

Investment Policies and Procedures

Version 1.8 Released June 29, 2001

**State of Alaska
Department of Revenue
Treasury Division**

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What's New in Version 1.8

Section	Summary of Changes
XII (A) GeFONSI IPS	Inserted paragraph relating to state's attorney general opinion regarding the investment earnings allocation methodology for certain funds participating in the GeFONSI during FY 1994 through FY 1997.
XII (H) International Airports Funds	Beginning June 2001, the Repair and Replacement Account participates in the Short-term Fixed Income Investment Pool; it no longer holds its own underlying investments. Treasury Division annually transfers investment earnings of the Repair and Replacement Account to the Revenue Fund so that the account will end the fiscal year with exactly \$500,000.
XII (V) Power Cost Equalization Endowment Fund	Governor signed enabling legislation for the new Power Cost Equalization Endowment Fund effective May 24, 2000; Treasury Division begins to manage invested assets of the new PCE Endowment Fund on July 3, 2000 (actual transfer date).
Appendix BE	Updated target asset allocation per ASPIB Resolution 2001-01 (effective July 1, 2001).
Appendix CA	New appendix, staff recommendation memo dated January 5, 2001 to resume Securities Lending Program.
Appendix CB	New Appendix, Securities Lending Income Distribution Procedure
Appendix CC	New Appendix, Power Cost Equalization Account Invested Daily Cash Balances July 1, 1998 through December 31, 2000.
Appendix EA	Added Agreement pertaining to Directed Brokerage for SOA International Equity Investment Pool.
Appendix I	Updated for current delegations for investment officers.
Appendix ZE	Updated to reflect current list of accounts at custodian bank.
Appendix ZM	Added Letter from Exxon Valdez Oil Spill Trustee Council's Executive Director Regarding Earnings of the Exxon Valdez Settlement Fund
Appendix ZQ	Updated ASPIB Delegation of Investment Authority per Resolution 2001-04.
Appendix ZR	Updated Private Equity Investment Policies and Plan per ASPIB Resolution 2001-03.

**TREASURY DIVISION
DEPARTMENT OF REVENUE
STATE OF ALASKA**

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	Appendix CB	Securities Lending Income Distribution Procedure
	Appendix CC	Power Cost Equalization Fund Invested Daily Cash Balances July 1, 1998 through December 31, 2000.
Annually	Appendix DA	Cash Deficiency Operating Plan
Upon contract renewal	Appendix EA	Agreement pertaining to Directed Brokerage for SOA International Equity Investment Pool
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Upon modifications	Appendix ZT	Investment Policies and Procedures of the Exxon Valdez Oil Spill Trustee Council
Upon modifications	Appendix ZU	Exxon Valdez Oil Spill Trustee Council Resolution Pertaining to Asset Allocation
Annually before July 1	Appendix ZV	Reimbursable Services Agreement between the Treasury Division and the Exxon Valdez Oil Spill Trustee Council
None	Appendix ZW	AG Opinion regarding Exxon Valdez Oil Spill Expenditures
Upon modifications	Appendix ZY	Exxon Valdez Oil Spill Fund Payout Schedule
None	Appendix ZZ	Attorney General's opinion no. 663-98-0298 dated October 26, 2000 regarding the investment earnings allocation methodology for certain funds participating in the GeFONSI during FY 1994 through FY 1997.

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I. Introduction and Overview

The Treasury Division (Treasury) of the Alaska Department of Revenue (Department) is responsible for the financial management functions the Alaska Legislature (Legislature) has delegated to the Commissioner of Revenue (Commissioner) or to the Department. These functions include:

- Managing and accounting for the collection and deposit of most state revenue including general revenue, federal receipts and miscellaneous revenue;
- Managing and accounting for the state funds placed under the stewardship of the Commissioner or the Department;
- Providing safe custody for the state funds placed under the stewardship of the Commissioner or the Department;
- Managing the state's day-to-day cash flows;
- Insuring there are adequate state funds available to honor all warrants drawn by the Department of Administration; and
- Managing state debt.

The basic statutes assigning these duties to the Department are set forth in [Appendix A](#).

