net Contribs		Investment Earnings
1988	1,331,905	1,348,677	(16,772)	409,656	58,541	37,584	96,126	78,590	17,536	126,055	1,475,495
1989	1,475,495	1,476,121	(626)	430,303	57,181	39,090	96,272	82,889	13,383	139,373	1,628,251
1990	1,628,251	1,614,564	13,687	451,990	55,328	37,668	92,995	87,343	5,653	153,391	1,787,295
1991	1,787,295	1,761,762	25,532	474,770	53,923	36,320	90,243	91,961	(1,718)	168,018	1,953,594
1992	1,953,594	1,918,539	35,056	498,699	55,872	38,051	93,922	96,757	(2,834)	183,608	2,134,368
1993	2,134,368	2,089,059	45,309	523,853	57,895	39,864	97,759	101,741	(3,982)	200,558	2,330,944
1994	2,330,944	2,274,591	56,353	550,234	59,995	41,763	101,757	106,927	(5,169)	218,993	2,544,767
1995	2,544,767	2,476,514	68,252	577,966	62,172	43,752	105,924	111,171	(5,247)	237,099	2,778,619
1996	2,778,619	2,697,541	81,078	607,096	64,429	45,836	110,265	120,690	(10,425)	260,860	3,029,054
1997	3,029,054	2,934,142	94,912	637,693	66,766	48,018	114,784	124,686	(9,901)	284,437	3,303,589
1998	3,303,589	3,193,767	109,822	669,833	69,185	50,304	119,490	132,547	(13,057)	310,115	3,600,647
1999	3,600,647	3,474,741	125,906	703,592	71,687	52,769	124,456	139,543	(15,087)	337,962	3,923,522
2000	3,923,522	3,780,270	143,252	739,053	74,272	55,429	129,701	143,580	(13,879)	368,383	4,278,026
2001	4,278,026	4,116,064	161,962	776,302	76,943	58,223	135,165	147,035	(11,869)	401,814	4,667,971
2002	4,667,971	4,485,809	182,162	815,427	79,696	61,157	140,853	155,255	(14,402)	438,375	5,091,944
2003	5,091,944	4,887,449	203,995	856,525	82,531	64,239	146,771	161,618	(14,847)	478,229	5,555,326

* Surpluses reduce employer contributions over 5 years
 * Deficits increase employer contributions over 25 years

PERCENTAGE RATIO RELATIONSHIPS OF ABOVE DATA

As of June 30	Funding Ratio	--As % of Salaries--				--As % of Assets--	
		Employer Contribs	Employee Contribs	Total Contribs	Benefit Payments	Net Contribs	Investment Earnings
1988	98.8	14.29%	9.17%	23.46%	19.18%	1.25%	9.00%
1989	100.0	13.20%	9.08%	22.37%	19.26%	0.86%	9.00%
1990	100.8	12.24%	8.33%	20.57%	19.32%	0.33%	9.00%
1991	101.4	11.36%	7.65%	19.01%	19.37%	-0.09%	9.00%
1992	101.8	11.20%	7.63%	18.83%	19.40%	-0.14%	9.00%
1993	102.2	11.05%	7.61%	18.66%	19.42%	-0.18%	9.00%
1994	102.5	10.90%	7.59%	18.49%	19.43%	-0.21%	9.00%
1995	102.8	10.76%	7.57%	18.33%	19.23%	-0.20%	9.00%
1996	103.0	10.61%	7.55%	18.16%	19.88%	-0.36%	9.00%
1997	103.2	10.47%	7.53%	18.00%	19.55%	-0.31%	9.00%
1998	103.4	10.33%	7.51%	17.84%	19.79%	-0.38%	9.00%
1999	103.6	10.19%	7.50%	17.69%	19.83%	-0.40%	9.00%
2000	103.8	10.05%	7.50%	17.55%	19.43%	-0.34%	9.00%
2001	103.9	9.91%	7.50%	17.41%	18.94%	-0.27%	9.00%
2002	104.1	9.77%	7.50%	17.27%	19.04%	-0.30%	9.00%
2003	104.2	9.64%	7.50%	17.14%	18.87%	-0.28%	9.00%

Table 4
State of Alaska TRS
Financial Projections ('000 omitted)

As of June 30	Investment Return 10.00% (nominal)			Salary Increases 5.04% (5.5/4.5 assumed)					Ending Asset Valuation		
	---Valuation Total Assets	Amounts on July 1--- Accrued Liability	Surplus* (Deficit)	-----Flow Total Salaries	Amounts During Employer Contribs	Following 12 Months Employee Contribs	----- Total Contribs	Benefit Payments		Net Contribs	Investment Earnings
1988	1,331,905	1,340,677	(16,772)	409,656	58,541	37,584	96,126	70,590	17,536	140,727	1,490,167
1989	1,490,167	1,476,121	14,046	430,303	55,722	39,090	94,812	82,889	11,923	157,064	1,659,155
1990	1,659,155	1,614,564	44,590	451,990	52,441	37,668	90,109	87,343	2,766	174,350	1,836,270
1991	1,836,270	1,761,762	74,508	474,770	49,349	36,320	85,669	91,961	(6,293)	192,494	2,022,472
1992	2,022,472	1,918,539	103,933	498,699	49,439	38,051	87,489	96,757	(9,267)	211,896	2,225,101
1993	2,225,101	2,087,059	136,042	523,833	49,421	39,864	89,284	101,741	(12,456)	233,013	2,445,657
1994	2,445,657	2,274,591	171,066	550,234	49,281	41,763	91,044	106,927	(15,883)	256,000	2,685,773
1995	2,685,773	2,476,514	209,259	577,966	49,003	43,752	92,755	111,171	(18,417)	281,085	2,940,442
1996	2,948,442	2,691,541	256,901	607,096	48,568	45,836	94,404	120,690	(26,286)	308,272	3,230,428
1997	3,230,428	2,934,142	296,286	637,693	47,958	48,018	95,976	124,686	(28,709)	337,760	3,539,479
1998	3,539,479	3,193,767	345,711	669,833	47,154	50,304	97,458	132,547	(35,089)	369,891	3,874,781
1999	3,874,781	3,474,741	399,540	703,592	46,130	52,769	98,900	139,543	(40,643)	404,767	4,238,405
2000	4,238,405	3,780,270	458,135	739,053	44,861	55,429	100,292	143,580	(43,288)	442,868	4,637,985
2001	4,637,985	4,116,064	521,921	776,302	43,324	58,223	101,546	147,035	(45,488)	484,714	5,077,211
2002	5,077,211	4,485,809	591,402	815,427	41,475	61,157	102,632	155,255	(52,624)	530,476	5,555,063
2003	5,555,063	4,887,949	667,114	856,525	39,277	64,239	103,517	161,618	(58,101)	580,377	6,077,339

* Surpluses reduce employer contributions over 5 years
 * Deficits increase employer contributions over 25 years

PERCENTAGE RATIO RELATIONSHIPS OF ABOVE DATA

As of June 30	Funding Ratio	-----As % of Salaries-----				--As % of Assets--	
		Employer Contribs	Employee Contribs	Total Contribs	Benefit Payments	Net Contribs	Investment Earnings
1988	98.8	14.29%	9.17%	23.46%	19.18%	1.25%	10.00%
1989	101.0	12.95%	9.08%	22.03%	19.26%	0.76%	10.00%
1990	102.8	11.60%	8.33%	19.94%	19.32%	0.16%	10.00%
1991	104.2	10.39%	7.65%	18.04%	19.37%	-0.33%	10.00%
1992	105.4	9.91%	7.63%	17.54%	19.40%	-0.44%	10.00%
1993	106.5	9.43%	7.61%	17.04%	19.42%	-0.53%	10.00%
1994	107.5	8.96%	7.59%	16.55%	19.43%	-0.62%	10.00%
1995	108.4	8.48%	7.57%	16.05%	19.23%	-0.66%	10.00%
1996	109.3	8.00%	7.55%	15.55%	19.08%	-0.85%	10.00%
1997	110.1	7.52%	7.53%	15.05%	19.55%	-0.85%	10.00%
1998	110.8	7.04%	7.51%	14.55%	19.79%	-0.95%	10.00%
1999	111.5	6.56%	7.50%	14.06%	19.83%	-1.00%	10.00%
2000	112.1	6.07%	7.50%	13.57%	19.43%	-0.98%	10.00%
2001	112.7	5.58%	7.50%	13.08%	18.94%	-0.94%	10.00%
2002	113.2	5.09%	7.50%	12.57%	17.04%	-0.99%	10.00%
2003	113.6	4.59%	7.50%	12.09%	18.87%	-1.00%	10.00%

Table 5
State of Alaska FERS
Financial Projections ('000 omitted)

As of June 30	Investment Return 9.00% (nominal)			Salary Increases 6.04% (6.5/5.5 assumed)					Ending Asset Valuation		
	--Valuation Amounts on July 1--			-----Flow Amounts During Following 12 Months-----							
	Assets	Accrued Liability	Surplus* (Deficit)	Total Salaries	Employer Contribs	Employee Contribs	Total Benefit Payments	Net Contribs		Investment Earnings	
1988	2,088,428	2,246,583	(158,155)	945,136	128,539	64,553	193,092	97,859	95,233	200,702	2,384,364
1989	2,384,364	2,511,963	(127,597)	1,002,222	126,601	68,452	195,053	106,870	88,183	228,218	2,700,764
1990	2,700,764	2,801,804	(101,039)	1,062,756	123,924	72,586	196,510	116,504	80,006	257,607	3,038,378
1991	3,038,378	3,118,259	(79,881)	1,126,946	122,858	76,970	199,829	125,883	73,946	289,087	3,401,411
1992	3,401,411	3,464,631	(63,221)	1,195,014	125,211	81,619	206,831	135,955	70,875	323,092	3,795,378
1993	3,795,378	3,843,567	(48,189)	1,267,193	128,328	86,549	214,877	148,046	66,832	359,963	4,222,172
1994	4,222,172	4,256,607	(34,435)	1,343,731	132,148	91,777	223,925	160,809	63,116	399,936	4,685,224
1995	4,685,224	4,706,881	(21,658)	1,424,893	136,626	97,320	233,946	175,544	58,402	443,273	5,186,899
1996	5,186,899	5,196,490	(9,591)	1,510,956	141,724	103,198	244,922	191,787	53,135	490,219	5,730,253
1997	5,730,253	5,728,256	1,997	1,602,218	147,698	109,431	257,130	209,342	47,788	541,081	6,319,122
1998	6,319,122	6,305,512	13,610	1,698,992	155,546	116,041	271,587	228,844	42,743	596,237	6,958,102
1999	6,958,102	6,931,281	26,820	1,801,611	163,784	123,050	286,834	247,363	39,471	656,186	7,653,758
2000	7,653,758	7,611,981	41,776	1,910,428	172,431	130,482	302,913	269,379	33,534	721,345	8,408,636
2001	8,408,636	8,349,986	58,650	2,025,818	181,505	138,363	319,869	293,243	26,625	792,030	9,227,292
2002	9,227,292	9,149,673	77,619	2,148,178	191,027	146,721	337,748	318,446	19,302	868,695	10,115,290
2003	10,115,290	10,016,415	98,874	2,277,928	201,018	155,582	356,601	344,013	12,587	951,909	11,079,787