In addition, Treasury is responsible for carrying out the instructions of and implementing the policies adopted by the Alaska State Pension Investment Board (ASPIB) with respect to the investment and management of the funds for which the Legislature has assigned the fiduciary responsibility to ASPIB. Those funds include:

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- Public Employees' Retirement Trust Fund;
- Teachers' Retirement Trust Fund;
- Judicial Retirement Trust Fund;
- National Guard and Naval Militia Retirement Trust Fund;
- State Deferred Compensation Plan; and
- State Supplemental Benefits System.

This publication sets forth the policies and procedures pertinent to the financial management functions that the Legislature has directly assigned to the Department or the Commissioner. As well, this publication contains the written Investment Policy Statements (IPS) that ASPIB has adopted with respect to the funds for which that board acts as the fiduciary.¹ This publication does not contain the investment policies pertaining to the funds under the control of quasi-independent state corporations. These quasi-independent state entities operate independently and cannot be monitored by Treasury to ensure the accuracy of their investment-related information.

Finally, this publication includes a voluminous set of appendices containing:

- Annotated compilations of the statutes governing each of Treasury's responsibilities and each of the important funds Treasury manages;
- Pertinent historical and other background material relating to many of the funds Treasury manages; and
- Key decision documents relating to the Commissioner's, the Department's and Treasury's fiduciary responsibilities.

¹ A complete set of ASPIB's Policies and Procedures are maintained by Treasury as a separate document.

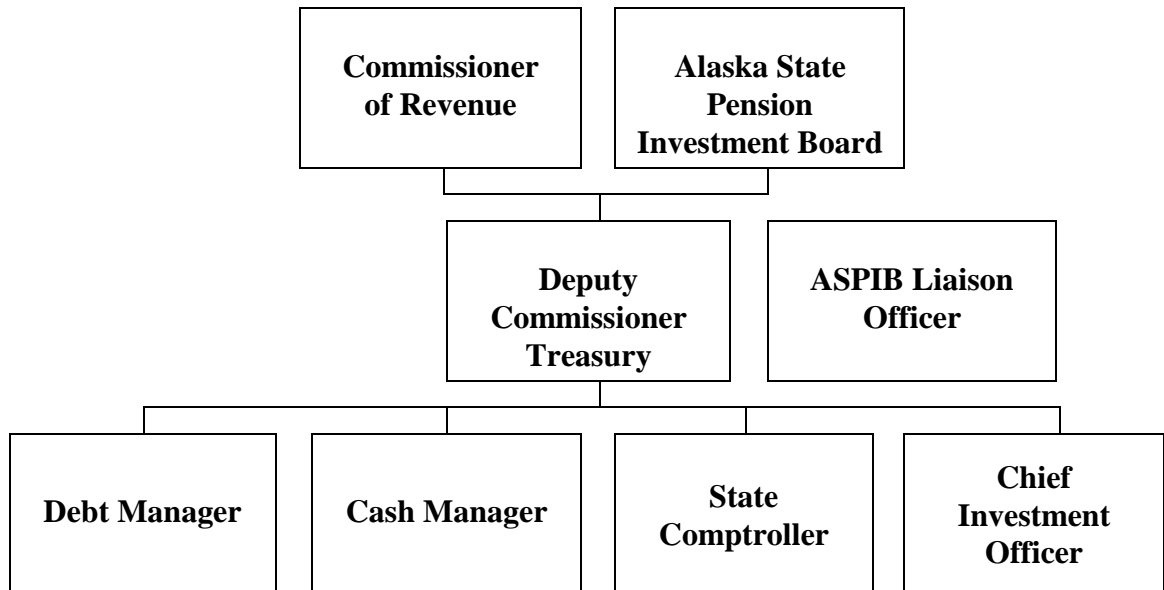
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II. Organization, Duties and Qualifications

A. Organization

The following chart reflects the functional organization of Treasury and the dual reporting relationship under which Treasury functions:



The specific administrative arrangements by which Treasury fulfills its responsibilities to the ASPIB are spelled out in a Reimbursable Services Agreement (RSA) between the ASPIB and the Department which is renewed each year. A copy of the agreement for the current and prior fiscal years is on file in the Department's fiscal office.