* Surpluses reduce employer contributions over 5 years
 * Deficits increase employer contributions over 25 years

PERCENTAGE RATIO RELATIONSHIPS OF ABOVE DATA

As of June 30	Funding Ratio	-----As % of Salaries-----				---As % of Assets---	
		Employer Contribs	Employee Contribs	Total Benefit Payments	Net Contribs	Investment Earnings	
1988	93.0	13.60%	6.83%	20.43%	10.35%	4.27%	9.00%
1989	94.9	12.63%	6.83%	19.46%	10.66%	3.48%	9.00%
1990	96.4	11.66%	6.83%	18.49%	10.96%	2.80%	9.00%
1991	97.4	10.90%	6.83%	17.73%	11.17%	2.30%	9.00%
1992	98.2	10.48%	6.83%	17.31%	11.38%	1.97%	9.00%
1993	98.7	10.13%	6.83%	16.96%	11.68%	1.67%	9.00%
1994	99.2	9.83%	6.83%	16.66%	11.97%	1.42%	9.00%
1995	99.5	9.59%	6.83%	16.42%	12.32%	1.19%	9.00%
1996	99.8	9.38%	6.83%	16.21%	12.69%	0.98%	9.00%
1997	100.0	9.22%	6.83%	16.05%	13.07%	0.79%	9.00%
1998	100.2	9.16%	6.83%	15.99%	13.47%	0.65%	9.00%
1999	100.4	9.09%	6.83%	15.92%	13.73%	0.54%	9.00%
2000	100.5	9.03%	6.83%	15.86%	14.10%	0.42%	9.00%
2001	100.7	8.96%	6.83%	15.79%	14.48%	0.30%	9.00%
2002	100.8	8.89%	6.83%	15.72%	14.82%	0.20%	9.00%

Table 6
State of Alaska PERS
Financial Projections ('000 omitted)

As of June 30	Investment Return 10.00% (nominal)			Salary Increases 6.04% (6.5/5.5 assumed)					Ending		
	--Valuation Amounts on July 1--			-----Flow Amounts During Following 12 Months-----					Investment		
	Assets	Accrued Liability	Surplus* (Deficit)	Total Salaries	Employer Contribs	Employee Contribs	Total Contribs	Benefit Payments	Net Contribs	Earnings	Asset Valuation
1988	2,088,428	2,246,583	(158,155)	945,136	128,539	64,553	193,092	97,859	95,233	224,047	2,407,708
1989	2,407,708	2,511,963	(104,255)	1,002,222	121,091	68,452	189,547	106,870	82,677	256,943	2,747,328
1990	2,747,328	2,801,804	(54,475)	1,062,756	112,941	72,586	185,527	116,504	69,024	291,921	3,108,273
1991	3,108,273	3,118,259	(9,987)	1,126,946	106,373	76,970	183,343	125,883	57,460	329,242	3,494,974
1992	3,494,974	3,464,631	30,343	1,195,014	107,466	81,619	189,085	135,955	53,130	369,629	3,917,733
1993	3,917,733	3,843,567	74,166	1,267,193	110,035	86,549	196,584	148,046	48,539	413,789	4,380,060
1994	4,380,060	4,256,607	123,453	1,343,731	112,496	91,777	204,273	160,809	43,464	462,080	4,885,604
1995	4,885,604	4,706,881	178,722	1,424,893	114,826	97,320	212,146	175,544	36,602	514,818	5,437,024
1996	5,437,024	5,196,490	240,533	1,510,956	116,996	103,198	220,195	191,787	28,408	572,308	6,037,739
1997	6,037,739	5,728,256	309,483	1,602,218	118,980	109,431	228,411	209,342	19,070	634,916	6,691,725
1998	6,691,725	6,305,512	386,213	1,698,992	120,746	116,041	236,787	228,844	7,943	703,028	7,402,696
1999	7,402,696	6,931,281	471,415	1,801,611	122,260	123,050	245,310	247,363	(2,053)	777,180	8,177,824
2000	8,177,824	7,611,981	565,842	1,910,428	123,485	130,482	253,967	269,379	(15,412)	857,901	9,020,312
2001	9,020,312	8,349,986	670,326	2,025,818	124,377	138,363	262,740	293,243	(30,503)	945,608	9,935,417
2002	9,935,417	9,149,673	785,743	2,148,178	124,891	146,721	271,611	318,446	(46,834)	1,040,877	10,929,459
2003	10,929,459	10,016,415	913,044	2,277,928	124,977	155,582	280,560	344,013	(63,454)	1,144,421	12,010,426

* Surpluses reduce employer contributions over 5 years
* Deficits increase employer contributions over 25 years

PERCENTAGE RATIO RELATIONSHIPS OF ABOVE DATA

As of June 30	Funding Ratio	-----As % of Salaries-----				---As % of Assets---	
		Employer Contribs	Employee Contribs	Total Contribs	Benefit Payments	Net Contribs	Investment Earnings
1988	93.0	13.60%	6.83%	20.43%	10.35%	4.25%	10.00%
1989	95.8	12.08%	6.83%	18.91%	10.66%	3.22%	10.00%
1990	98.1	10.63%	6.83%	17.46%	10.96%	2.36%	10.00%
1991	99.7	9.44%	6.83%	16.27%	11.17%	1.75%	10.00%
1992	100.9	8.99%	6.83%	15.82%	11.38%	1.44%	10.00%
1993	101.9	8.68%	6.83%	15.51%	11.66%	1.17%	10.00%
1994	102.9	8.37%	6.83%	15.20%	11.97%	0.94%	10.00%
1995	103.8	8.06%	6.83%	14.89%	12.32%	0.71%	10.00%
1996	104.6	7.74%	6.83%	14.57%	12.69%	0.50%	10.00%
1997	105.4	7.43%	6.83%	14.26%	13.07%	0.30%	10.00%
1998	106.1	7.11%	6.83%	13.94%	13.47%	0.11%	10.00%
1999	106.8	6.79%	6.83%	13.62%	13.73%	-0.03%	10.00%
2000	107.4	6.46%	6.83%	13.29%	14.10%	-0.18%	10.00%
2001	108.0	6.14%	6.83%	12.97%	14.48%	-0.32%	10.00%
2002	108.6	5.81%	6.83%	12.64%	14.82%	-0.45%	10.00%

Table 7
State of Alaska PERS
Financial Projections ('000 omitted)

As of June 30	Investment Return 9.00% (nominal)			Salary Increases 5.04% (5.5/4.5 assumed)				Flow Amounts During Following 12 Months		Ending Asset Valuation	
	Valuation Amounts on July 1-- Assets	Accrued Liability	Surplus* (Deficit)	Total Salaries	Employer Contribs	Employee Contribs	Total Benefit Payments	Net Contribs	Investment Earnings		
1988	2,088,428	2,246,583	(158,155)	936,223	127,717	63,944	191,661	97,502	94,159	200,654	2,383,240
1989	2,383,240	2,497,668	(114,428)	983,408	121,758	67,167	188,925	106,061	82,864	227,873	2,693,977
1990	2,693,977	2,770,007	(76,030)	1,032,972	115,276	70,552	185,828	115,134	70,694	256,550	3,021,221
1991	3,021,221	3,065,357	(44,136)	1,085,034	110,559	74,108	184,666	123,029	60,837	286,884	3,368,942
1992	3,368,942	3,386,586	(17,645)	1,139,719	109,358	77,843	187,201	133,080	54,121	319,284	3,742,347
1993	3,742,347	3,735,867	6,480	1,197,161	109,893	81,766	191,659	144,194	47,465	354,104	4,143,915
1994	4,143,915	4,114,220	29,696	1,257,498	113,294	85,887	199,181	155,808	43,373	391,687	4,578,975
1995	4,578,975	4,524,205	54,770	1,320,876	116,802	90,216	207,017	169,199	37,818	432,354	5,049,148
1996	5,049,148	4,967,303	81,845	1,387,448	120,417	94,763	215,180	183,882	31,298	476,281	5,556,726
1997	5,556,726	5,445,658	111,069	1,457,376	124,142	99,539	223,681	199,637	24,044	523,692	6,104,462
1998	6,104,462	5,961,862	142,600	1,530,827	127,977	104,556	232,532	217,073	15,460	574,820	6,694,743
1999	6,694,743	6,518,135	176,608	1,607,981	131,922	109,825	241,747	233,228	8,519	630,024	7,333,285
2000	7,333,285	7,120,015	213,270	1,689,023	135,978	115,360	251,338	252,553	(1,214)	689,641	8,021,712
2001	8,021,712	7,768,923	252,789	1,774,150	140,144	121,174	261,319	273,361	(12,043)	753,900	8,763,570
2002	8,763,570	8,468,197	295,372	1,863,567	144,420	127,282	271,702	295,108	(23,406)	823,160	9,563,325
2003	9,563,325	9,222,083	341,242	1,957,491	148,806	133,697	282,502	316,776	(34,274)	897,888	10,426,939

* Surpluses reduce employer contributions over 5 years
* Deficits increase employer contributions over 25 years

PERCENTAGE RATIO RELATIONSHIPS OF ABOVE DATA

As of June 30	Funding Ratio	-----As % of Salaries-----				---As % of Assets---	
		Employer Contribs	Employee Contribs	Total Contribs	Benefit Payments	Net Contribs	Investment Earnings
1988	93.0	13.64%	6.83%	20.47%	10.41%	4.22%	9.00%
1989	95.4	12.38%	6.83%	19.21%	10.79%	3.27%	9.00%
1990	97.3	11.16%	6.83%	17.99%	11.15%	2.48%	9.00%
1991	98.6	10.19%	6.83%	17.02%	11.41%	1.91%	9.00%
1992	99.5	9.60%	6.83%	16.43%	11.68%	1.53%	9.00%
1993	100.2	9.18%	6.83%	16.01%	12.04%	1.21%	9.00%
1994	100.7	9.01%	6.83%	15.84%	12.39%	1.00%	9.00%
1995	101.2	8.84%	6.83%	15.67%	12.81%	0.79%	9.00%
1996	101.6	8.68%	6.83%	15.51%	13.25%	0.59%	9.00%
1997	102.0	8.57%	6.83%	15.35%	13.70%	0.41%	9.00%
1998	102.4	8.36%	6.83%	15.19%	14.18%	0.24%	9.00%
1999	102.7	8.20%	6.83%	15.03%	14.50%	0.12%	9.00%
2000	103.0	8.03%	6.83%	14.88%	14.95%	-0.02%	9.00%
2001	103.3	7.90%	6.83%	14.73%	15.41%	-0.14%	9.00%
2002	103.5	7.75%	6.83%	14.58%	15.84%	-0.26%	9.00%

Table 8
State of Alaska FERS
Financial Projections ('000 omitted)

As of June 30	Investment Return 10.00% (nominal)			Salary Increases 5.04% (5.5/4.5 assumed)				Flow Amounts During Following 12 Months		Ending Asset Valuation	
	--Valuation Amounts on July 1-- Assets	Accrued Liability	Surplus* (Deficit)	Total Salaries	Employer Contribs	Employee Contribs	Total Benefit Payments	Net Contribs	Investment Earnings		
1988	2,088,428	2,244,583	(156,155)	936,223	127,717	63,944	191,661	97,502	94,159	223,993	2,406,579
1989	2,406,579	2,497,668	(91,089)	983,408	116,253	67,167	183,420	106,061	77,359	256,559	2,740,497
1990	2,740,497	2,770,007	(29,509)	1,032,972	104,304	70,552	174,856	115,134	59,722	290,738	3,090,957
1991	3,090,957	3,065,357	25,601	1,085,034	97,758	74,108	171,865	123,829	48,036	326,952	3,465,946
1992	3,465,946	3,386,586	79,360	1,139,719	97,784	77,843	175,627	133,080	42,547	366,052	3,874,544
1993	3,874,544	3,735,867	138,678	1,197,161	97,546	81,766	179,312	144,194	35,118	408,583	4,318,246
1994	4,318,246	4,114,220	204,026	1,257,498	97,012	85,887	182,899	155,808	27,091	454,770	4,800,107
1995	4,800,107	4,524,203	275,902	1,320,876	96,149	90,216	186,364	169,199	17,165	504,867	5,322,142
1996	5,322,142	4,967,303	354,838	1,387,448	94,921	94,763	189,683	183,882	5,801	559,115	5,887,058
1997	5,887,058	5,445,658	441,400	1,457,376	93,290	99,539	192,829	199,637	(6,808)	617,801	6,498,050
1998	6,498,050	5,961,862	536,188	1,530,827	91,217	104,556	195,773	217,073	(21,300)	681,230	7,157,981
1999	7,157,981	6,518,135	639,846	1,607,981	88,657	109,825	198,482	233,228	(34,746)	749,851	7,873,085
2000	7,873,085	7,120,015	753,070	1,689,023	85,562	115,360	200,923	252,553	(51,630)	824,092	8,645,548
2001	8,645,548	7,768,923	876,625	1,774,150	81,880	121,174	203,055	273,361	(70,307)	904,267	9,479,508
2002	9,479,508	8,468,197	1,011,311	1,863,567	77,554	127,282	204,836	295,108	(90,272)	990,835	10,380,071
2003	10,380,071	9,222,083	1,157,988	1,957,491	72,524	133,697	206,221	316,776	(110,556)	1,084,380	11,353,895

* Surpluses reduce employer contributions over 5 years
* Deficits increase employer contributions over 25 years

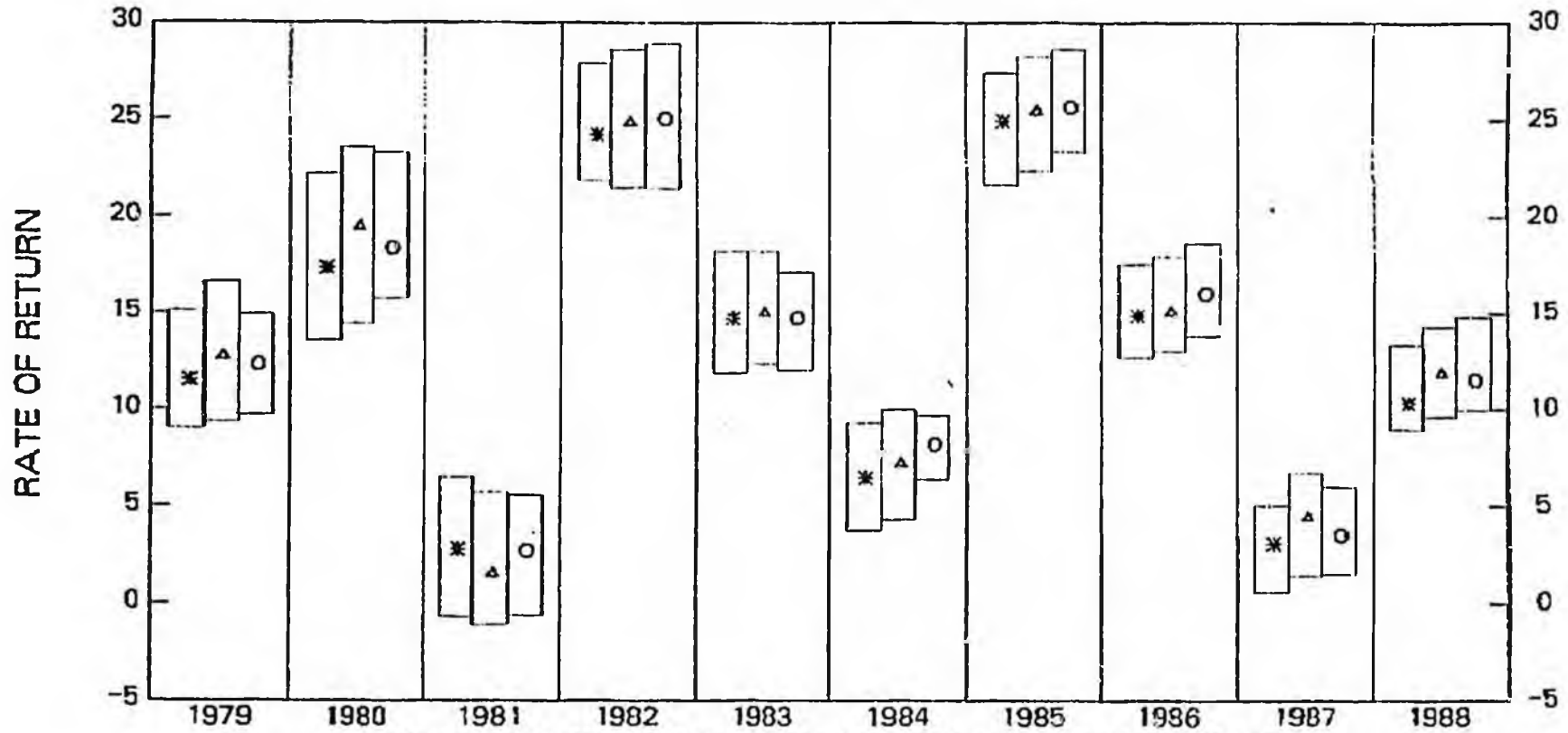
PERCENTAGE RATIO RELATIONSHIPS OF ABOVE DATA

As of June 30	Funding Ratio	-----As % of Salaries-----				---As % of Assets---	
		Employer Contribs	Employee Contribs	Total Contribs	Benefit Payments	Net Contribs	Investment Earnings
1988	93.0	13.64%	6.83%	20.47%	10.41%	4.20%	10.00%
1989	96.4	11.82%	6.83%	18.65%	10.79%	3.02%	10.00%
1990	98.9	10.10%	6.83%	16.93%	11.15%	2.05%	10.00%
1991	100.8	9.01%	6.83%	15.84%	11.41%	1.47%	10.00%
1992	102.3	8.58%	6.83%	15.41%	11.68%	1.16%	10.00%
1993	103.7	8.15%	6.83%	14.98%	12.04%	0.86%	10.00%
1994	105.0	7.71%	6.83%	14.54%	12.39%	0.60%	10.00%
1995	106.1	7.28%	6.83%	14.11%	12.81%	0.34%	10.00%
1996	107.1	6.84%	6.83%	13.67%	13.25%	0.10%	10.00%
1997	108.1	6.40%	6.83%	13.23%	13.70%	-0.11%	10.00%
1998	109.0	5.96%	6.83%	12.79%	14.18%	-0.31%	10.00%
1999	109.8	5.51%	6.83%	12.34%	14.50%	-0.46%	10.00%
2000	110.6	5.07%	6.83%	11.90%	14.95%	-0.63%	10.00%
2001	111.3	4.62%	6.83%	11.45%	15.41%	-0.78%	10.00%
2002	111.9	4.16%	6.83%	10.99%	15.84%	-0.91%	10.00%



TOTAL FUND: RATES OF RETURN BY ASSET SIZE

FOR PERIODS ENDING DECEMBER 31



BARS REPRESENT THE RANGE OF RETURNS BETWEEN THE FIRST AND THIRD QUARTILE

ANNUAL MEDIAN RETURNS

	(*)	(Δ)	(○)	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988
UNDER \$10 MILLION	(*)			11.7	17.5	3.0	24.4	14.9	6.6	25.1	15.0	3.2	10.5
\$10 TO \$50 MILLION		(Δ)		12.9	19.6	1.7	25.0	15.1	7.3	25.6	15.2	4.6	12.0
OVER \$50 MILLION			(○)	12.5	18.5	2.8	25.2	14.9	8.3	25.8	16.1	3.7	11.7

ANNUALIZED LINKED MEDIAN RETURNS

	1979-88	1980-86	1981-88	1982-86	1983-88	1984-88	1985-88	1986-88	1987-86	1988
UNDER \$10 MILLION	12.9	13.1	12.5	14.0	12.3	11.8	13.2	9.4	6.8	10.5
\$10 TO \$50 MILLION	13.6	13.7	13.0	14.7	13.1	12.7	14.1	10.5	8.2	12.0
OVER \$50 MILLION	13.7	13.8	13.3	14.8	13.2	12.9	14.0	10.4	7.6	11.7

MEMORANDUM

STATE OF ALASKA

DEPARTMENT OF REVENUE

TO: The Honorable Hugh Malone
Commissioner of Revenue

FROM: Milton B. Barber *MB*
Deputy Commissioner

DATE: November 1, 1988

SUBJECT: Foreign Equity
Investment
Accounting

End-of-period valuation reports in investment accounting are computed based on reported market values for marketable securities. If the investments and the domicile of the investor are in the same country (and, therefore, denominated in the same currency), then the books of account are probably kept in the country's currency. However, if the investments are located in another country and are denominated and traded in a foreign currency, then the market valuation at the end of a period is denominated in the foreign currency. In order to provide a valuation report in terms of the investor's domestic currency and books of account, the foreign denominated value is converted to domestic value by applying the momentary foreign exchange rate prevailing at the end of the period between the domestic currency and the foreign currency. This is an entirely appropriate methodology for valuation reports, but it is not appropriate for reporting foreign investment activity or for recording foreign investment transactions on the investor's domestic books of account.

If investments are made in different countries having different currencies, then purchases, sales, gains, losses, and income transactions should not be converted into U.S. dollar books of account. The value is not fixed in terms of U.S. dollars and will not become fixed until the foreign currency is sold and the proceeds are used to buy U.S. dollars which are repatriated. When the U.S. dollars are repatriated, that is when events should be recognized on the U.S. dollar books of account.

Over the last five years the retirement funds have been investing in foreign markets through our two contract managers, Citibank and Morgan Guaranty, both of London, England. The funds' domestic book values should reflect the amount of U.S. dollars we advanced to the managers for investment purposes and not foreign transactions which are arbitrarily valued at a presumably appropriate exchange rate somewhere near that point in time. By attempting to convert all foreign investment activity into recordable U.S. dollar equivalents, we are essentially marking up the funds' book values to market values (albeit on a lagging basis). Such actions destroy the historical nature of book value in keeping track of the net U.S. dollar amount which was invested in the securities, creates a book value which is inconsistent with the other book values on the domestic books of account, and misleads users of the data.

The foreign investing through managers is analogous to buying stock in a single foreign company or a mutual fund. The book value is the U.S. dollars used to acquire the stock. If the company or mutual fund buys or sells some

The Honorable Hugh Malone
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November 1, 1988

of its assets, it does not affect book value. If the company or mutual fund retains income for investment in the business or fund or uses it to buy other assets, it does not change book value. The only things which could change book value would be investing more U.S. dollars to buy more of the stock or selling some of the stock for foreign currency and then exchanging the foreign currency for U.S. dollars. The fact that the book value of the company's assets are increasing or decreasing does not change the book value of the retirement funds' investment. It does, however, change the market values.

Even dividend or interest income earned in foreign currencies should not be ascribed as U.S. dollar income. As long as the income remains in foreign currency investments, its amount in U.S. dollar terms is not fixed and varies with each transitory change in the exchange rates. If the income is remitted in U.S. dollars, then its amount is fixed and then we can recognize it as U.S. dollar income on accounting reports.

Attached is Chapter 16 of the Miller Comprehensive GAAP Guide 1988 which discusses FASB-52, the statement of the Financial Accounting Standards Board that establishes generally accepted accounting principles for foreign operations and exchange. FASB-52 requires recognition in U.S. dollars of the book value of the income, gains, and losses realized in foreign currencies but not converted into U.S. dollars.

There are several aspects of FASB-52 that suggest this is a less than satisfactory treatment of the accounting problem.

1. For one thing, FASB-52 was highly controversial and was adopted by only a 4-3 vote.
2. Significantly, any foreign currency exchange gain or loss that results from translating (but not converting) income, gains, and losses realized in foreign currencies into U.S. dollars is not recorded as income on the U.S. dollar books of account, but is instead to be posted directly to a separate component of shareholder equity and realized as income only on partial or complete liquidation of the foreign investment. This seems rather arbitrary since not only the gain or loss component but also the original book value of the investment is just as much at risk to fluctuations in foreign exchange rates.
3. Along these lines, it is interesting to note that on page 22 Miller suggests that if it is not possible to compute meaningful exchange rates (in his examples, owing to foreign strife or exchange restrictions), "it is best to include earnings of a foreign operation only to the extent that cash has been received in unrestricted funds." Similarly, on page 24 Miller states "disclosure of exchange rate changes. . . that occur subsequent to the balance sheet date should be disclosed, if the effects are material." Given that the retirement funds investments are of a

The Honorable Hugh Malone
Page 3
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long-term nature, the exchange rate as of the balance sheet date is not meaningful. Partial or complete liquidations of these foreign investments are highly infrequent.

Perhaps the basic problem is that FASB-52 is oriented toward business activities in foreign countries that generate liabilities in foreign currencies. (The second model which FASB-52 addresses (page 4), a business which conducts operations in U.S. dollars, is certainly not relevant.) The retirement systems are a misfit in that they operate in foreign currencies yet all their liabilities are in U.S. dollars. Indeed, this would be true of any foreign investment, as opposed to business, activity. The examples and language of FASB-52 do not explicitly address investment activities.

MBB/gb

Attachments

ANNUAL RATES OF RETURN (a)
ON EXTERNALLY MANAGED EQUITIES
OF ALASKA RETIREMENT FUNDS

MANAGER AND INCEPTION DATE	03-31-89 to 06-30-89	06-30-88 to 06-30-89	Inception to 06-30-89
R.E. Equity Managers:	MANAGER R of R	MANAGER R of R	MANAGER R of R
Aetna (09-30-80)	N/A	4.77% (b)	6.19% (b)
Hancock (09-30-80)	N/A	-0.42 (b)	3.24 (b)
Equitable (12-31-80)	8.67	8.00	8.39
Sentinel (03-05-81)	N/A	6.54 (b)	7.02 (b)
JMB (04-12-84)	3.49	11.57	8.92
Morgan (06-01-84)	10.50	9.27	12.08
Karsten (12-26-84)	N/A	4.82 (b)	6.74 (b)
<u>Group Average</u>		<u>7.64%</u>	<u>7.54%</u>
<u>Domestic Equity Managers:</u>			
Alger (06-14-84)	47.58%	10.12%	10.81%
Invesco (06-14-84)	33.64	1.90	13.88
Lehman (06-14-84)	32.09	18.99	17.27
IDS (01-12-89)	37.24	28.21	28.21
Loomis, Sayles (01-12-89)	31.37	31.31	31.31
Miller Anderson (01-12-89)	26.20	27.74	27.74
United Capital (01-12-89)	27.35	22.13	22.13
<u>Active Group Average*</u>	<u>32.51%</u>	<u>17.69%</u>	<u>15.06%</u>
State Street (07-13-88)	29.21	17.40	17.40
Treasury (11-02-87)	11.22	8.56	7.98
<u>Domestic Group Average</u>	<u>32.24%</u>	<u>17.59%</u>	<u>15.15%</u>
<u>International Equity Managers:</u>			
Citicorp (11-01-83)	-18.59	7.77	24.83
Morgan Guaranty (11-01-83)	-7.71	10.74	25.56
<u>Group Average</u>	<u>-13.27%</u>	<u>9.26%</u>	<u>25.20%</u>
<u>ALL EQUITY MANAGER AVERAGE</u>		<u>14.55%</u>	<u>15.08%</u>

* - Not net of fees of approximately .31%.

a - Pure internal rate of return weighted by amount and date of deposits.

b - Used 03-31-89 value because 06-30-89 was not available.

Portfolio Management, Treasury Division
August 16, 1989

ANNUAL RATES OF RETURN (a)
ON INTERNALLY MANAGED FIXED INCOME INVESTMENTS
AND ON THE TOTAL FUNDS OF ALASKA RETIREMENT FUNDS
Fiscal Years 1985 through June 30, 1989

	<u>Fiscal Year 1989</u>		<u>Fiscal Year 1988</u>		<u>Fiscal Year 1987</u>		<u>Fiscal Year 1986</u>		<u>Fiscal Year 1985</u>		<u>Fiscal Year 1985 Through June 30, 1989</u>	
	<u>Rates of Return at Cost (c)</u>	<u>Market</u>	<u>Rates of Return at Cost (c)</u>	<u>Market</u>	<u>Rates of Return at Cost (c)</u>	<u>Market</u>	<u>Rates of Return at Cost (c)</u>	<u>Market</u>	<u>Rates of Return at Cost (c)</u>	<u>Market</u>	<u>Rates of Return at Cost (c)</u>	<u>Market</u>
R. E. Mortgages	9.08%	11.81%	10.63%	8.60%	13.38%	4.05%	11.74%	17.96%	13.05%	26.61%	12.07%	16.45%
Bonds and Reserves (b)	<u>9.68</u>	<u>15.04</u>	<u>9.48</u>	<u>7.67</u>	<u>10.43</u>	<u>4.87</u>	<u>11.61</u>	<u>23.24</u>	<u>9.75</u>	<u>29.65</u>	<u>10.14</u>	<u>15.18</u>
Total Fixed Income	9.62%	14.72%	9.63%	7.79%	10.98%	4.71%	11.64%	21.67%	10.83%	28.62%	10.55%	15.44%
Total Equities	<u>14.55%</u>	<u>14.55%</u>	<u>-5.12%</u>	<u>-5.12%</u>	<u>20.39%</u>	<u>20.39%</u>	<u>37.80%</u>	<u>37.80%</u>	<u>21.54%</u>	<u>21.54%</u>	<u>15.08%</u>	<u>15.08%</u>
TOTAL FUND	<u>11.58%</u>	<u>14.65%</u>	<u>2.73%</u>	<u>1.93%</u>	<u>14.94%</u>	<u>10.90%</u>	<u>19.74%</u>	<u>26.59%</u>	<u>13.27%</u>	<u>26.84%</u>	<u>12.14%</u>	<u>15.31%</u>

a - Internal rates of return under simplifying assumption of mid-month flows for fixed income investments.

b - Net of gains, losses, and amortizations.

c - Cost returns for fixed income investments; but market returns on equities. The returns for total fund approximate actuary's calculation of returns.

Portfolio Management, Treasury Division
August 18, 1989

Item 6

BY THE RULES COMMITTEE BY REQUEST OF THE LEGISLATIVE BUDGET AND AUDIT
COMMITTEE

1 IN THE SENATE

2

SENATE BILL NO. 417

3

IN THE LEGISLATURE OF THE STATE OF ALASKA

4

SIXTEENTH LEGISLATURE - SECOND SESSION

5

A BILL

6

For an Act entitled: "An Act relating to management and investment of
7 certain state funds; and providing for an effective
8 date."

9

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

10

* Section 1. AS 14.25.035(d) is amended to read:

11

(d) The commissioner of administration shall report to the board

12

concerning the condition and administration of the system. The re-

13

ports shall be distributed to the members of the system. The State

14

Investment Board [COMMISSIONER OF REVENUE] shall provide reports to

15

the board on the condition and investment performance of the teachers'

16

retirement trust fund and an annual external performance review. The

17

review must be complete, understandable, and presented in acceptable

18

format according to industry patterns and customs.

19

* Sec. 2. AS 14.25.180 is amended to read:

20

Sec. 14.25.180. MANAGEMENT AND INVESTMENT OF FUND. (a) The

21

State Investment Board [COMMISSIONER OF REVENUE] is the [TREASURER OF

22

THE SYSTEM AND THE] fiduciary of the fund. In managing the fund, the

23

State Investment Board [COMMISSIONER OF REVENUE] shall

24

(1) consider the status of the fund's investments and the

25

system's liabilities on both a current and a probable future basis;

26

(2) determine the appropriate investment objectives for the

27

fund;

28

(3) establish investment policies aimed at achieving the

29

objectives; and

1 (4) act only in regard to the best financial interests of
2 the system's beneficiaries.

3 (b) The State Investment Board [COMMISSIONER OF REVENUE] may
4 invest the fund on the basis of probable total rate of return without
5 regard to the distinction between principal and income or to the
6 generation of income.

7 (c) In carrying out investment duties under this chapter, the
8 State Investment Board [COMMISSIONER OF REVENUE] has the same powers
9 and duties in regard to the teacher's retirement trust fund as are
10 provided in AS 37.10.071, except that the standard of prudence that
11 the board [COMMISSIONER] must obey under AS 37.10.071(c) shall be in
12 regard to the management of large trust investments rather than large
13 investments.

14 * Sec. 3. AS 14.40.400(b) is amended to read:

15 (b) The State Investment Board [COMMISSIONER OF REVENUE] is the
16 fiduciary of the trust fund and shall account for and invest the fund
17 as set out in AS 37.14.110(c), 37.14.160, and 37.14.170, except that
18 the board [COMMISSIONER] shall report the condition and investment
19 performance of the fund to the Board of Regents.

20 * Sec. 4. AS 18.56.095(a) is amended to read:

21 (a) There is a special fund of the state to be known as the
22 "state mortgage insurance fund," referred to in this section as
23 [(CALLED) the "mortgage insurance fund," {}] which shall be completely
24 segregated and set apart from all other funds of the state, and which
25 is a trust fund for the uses and purposes of this section and into and
26 from which money shall be paid as provided in this section. The mort-
27 gage insurance fund shall be held by the State Investment Board [COM-
28 MISSIONER OF REVENUE], subject to the power of the commissioner of
29 commerce and economic development to enter into and perform agreements

1 with respect to the use of money in the mortgage insurance fund and to
2 pledge, assign, or grant interests in the mortgage insurance fund as
3 provided in this section. The commissioner of commerce and economic
4 development may enter into agreements with the corporation with re-
5 spect to the exercise of any power or approval relating to the mort-
6 gage insurance fund under this section, including, without limitation,
7 agreements as to the use of money in the mortgage insurance fund,
8 agreements with respect to the terms and conditions upon which pay-
9 ments from the mortgage insurance fund shall be made to the corpo-
10 ration with respect to mortgage loans insured under this section, and
11 agreements regarding the payment of and security for mortgage insur-
12 ance bonds, and in connection with these agreements the commissioner
13 of commerce and economic development may pledge, assign, or grant
14 other interests in the mortgage insurance fund to the corporation as
15 may be necessary or appropriate in connection with the insurance of
16 mortgage loans and to provide for the payment of and security for
17 mortgage insurance bonds. An [ANY SUCH] agreement or [ANY OF] the
18 rights of the corporation under the agreement and payments received or
19 to be received under the agreement may be pledged or assigned by the
20 corporation for the benefit of the holders of mortgage insurance
21 bonds.

22 * Sec. 5. AS 18.56.095(b) is amended to read:

23 (b) In addition to any other fees and charges that the corpo-
24 ration may charge on mortgage loans, it may collect or cause to be
25 collected on all mortgage loans made or purchased with the proceeds of
26 the sale of mortgage insurance bonds, either both a special mort-
27 gage loan insurance commitment fee or a mortgage loan insurance pre-
28 mium. The special mortgage loan insurance commitment fees and special
29 mortgage loan insurance premiums when received shall be deposited in

1 the mortgage insurance fund by the corporation, or by any mortgage
2 loan servicer, trustee, or agent designated by the corporation to
3 receive them, and shall be held, invested and, together with all
4 investment income derived from them, reinvested by the State Invest-
5 ment Board [COMMISSIONER OF REVENUE] as set out in AS 37.10.071,
6 subject to any agreement with the corporation under (a) of this sec-
7 tion.

8 * Sec. 6. AS 22.25.048(c) is amended to read:

9 (c) The State Investment Board [COMMISSIONER OF REVENUE] is the
10 [TREASURER OF THE SYSTEM AND THE] fiduciary of the fund and has the
11 same powers and duties under this section in regard to the judicial
12 retirement trust fund as are provided in AS 14.25.180.

13 * Sec. 7. AS 26.05.278(c) is amended to read:

14 (c) The State Investment Board [COMMISSIONER OF REVENUE] is the
15 [TREASURER OF THE SYSTEM AND THE] fiduciary of the fund and has the
16 same powers and duties under this section in regard to the fund as are
17 provided under AS 14.25.180.

18 * Sec. 8. AS 36.30.850(b) is amended to read:

19 (b) This chapter applies to every expenditure of state money by
20 the state, acting through an agency, under a contract, except that
21 this chapter does not apply to

22 (1) grants;

23 (2) contracts for professional witnesses to provide for
24 professional services or testimony relating to existing or probable
25 lawsuits in which the state is or may become a party;

26 (3) contracts of the University of Alaska where the work is
27 to be performed substantially by students enrolled in the university;

28 (4) contracts for medical doctors and dentists;

29 (5) acquisitions or disposals of real property or interest

1 in real property, except as provided in AS 36.30.080;

2 (6) disposals under AS 38.05;

3 (7) contracts for the preparation of ballots under AS 15.-
4 15.030;

5 (8) acquisitions or disposals of property and other con-
6 tracts relating to airports under AS 02.15.070, 02.15.090, and 02.-
7 15.091;

8 (9) disposals of obsolete property under AS 19.05.060;

9 (10) disposals of obsolete material or equipment under
10 AS 35.20.060;

11 (11) agreements with providers of services under AS 44.47.-
12 250; AS 47.07; AS 47.08; AS 47.10; AS 47.17; AS 47.24; AS 47.25.195,
13 and 47.25.310;

14 (12) contracts of the Department of Fish and Game for
15 flights that involve specialized flying and piloting skills and are
16 not point-to-point;

17 (13) purchases of income-producing assets for the state
18 treasury or a public corporation of the state;

19 (14) operation of the state boarding school established
20 under AS 14.16, if the State Board of Education or the commissioner of
21 education adopts regulations for use by the state boarding school in
22 procurement and contracting;

23 (15) a contract that is a delegation, in whole or in part,
24 of investment powers held by the State Investment Board [COMMISSIONER
25 OF REVENUE] under AS 14.25.180, AS 14.40.400, AS 14.42.200, 14.42.210,
26 AS 18.56.095, AS 22.25.048, AS 26.05.228, AS 37.10.070, 37.10.071,
27 AS 37.14, or AS 39.35.080;

28 (16) a contract that is a delegation, in whole or in part,
29 of investment powers of the Board of Trustees of the Alaska Permanent

1 Fund Corporation under AS 37.13;

2 (17) the purchase of books, book binding services, newspa-
3 pers, periodicals, audio-visual materials, network information ser-
4 vices access, approval plans, professional memberships, archival
5 materials, objects of art, and items for museum or archival acquisi-
6 tion having cultural, historical, or archaeological significance; in
7 this paragraph

8 (A) "approval plans" means book selection services in
9 which current book titles meeting an agency's customized speci-
10 fications are provided to the agency subject to the right of the
11 agency to return those books that do not meet with the agency's
12 approval;

13 (B) "archival materials" means the noncurrent records
14 of an agency that are preserved after appraisal because of their
15 value;

16 (C) "audio-visual materials" means nonbook prerecorded
17 materials, including records, tapes, slides, transparencies,
18 films, filmstrips, cassettes, videos, compact discs, laser discs,
19 and items that require the use of equipment to render them us-
20 able;

21 (D) "network information services" means a group of
22 resources from which cataloging information, holdings records,
23 inter-library loans, acquisitions information, and other refer-
24 ence resources can be obtained;

25 (18) contracts for the purchase of standardized examinations
26 for licensure under AS 08;

27 (19) contracts for home health care and adult residential
28 and foster care services provided under regulations adopted by the
29 Department of Health and Social Services;

1 (20) contracts for supplies or services for research
2 projects funded by money received from the federal government or
3 private grants; or

4 (21) guest speakers or performers for an educational or
5 cultural activity.

6 * Sec. 9. AS 37.05.540(d) is amended to read:

7 (d) The State Investment Board [DEPARTMENT OF REVENUE] shall
8 manage and invest assets of the budget reserve fund in the manner set
9 out for the management and investment of the assets of the general
10 fund under AS 37.10.070. Income from investment of the budget reserve
11 fund may be appropriated to the fund each year by law.

12 * Sec. 10. AS 37.10.070 is amended to read:

13 Sec. 37.10.070. INVESTMENT OF RESIDUAL MONEY. (a) The board
14 [COMMISSIONER] shall invest, as set out in AS 37.10.071, the money in
15 the state treasury above an amount sufficient to meet immediate expen-
16 diture needs. In managing the invested assets, the board [COMMIS-
17 SIONER] shall

18 (1) consider the status of the assets and liabilities on
19 both a current and a probable future basis;

20 (2) determine the appropriate investment objectives;

21 (3) establish investment policies to achieve the objec-
22 tives; and

23 (4) act only in regard to the best financial interests of
24 the state.

25 (b) The board [COMMISSIONER] may invest on the basis of probable
26 total rate of return without regard to the distinction between princi-
27 pal and income and without regard to the generation of income.

28 (c) In this section, "board" means the State Investment Board
29 ["COMMISSIONER" MEANS THE COMMISSIONER OF REVENUE].

1 * Sec. 11. AS 37.10.071 is amended to read:

2 Sec. 37.10.071. INVESTMENT POWERS AND DUTIES. (a) In making
3 investments under this section, the board [COMMISSIONER OF REVENUE]
4 shall

5 (1) act as official custodian of cash and investments by
6 securing adequate and safe custodial facilities for them;

7 (2) receive all items of cash and investments;

8 (3) collect and deposit the principal of and income from
9 owned or acquired investments;

10 (4) invest and reinvest the assets in accordance with this
11 section;

12 (5) receive and spend appropriations to cover the cost of
13 the exercise of duties under this section;

14 (6) exercise the powers of an owner with respect to the
15 assets;

16 (7) perform all acts, not prohibited by this section,
17 whether or not expressly authorized, that the board [COMMISSIONER]
18 considers necessary or proper in administering the assets;

19 (8) maintain accounting records in accordance with gener-
20 ally accepted [INVESTMENT] accounting principles;

21 (9) engage an independent certified public accountant to
22 conduct an annual audit of the financial condition and investment
23 transactions;

24 (10) enter into and enforce contracts or agreements con-
25 sidered necessary, convenient, or desirable for the investment pur-
26 poses of this section; and

27 (11) when choosing to acquire or dispose of investments,
28 secure competitive national or international market rates or prices,
29 or the equivalence of those rates or prices in the judgment of the

1 board [COMMISSIONER].

2 (b) Under this section, the board or the board's [COMMISSIONER
3 OR THE COMMISSIONER'S] designee may

4 (1) delegate investment, custodial, or depository authority
5 on a discretionary or nondiscretionary basis to officers or employees
6 of the state or to independent firms, banks, or trust companies, by
7 designation through appointments, contracts, or letters or authority;

8 (2) acquire or dispose of investments either directly,
9 indirectly, or through investment pools or trusts, by competitive or
10 negotiated agreements, contracts, or auctions, in public or private
11 markets;

12 (3) concentrate or diversify investments as the board
13 [COMMISSIONER] considers appropriate to increase the probable total
14 rate of return or to decrease the overall exposure to potentially
15 adverse market value risks;

16 (4) protect the market value or the rate of return of the
17 investments by entering into forward agreements to buy or sell assets
18 at a future date as a hedge against existing held assets or as a
19 precommitment of future cash flows;

20 (5) lend assets, under an agreement and for a fee, against
21 deposited collateral of equivalent market value;

22 (6) borrow assets on a short-term basis, under an agreement
23 and for a fee, against the deposit of collateral consisting of other
24 assets in order to accommodate temporary cash or investment needs;

25 (7) hold investments in bearer or registered form in the
26 name of the state, a fund, or nominees authorized by the board [COM-
27 MISSIONER];

28 (8) utilize consultants, advisors, custodians, investment
29 services, and legal counsel for assistance in investment matters on

1 either a continuing or a limited-term basis and with or without
2 compensation;

3 (9) declare records to be confidential and exempt from
4 AS 09.25.110 and 09.25.120 if the records contain information that
5 discloses the particulars of the business or the affairs of a private
6 enterprise, investor, borrower, advisor, consultant, counsel, or
7 manager.

8 (c) In exercising investment, custodial, or depository powers or
9 duties under this section, the board [COMMISSIONER] shall exercise the
10 judgment and care under the circumstances then prevailing that an
11 institutional investor of ordinary professional prudence, discretion,
12 and intelligence exercises in managing large investments with consid-
13 eration for the purpose of the fund, the investment objectives, the
14 continuing disposition of the fund's investments, and the probable
15 safety of the capital as well as the probable investment returns.

16 (d) In exercising investment, custodial, or depository powers or
17 duties under this section, the board or the board's [COMMISSIONER OR
18 A] designee [OF THE COMMISSIONER] is liable for a breach of a duty
19 that is assigned or delegated under this section, or under AS 14.25.-
20 180, AS 14.40.400(b), AS 37.10.070, AS 37.14.110(c), 37.14.160, 37.-
21 14.170, or AS 39.35.080. However, the board or the board's [COMMIS-
22 SIONER OR THE COMMISSIONER'S] designee is not liable for a breach of a
23 duty that has been delegated to another person if the delegation is
24 prudent under the applicable standard of prudence set out in statute
25 or if the duty is assigned by law to another person, except to the
26 extent that the board [COMMISSIONER] or designee

27 (1) knowingly participates [PARTICIPATE] in, or knowingly
28 undertakes to conceal, an act or omission of another person, knowing
29 that the act or omission is a breach of that person's duties under

1 this chapter;

2 (2) by failure to comply with this section in the adminis-
3 tration of specific responsibilities, enables another person to commit
4 a breach of duty; or

5 (3) has knowledge of a breach of duty by another person,
6 unless the board [COMMISSIONER] or designee makes reasonable efforts
7 under the circumstances to remedy the breach.

8 (e) The state shall defend and indemnify the board [COMMIS-
9 SIONER] or an officer or employee of the state against liability under
10 (d) of this section to the extent that the alleged act or omission was
11 performed in good faith and was prudent under the applicable standard
12 of prudence.

13 (f) In this section, "board" ["COMMISSIONER OF REVENUE" OR
14 "COMMISSIONER"] means

15 (1) the State Investment Board [COMMISSIONER OF REVENUE]
16 for investments under AS 14.25.180 or AS 37.10.070; or

17 (2) the person or body provided by law to manage the in-
18 vestments, for investments not subject to AS 14.25.180 or AS 37.10.-
19 070.

20 * Sec. 12. AS 37.10 is amended by adding new sections to read:

21 ARTICLE 5. STATE INVESTMENT BOARD.

22 Sec. 37.10.210. STATE INVESTMENT BOARD. (a) There is estab-
23 lished in the Department of Revenue the State Investment Board. The
24 purpose of the board is to manage and invest, with the assistance of
25 the Department of Revenue, state funds and revenue.

26 (b) The board consists of nine members:

27 (1) two members who are members of the Teachers' Retirement
28 Board, nominated by that board and appointed by the governor;

29 (2) two members who are members of the Public Employees'

1 Retirement Board, nominated by that board and appointed by the
2 governor;

3 (3) the commissioner of revenue;

4 (4) the commissioner of administration;

5 (5) three public members, appointed by the governor.

6 (c) The public members must have recognized competence and wide
7 experience in finance, investments, or other business management-
8 related fields. A public member may not hold another state or federal
9 office, position, or employment, either elective or appointive, except
10 as a member of the armed forces of either the United States or of this
11 state. The public members of the board shall be appointed for stag-
12 gered terms of six years and may be reappointed to the board.

13 (d) The governor may remove a public member of the board from
14 office. A removal by the governor must be in writing and must state
15 the reason for the removal. After a member receives written notice of
16 removal from the governor, the member may not participate in board
17 business and may not be counted for purposes of establishing a quorum.

18 (e) A vacancy on the board shall be promptly filled in the same
19 manner as the seat was originally filled. An appointee to a vacancy
20 holds office for the balance of the unexpired term of the appointee's
21 predecessor. A vacancy on the board does not impair the authority of
22 a quorum of the board to exercise all the powers and perform all the
23 duties of the board.

24 (f) The board shall annually elect a chair from among its mem-
25 bers.

26 (g) Five members of the board constitute a quorum for the trans-
27 action of business and the exercise of the powers and duties of the
28 board.

29 (h) A member of the board may receive a per diem allowance and

1 transportation expenses in carrying out the duties set out in this
2 chapter.

3 Sec. 37.10.220. POWERS AND DUTIES OF THE BOARD. (a) The board
4 shall

5 (1) hold regular and special meetings at the call of the
6 chair or of at least five of the members;

7 (2) invest and manage all state funds whose investment and
8 management is not specifically provided for by another law;

9 (3) submit long-range and quarterly investment reports to
10 the Legislative Budget and Audit Committee;

11 (4) report to the governor and the legislature by Septem-
12 ber 30 of each year concerning the investment of state funds.

13 (b) The board may

14 (1) employ outside investment advisors to review investment
15 policies and make recommendations to the board;

16 (2) establish investment policies for the funds;

17 (3) engage independent certified public accountants to
18 audit the funds for which the board is responsible and to report to
19 the board with the results of the audit;

20 (4) contract with external performance evaluators to review
21 the performance of each fund managed or invested by the board and
22 report to the board and to the other boards directly responsible for
23 the activities supported by the fund on the fund's condition;

24 (5) do all acts necessary, convenient, or desirable to
25 carry out the powers expressly granted or necessarily implied in this
26 chapter.

27 Sec. 37.10.230. CONFLICTS OF INTEREST. (a) Members of the
28 board are subject to the provisions of AS 39.50.

29 (b) If a member of the board or an employee of the board ac-

1 quires, owns, or controls an interest, direct or indirect, in an
2 entity or project in which assets under the control of the board are
3 invested, the member shall immediately disclose the interest to the
4 board. The disclosure is a matter of public record and shall be
5 included in the minutes of the board meeting next following the dis-
6 closure.

7 Sec. 37.10.240. REGULATIONS. The board may adopt regulations
8 under the Administrative Procedure Act (AS 44.62).

9 * Sec. 13. AS 37.14.110(c) is amended to read:

10 (c) The State Investment Board [COMMISSIONER OF REVENUE] shall
11 account for the fund in accordance with generally accepted accounting
12 principles and shall determine the net income of the fund [IN ACCOR-
13 DANCE WITH INVESTMENT ACCOUNTING PRINCIPLES AND] in a manner that
14 preserves the distinction between principal and income and that ex-
15 cludes capital gains or losses realized on principal. The principal
16 of the fund and the capital gains or losses realized on principal
17 shall be perpetually retained in the fund for investment purposes.

18 * Sec. 14. AS 37.14.140 is amended to read:

19 Sec. 37.14.140. UTILIZATION OF INCOME. The net income of the
20 fund may not be appropriated for a purpose other than the support of
21 the state public school program. The State Investment Board [COMMIS-
22 SIONER OF REVENUE] shall invest realized net income that has not been
23 appropriated or that has been appropriated but not expended until the
24 income is appropriated and expended.

25 * Sec. 15. AS 37.14.160 is amended to read:

26 Sec. 37.14.160. DUTIES OF THE STATE INVESTMENT BOARD [COMMIS-
27 SIONER OF REVENUE]. The State Investment Board [COMMISSIONER OF
28 REVENUE] is the treasurer of the trust fund created in AS 37.14.110
29 and shall

1 (1) exercise the powers and duties established in
2 AS 14.25.180(c);

3 (2) deposit the principal and income from investments in
4 separate principal and income accounts for the fund;

5 (3) invest and maintain accounting records that distinguish
6 between the principal and income of the fund;

7 (4) provide reports to the board established under AS 37.-
8 14.120 on the condition and investment performance of the fund.

9 * Sec. 16. AS 37.14.170 is amended to read:

10 Sec. 37.14.170. INVESTMENTS. The State Investment Board [COM-
11 MISSIONER OF REVENUE] is the fiduciary of the trust fund and shall
12 invest the fund to provide increasing net income over long-term peri-
13 ods to the fund's income beneficiaries. The board [COMMISSIONER] may
14 invest the money in the fund on the basis of probable total rate of
15 return to promote the long-term generation of income. In managing the
16 trust fund, the board [COMMISSIONER] shall

17 (1) consider the status of the fund's capital and the
18 income generated on both a current and a probable future basis;

19 (2) determine the appropriate investment objectives;

20 (3) establish investment policies to achieve the objec-
21 tives; and

22 (4) act only in regard to the financial interests of the
23 fund's beneficiaries.

24 * Sec. 17. AS 37.14.200(c) is amended to read:

25 (c) The net income of the fund shall be determined by the State
26 Investment Board [COMMISSIONER OF REVENUE] in accordance with gener-
27 ally accepted [INVESTMENT] accounting principles. However, the board
28 shall preserve [AND IN A MANNER THAT PRESERVES] the distinction be-
29 tween principal and income.

1 * Sec. 18. AS 37.14.210 is amended to read:

2 Sec. 37.14.210. POWERS AND DUTIES OF THE STATE INVESTMENT BOARD
3 [COMMISSIONER OF REVENUE]. The State Investment Board [COMMISSIONER
4 OF REVENUE] is the fiduciary [TREASURER] of the fund and has the power
5 and duty to:

6 (1) act as official custodian of the cash and investments
7 belonging to the fund by securing adequate and safe custodial facil-
8 ities;

9 (2) receive all items of cash and investments belonging to
10 the fund;

11 (3) collect the principal and income from investments owned
12 or acquired by the fund and deposit the amounts in separate principal
13 and income accounts for the fund;

14 (4) invest and reinvest the assets of the fund as provided
15 in this section and as provided for the investment of funds under
16 AS 14.25.180(c) and AS 37.14.170;

17 (5) exercise the powers of an owner with respect to the
18 assets of the fund;

19 (6) maintain accounting records of the fund in accordance
20 with generally accepted [INVESTMENT] accounting principles; however,
21 the board shall preserve the [AND WITH] distinction between the prin-
22 cipal and income accounts of the fund;

23 (7) engage an independent firm of certified public accoun-
24 tants to annually audit the financial condition of the fund's invest-
25 ments and investment transactions;

26 (8) enter into and enforce contracts or agreements con-
27 sidered necessary for the investment purposes of the fund;

28 (9) report to the board the condition and investment per-
29 formance of the fund;

1 (10) do all acts, whether or not expressly authorized, that
2 the State Investment Board [COMMISSIONER OF REVENUE] considers neces-
3 sary or proper in administering the assets of the fund.

4 * Sec. 19. AS 39.30.095(d) is amended to read:

5 (d) If the commissioner of administration determines that there
6 is more money in the fund than the amount needed to pay premiums or
7 benefits for the current fiscal year, the surplus, or so much of it as
8 the commissioner of administration considers advisable, may be in-
9 vested by the State Investment Board [COMMISSIONER OF REVENUE] in the
10 same manner as retirement funds are invested under AS 14.25.180.

11 * Sec. 20. AS 39.30 is amended by adding a new section to read:

12 Sec. 39.30.175. INVESTMENT OF BENEFIT PROGRAM RECEIPTS. The
13 State Investment Board is the fiduciary of the receipts of the employ-
14 ee benefits program established under AS 39.30.150 - 39.30.180 and has
15 the same powers and duties concerning the management and investment in
16 regard to those receipts as are provided under AS 14.25.180.

17 * Sec. 21. AS 39.35.020 is amended to read:

18 Sec. 39.35.020. ADMINISTRATION. The commissioner of administra-
19 tion is responsible for the administration of the system and for
20 carrying out this chapter. In addition the commissioner shall

21 (1) maintain the accounts of the system;

22 (2) make payments for the various purposes specified;

23 (3) submit periodic reports or statements of account that
24 are needed;

25 (4) issue a statement of account to an employee requesting
26 it showing the amount of the employee's contributions to the system;

27 (5) as soon as possible after the close of each fiscal
28 year, and not later than six months after the close of each fiscal
29 year, send to the governor, the legislature, and the board an annual

1 statement on the operations of the system containing

2 (A) a balance sheet;

3 (B) a statement of income and expenditures for the
4 year;

5 (C) a report on an actuarial valuation of its assets
6 and liabilities;

7 (D) a summary of assets held in the pension fund
8 listed by the categories of investment, as provided by the State
9 Investment Board [COMMISSIONER OF REVENUE];

10 (E) other statistical financial data that are neces-
11 sary for a proper understanding of the financial condition of the
12 system and the result of its operations;

13 (6) establish a public employees retirement trust fund in
14 which the assets of the system shall be deposited and held;

15 (7) engage an independent certified public accountant to
16 conduct an annual audit of the system's accounts and the annual report
17 of the system's financial condition and activity;

18 (8) report to the board concerning the condition and admin-
19 istration of the system and distribute the report to the members of
20 the system.

21 * Sec. 22. AS 39.35.080 is amended to read:

22 Sec. 39.35.080. DUTIES OF THE STATE INVESTMENT BOARD [COMMIS-
23 SIONER OF REVENUE]. The State Investment Board [COMMISSIONER OF
24 REVENUE] is the [TREASURER OF THE SYSTEM AND THE] fiduciary of the
25 fund. The board [COMMISSIONER] has the same powers and duties estab-
26 lished under this chapter in regard to the fund as are provided in
27 AS 14.25.035(d) and 14.25.180.

28 * Sec. 23. AS 39.45.030(a) is amended to read:

29 (a) The State Investment Board [ADMINISTRATOR OF THE STATE OR

1 POLITICAL SUBDIVISION DEFERRED COMPENSATION PROGRAM] is authorized,
2 subject to contracts with individual employees, to invest the funds
3 held under a deferred compensation program in

4 (1) fixed and variable life insurance and annuity contracts
5 or other contracts issued by life insurance companies;

6 (2) shares of or deposits in insured state or federal
7 chartered credit unions in the state;

8 (3) shares of or deposits in insured state or federal
9 chartered savings and loan associations in the state;

10 (4) deposits in insured mutual savings banks in the state;

11 (5) deposits in insured state and national banks in the
12 state; and

13 (6) multi-employer trusts established for investment of
14 deferred compensation assets of state and local governments.

15 * Sec. 24. AS 39.50.200(b) is amended by adding a new paragraph to
16 read:

17 (50) State Investment Board (AS 37.10.210).

18 * Sec. 25. AS 43.23.015(e) is amended to read:

19 (e) If a public agency claims a permanent fund dividend on
20 behalf of an individual, the public agency shall hold the dividend in
21 trust for the individual. Money held in trust under this subsection
22 shall be invested by the State Investment Board under [COMMISSIONER IN
23 ACCORDANCE WITH] AS 37.10.070.

24 * Sec. 26. AS 43.23.045(a) is amended to read:

25 (a) The dividend fund is established as a separate fund in the
26 state treasury. The dividend fund shall be administered by the com-
27 missioner and shall be invested by the State Investment Board [COMMIS-
28 SIONER] in the same manner as provided in AS 37.10.070.

29 * Sec. 27. AS 44.25.020 is amended to read:

1 Sec. 44.25.020. DUTIES OF DEPARTMENT. The Department of Revenue
2 shall

3 (1) enforce the tax laws of the state;

4 (2) collect, account for, and have custody of [, INVEST,
5 AND MANAGE] all state funds and all revenues of the state except
6 revenues incidental to a program of licensing and regulation carried
7 on by another state department;

8 (3) register cattle brands;

9 (4) supply necessary clerical and administrative services
10 for the Alcoholic Beverage Control Board and the State Investment
11 Board; and

12 (5) implement the investment and management policies and
13 directives of the State Investment Board [INVEST AND MANAGE THE BAL-
14 ANCE OF THE POWER DEVELOPMENT FUND IN ACCORDANCE WITH AS 44.83.386].

15 * Sec. 28. AS 44.83.386 is amended to read:

16 Sec. 44.83.386. INVESTMENT OF FUND. The State Investment Board
17 [DEPARTMENT OF REVENUE] shall invest the money in the fund in accor-
18 dance with AS 37.10.070, 37.10.071, and 37.10.075. The board [DEPART-
19 MENT OF REVENUE] shall provide money in the fund to the authority only
20 after costs have been incurred or amounts in the fund have been other-
21 wise obligated under contracts for the acquisition and construction of
22 a project. Amounts that have been obligated, but for which costs have
23 not yet been incurred, may be segregated by the Department of Revenue
24 or transferred to the authority only with the prior approval or agree-
25 ment of the commissioner of revenue. Income received on money that is
26 segregated or transferred under this section must be deposited in the
27 general fund.

28 * Sec. 29. AS 46.11.050(b) is amended to read:

29 (b) A [AFTER DECEMBER 31, 1980, A] financial institution that

1 makes home mortgage loans with money provided to it by the State
2 Investment Board [COMMISSIONER OF REVENUE] from surplus state general
3 fund investments authorized by AS 37.10.070, or a state agency that
4 [WHICH] makes a direct home mortgage loan to an applicant, shall
5 include estimated heating and lighting costs as determined by an
6 energy audit in standard principal, interest, taxes and insurance
7 calculation of the cost of buying a housing unit. An applicant for a
8 home mortgage loan shall provide the financial institution or the
9 state agency with a copy of an energy audit.

10 * Sec. 30. TRANSITION. All litigation, hearings, investigations, and
11 other proceedings pending under a law amended or repealed by this Act, or
12 in connection with functions transferred by this Act, continue in effect
13 and may be continued and completed notwithstanding a transfer, amendment,
14 or repeal provided for in this Act. Orders and regulations issued or
15 adopted under authority of a law amended or repealed by this Act remain in
16 effect for the term issued, or until revoked, vacated, or otherwise mod-
17 ified under the provisions of this Act. All contracts, rights, liabilities
18 and obligations created by or under a law amended or repealed by this Act,
19 and in effect on the effective date of this Act, remain in effect notwith-
20 standing this Act's taking effect. Records, equipment, and other property
21 of agencies of the state whose functions are transferred under this Act
22 shall be transferred commensurate with the provisions of this Act.

23 * Sec. 31. The State Investment Board may hold organizational meetings
24 as soon as a quorum of the board has been appointed to or selected for the
25 board.

26 * Sec. 32. AS 37.10.210, 37.10.230, and 37.10.240, enacted by sec. 12
27 of this Act, and sec. 31 of this Act take effect immediately under AS 01.-
28 10.070(c).

29 * Sec. 33. Except for those sections that take effect under sec. 32 of

1 this Act, this Act takes effect January 1, 1991.

Alaska State Legislature

Sen. Pat Pourchot, Chairman

Sen. Jan Faika, Vice Chairman
Sen. Al Adams
Sen. Tim Kelly
Sen. Rick Uehling



P.O. Box V
State Capitol
Juneau, Alaska 99811

907-465-3712

Senate State Affairs Committee

MEMORANDUM

TO: Senate State Affairs Committee Members
FROM: Senator Pat Pourchot
RE: Wednesday, March 14 Committee Hearing
DATE: March 13, 1990

On Wednesday, March 14 at 1:30 p.m. in the Beltz Room the Senate State Affairs Committee will hear the following bills:
TELECONFERENCE; Limited Testimony from the Texas Trust Company only.

SB 509, An Act establishing the Alaska State Trust Company. This bill establishes a separate corporate structure for a State Trust Company, which would be governed by a board of professional investors and beneficiaries. The board would have the authority to directly access U.S. Federal Reserve bank services, which would establish the corporation as the singular entity in this state allowed this service. This bill transfers management of the PERS, TRS, Judicial and Military Retirement Funds, as well as the University of Alaska and the Public School Trust Fund, from the Commissioner of Revenue to the trust company. The bill allows the trust company to manage other public funds, including the General Fund and the SBS funds.

→ SB 417, An Act relating to management and investment of certain state funds. Introduced by Senator Kerttula, who serves as Chairman of the Legislative Budget and Audit Committee, this bill would establish a State Investment Board which would be responsible for managing the state's trust funds, the board would be composed of nine members: two from PERS, two from TRS, Commissioner of Revenue, Commissioner of Administration and three public members. The State Investment Board concept is based on a recommendation from the Legislative Auditor after completing an inquiry into the Department of Administration's investment strategy for SBS funds. SB 417, specifies oversight of the SBS and deferred compensation funds.

SB 197, An Act relating to management and investment of state retirement funds. This bill, as introduced by Senator Binkley, would transfer the management of the retirement trust funds and the Public School Trust funds from the Commissioner of Revenue to the Alaska Permanent Fund Corporation. It does not impact the management of University of Alaska Trust Fund, the General Fund nor the SBS, deferred compensation monies. Beneficiaries do not currently sit on the Alaska Permanent Fund Board.

MEMORANDUM

STATE OF ALASKA
DEPARTMENT OF REVENUE

TO: Milt Barker
Deputy Commissioner
Treasury Division

DATE: December 18, 1989

TELEPHONE: 465-2350

FROM: Michael Cheung
State Investment Officer
Treasury Division

M.C.

RE: GIC Investment For SBS

Per your request, I have reviewed our SBS GIC investment. To summarize, the State should thoroughly examine the overall nature and purposes of the SBS. The State should determine a plan objective that can incorporate both short-term and long-term needs of the plan. An investment strategy should then be set up for accomplishing this objective. As for our current GIC investments, the State should be cautious about the current turmoil in the high yield securities market, as Executive Life's business structure has been severely affected and will continue to be. Finally, any future ITB should require financial information that will enable the State to properly evaluate the financial structure and its soundness of a potential GIC provider.

The State of Alaska is the annuity plan sponsor and the plan is qualified as a defined contribution plan under IRS code 401(a). It is critical for any plan sponsor to understand the nature of its plan and the strategy it takes to accomplish its objectives. A fiduciary has to act like a Prudent Expert in all related matters with primary responsibilities on reducing risk and secondarily on earning a reasonable return. Basically a plan must have:

- a. Competitive rate of return;
- b. Maintain sufficient liquidity for benefit payments; and
- c. Maintain the safeguards and diversification that is prudent in order to reduce risk on portfolio return.

Here are a few major factors that will influence the nature of a plan. A fiduciary should carefully evaluate each of them in order to determine the objectives of the plan and the necessary strategy to accomplish it.

Need for Current Income: Is the plan in a net cash outflow stage? This will be largely influenced by the characteristics of the plan participants.

Milt Barker
December 18, 1989
Page 2

Inflation Protection: Analyze how the minimum investment income requirement will change over time with inflation.

Capital Risk Tolerance: What are the probable emotional reactions to an adverse outcome? How much volatility can be comfortably accepted?

Liquidity Requirement: Assess the probability of forced sale.

After evaluating the above factors, an investment strategy needs to be set up. Asset allocation decisions must be made. The main reason for having various asset classes is that portfolio return risk can be reduced and in the long run, a sustainable growth can also be achieved.

Currently, the State of Alaska has its SBS monies invested only in GIC instruments. The longest maturity GIC is six years and a weighted average life of 3.3 years for the entire portfolio. However, the nature of the SBS plan is for long-term purposes. The plan is in a positive cash contribution stage as annual contribution will exceed annual annuity payments in 1990. Assuming this trend will continue in the foreseeable future, long-term returns will be more critical to the plan than current income. This means the investment strategy should be one that has a long time horizon with diversified assets in order to provide sustainable growth.

To satisfy both the current annuity payments and long-term growth needs of the plan, the portfolio should be divided into two sections. One portion of it should be set up with high quality fixed income securities. A dedicated cashflow strategy will be employed for this sector, whereby principal payments and interest payments from the bond portfolio will be used to fund annuity payments. A dedicated cashflow strategy is one of the methods a GIC insurer employs to match their assets and liabilities. Another method for asset/liability matching is a bond immunization strategy. An immunization strategy will try to match the duration of annuity payments with the duration of the bond portfolio. This technique permits the locking in of a yield, at the same time the reinvestment rate risk is minimized. Immunization requires three conditions be met:

1. Portfolio Duration = Liability Duration
2. Portfolio Value = Present Value of the Liability Stream
3. Dispersion of portfolio cashflows is equal or slightly greater than the dispersion of the liability stream.

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After evaluating the long-term objectives of the fund, another section of the portfolio should be geared for the long-term inflation protected growth and benefits, and asset allocation decisions should be made. Investment strategy should encompass a long investment horizon with various assets that should contribute to a sustainable portfolio return and growth. To have the proper assets mix, risks (variability of return), and expected rates-of-return of different asset types should be evaluated with respect to various economic scenarios. This process will determine the proper asset allocation that is necessary to accomplish the plan objectives. As the economy and the plan characteristics change, plan sponsors should review the plan objectives and investment strategy. Therefore, a fiduciary can take proper actions to ensure the safety, returns, and value of the plan assets.

Within the context of our current GIC portfolio, the State has diversified its investments among various GIC insurers and has set up a ladder maturity schedule. The ability of an insurer to live up to its contractual agreement is dictated by its financial strength and assets quality. There are two levels of comfort an insurer can provide: 1) conservative investment management, which includes lending assets to solid borrowers, diversification of loans by geography and industry, and limiting the amounts invested in any one company, industry, or area; and 2) maintenance of a substantial contingency fund to cover losses of any sour investments. If an insurer does not invest prudently and realized losses occur, all it has to fall back on is its contingency reserve fund.

At present, approximately 25% of our GIC's is provided by Executive Life, a principal subsidiary of First Executive Corporation. First Executive has been known in the investment community as a major player in high yield fixed income securities. At the end of 1988 fixed income securities investments represented over 80% of total assets as compared with the industry's 50% average. Approximately 50% of its assets were invested in speculative-grade bonds and private placements, while industry average is less than 15%.

Executive Life competes in the GIC market by offering higher yields than some of its competitors. Executive Life has this ability because of its higher proportion of below-investment grade securities. This strategy involves some long-term risk. Although the company follows a policy of diversification by issuer and industry, any problems that arise from any bond issuer can affect the whole high yield industry. Presently, we are already witnessing the current shakeout in the high yield fixed income industry. Executive Life has already felt the turmoil in the high yield securities market. At year end 1988, the market value of the bond portfolio was below book value by over \$400 million. And a trading out of problem investments may result in a reduction of capital when realized losses are incurred in restructuring in portfolio.

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Recently, a Wall Street Journal article stated that First Executive (parent company) was involved in restructuring its bond portfolio. By setting up six non-disclosed subsidiaries, First Executive was able to transfer \$750 million of its high yield bonds to its subsidiaries. (Any investments worth at least 10% of the net worth has to be publicly disclosed, and 10% of the net worth for First Executive was \$140 million. First Executive only invested \$128 million in each of the subsidiaries.) In return, First Executive received \$770 million notes issued by the subsidiaries. The interests and principal payments on the subsidiaries' notes will be supported by the high yield bonds that First Executive has swapped out. In other words, First Executive was able to unload these high yield securities to its subsidiaries without incurring any realized losses. The new notes issued by the subsidiaries also received a more favorable rating by the insurance regulators. Thus, First Executive was able to reduce an estimated \$120 million from its reserve for investment losses. Therefore, liability or insurance claim holders should not view their claims as supported by improved asset quality, because the only benefits realized was First Executive's ability to reduce its reserve account. With the continued turmoil in the high yield securities market. First Executive will be hard pressed to change its business and investment strategy. The State should closely monitor this situation and do any necessary actions to preserve the safety of the SBS assets. Currently, Moody's has placed Executive Life's A1 claims-paying rating on review. The review will focus on the shakeout in the high-yield bond market and its affect on Executive Life.

For any future GIC investment, the State should also request audited financial statements and 10 Q's, quarterly statements and 10K's. These statements are filed with the SEC by publicly traded companies. Insurers should also furnish various types of investment quality ratios: delinquent percent, foreclosed percent, and below investment grade percent. Other ratios on financial strength and capital structure should also be provided. These ratios will indicate the management style and profitability of an insurer. The ITB or contract should also include explicit language that an insurer has to act like a prudent expert in order to prevent the insurer from any actions that will jeopardize the plan assets and its ability to generate the contractual return.

MC/mem

M E M O R A N D U M

January 29, 1990

SUBJECT: Sectional summary of Work Order No. 6-1875A
(Management and investment of state funds)

TO: Senator Jalmar Kerttula, Chairman
Legislative Budget and Audit Committee

FROM: Teresa B. Cramer
Legislative Counsel

You have requested a sectional analysis of the above described bill.

As a preliminary matter, note that a sectional analysis or summary of a bill should not be considered an authoritative interpretation of the bill and the bill itself is the best statement of its contents.

Section 1 substitutes the State Investment Board for the Commissioner of Revenue in reporting about the condition of the teachers' retirement trust fund and requires the State Investment Board to provide the Teachers' Retirement Board with an annual external performance review of the trust fund.

Sec. 2 makes the State Investment Board fiduciary of the teachers' retirement trust fund in place of the Commissioner of Revenue. The phrase "treasurer of the system" is removed as redundant to the remaining "fiduciary of the fund."

Sec. 3 substitutes the State Investment Board for the Commissioner of Revenue in management and investment of the University trust fund, which was established for revenues from the sale of federally granted lands.

Secs. 4 and 5 substitute the State Investment Board for the Commissioner of Revenue in the management and investment of the mortgage insurance fund of the Alaska Housing Finance Corporation.

Sec. 6 substitutes the State Investment Board for the Commissioner of Revenue in the management and investment of the judicial retirement trust fund.

Sec. 7 substitutes the State Investment Board for the Commissioner of Revenue in the management and investment of the Alaska National Guard and Alaska Naval Militia retirement fund.

Sec. 8 substitutes the State Investment Board for the Commissioner of Revenue in the management and investment of the funds cited, including the funds specifically amended in this bill and money held by the Alaska Student Loan Corporation (AS 14.42.200) including the student loan fund (AS 14.-42.210).

Sec. 9 substitutes the State Investment Board for the Commissioner of Revenue in the management and investment of the budget reserve fund.

Sec. 10 substitutes the State Investment Board for the Commissioner of Revenue in the management and investment of the money in the state treasury.

Sec. 11 substitutes the State Investment Board for the Commissioner of Revenue in the section that sets out the powers and duties of the entity that invests and manages state funds. In paragraph (a)(8), the bill also substitutes the phrase "in accordance with generally accepted accounting principles" for "in accordance with investment accounting principles."

Sec. 12 adds new sections creating the State Investment Board, setting out its powers and duties, requiring that members of the State Investment Board comply with state conflict of interest provisions, and permitting the State Investment Board to adopt regulations under the Administrative Procedure Act.

Secs. 13 - 16 substitute the State Investment Board for the Commissioner of Revenue in the management and investment of the public school trust fund. Sec. 13 also substitutes "generally accepted accounting principles" for "investment accounting principles" as the standard that the board must use in accounting for the fund.

Secs. 17 and 18 substitute the State Investment Board for the Commissioner of Revenue in the management and investment of the Alaska Children's trust fund. Sec. 17 and paragraph (6) in sec. 18 also substitute "generally accepted accounting principles" for "investment accounting principles" as the standard that the board must use in accounting for the fund. In the beginning of sec. 18, the bill substitutes "fiduciary" of the fund for "treasurer" of the fund.

Sec. 19 substitutes the State Investment Board for the Commissioner of Revenue in the management and investment of the group health and life benefits fund, which provides for group life and health insurance for public employees and retirees.

Sec. 20 adds a new section to the supplemental benefit system (SBS) statutes, identifying the State Investment Board as the fiduciary of SBS receipts.

Secs. 21 and 22 substitute the State Investment Board for the Commissioner of Revenue in the management and investment of the public employees' retirement fund.

Sec. 23 substitutes the State Investment Board for the Commissioner of Revenue in the management and investment of the deferred compensation program funds.

Sec. 24 adds the members of the State Investment Board to coverage of the conflict of interest statutes.

Sec. 25 substitutes the State Investment Board for the Commissioner of Revenue in the management and investment of the permanent fund dividends held in trust by public agencies for individuals.

Sec. 26 substitutes the State Investment Board for the Commissioner of Revenue in the management and investment of the permanent fund dividend fund.

Sec. 27 amends the duties of the Department of Revenue to reflect the changes made by the bill. The department is directed to implement the investment and management policies and directives of the State Investment Board.

Sec. 28 substitutes the State Investment Board for the Commissioner of Revenue in the management and investment of the power development fund of the Alaska Energy Authority.

Senator Jalmar Kerttula
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Sec. 29 substitutes reference to the State Investment Board for reference to the Commissioner of Revenue as the manager of the surplus state general fund investments.

Sec. 30 is a transition section.

Sec. 31 permits the State Investment Board to hold organizational meetings as soon as a quorum of the board has been appointed.

Sec. 32 is an immediate effective date for sec. 31 and for those provisions of Sec. 12 of the bill which create the State Investment Board, require its members to comply with conflict of interest provisions, and permit the board to adopt regulations.

Sec. 33 sets January 1, 1991, as the effective date for the remainder of the bill.

If I may be of further assistance, please advise.

TC:lmb
L9/079