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B. Duties

The principal financial management duties of the individuals reflected on the organization chart depicted above are:

a. Commissioner of Revenue

- Manage and account for the collection and deposit of most state revenue including general revenue, federal receipts and miscellaneous revenue (see section IV for statutory requirements);
- Manage and account for the state funds placed under the stewardship of the Commissioner or the Department;
- Provide safe custody for the state funds placed under the stewardship of the Commissioner or the Department;
- Establish investment policies for the state funds placed under the stewardship of the Commissioner or the Department;
- Review the performance of each state fund placed under the stewardship of the Commissioner or the Department;
- Manage the state's day-to-day cash flows;
- Ensure there are adequate state funds available to honor all warrants drawn by the Department of Administration;
- Establish state debt policy;
- Serve as Trustee on the ASPIB; and
- Provide staff to the ASPIB and the State Bond Committee.

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b. Alaska State Pension Investment Board

- Exercise fiduciary responsibility for the invested assets of the Public Employees', Teachers', Judicial, and Military Retirement Systems (retirement funds), Supplemental Benefits System (SBS), and the Deferred Compensation Plan (DCP);
- Establish investment policies for the retirement funds;
- Establish investment options for the SBS and DCP participants;
- Review the performance of each of the retirement funds, SBS, and DCP;
- Review actuarial assumptions and adopt asset allocation for the retirement funds;
- Select pertinent consultants, external investment managers, legal counsel and custodian;
- Develop annual budget for managing the assets of the retirement funds, SBS, and DCP;
- Engage independent certified public accountant to perform an annual audit;
- Adopt and implement investment education policy for trustees;
- Report financial and investment policies and performance of the retirement funds to the Governor and participating employers; and
- Submit quarterly and long-range investment reports to the Legislative Budget and Audit Committee.

c. Deputy Commissioner of Revenue for Treasury

Under the policy and executive direction of the Commissioner of Revenue, and acting as state treasurer:

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- Exercise responsibility for the administration and management of the Treasury Division, including debt, cash, comptroller and investment functions;
- Ensure Treasury and ASPIB compliance with Alaska Statutes, Alaska Administrative Code, policies, and guidelines;
- Recommend budget strategies and proposals to the Commissioner of Revenue and the ASPIB, and present approved proposals to the Legislature; and
- Act as designee for the Commissioner of Revenue on various boards and commissions when otherwise directed.

d. Liaison Officer to the Alaska State Pension Investment Board

Under the direction of the Deputy Commissioner of Revenue for Treasury, the Liaison Officer to Alaska State Pension Investment Board is responsible for coordinating general administrative functions for the board members. Duties include:

- Plan and coordinate elections of trustees;
- Prepare and distribute agenda packets for board members;
- Coordinate and distribute newsletters, annual reports, and other information to the Legislature, beneficiaries, and employers of the various retirement systems; and
- Prepare meeting and election notification for publication in accordance with statutes and regulations.

e. Chief Investment Officer

- Act as "prudent expert" on behalf of the Commissioner of Revenue and the ASPIB;

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- Develop and recommend investment policy and strategy for the Commissioner of Revenue and the ASPIB;
- Implement investment policy and strategy for the Commissioner of Revenue and the ASPIB;
- Manage specific portfolios within guidelines set by the Commissioner of Revenue and the ASPIB;
- Evaluate the results of the investment policies and performance of the portfolios; and
- In conjunction with the State Comptroller, assist in the maintenance of this document.

f. State Comptroller

- Develop, recommend and implement internal control systems and procedures to ensure all investment assets are safeguarded;
- Account for and report on the investment activity of all funds under the investment responsibility of the Commissioner of Revenue and the ASPIB;
- Monitor investment manager(s) and custodian(s) for compliance with investment policies established by the Commissioner of Revenue and the ASPIB;
- In conjunction with the Chief Investment Officer, assist in the maintenance of this document;
- Prepare the annual Treasury Division and ASPIB budgets;
- Recommend and maintain information technology systems adequate to fulfill the accounting, monitoring, investing, cash management and other information needs of the Division;
- Prepare fiscal notes and other related reports for the Legislature on proposed legislation affecting Treasury;

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- Schedule meetings for the Public School Advisory Board and maintain the minutes of those meetings; and
 - Coordinate the annual audits of all funds in accordance with statutory requirements.
- g. Cash Manager
- Develop, recommend, and implement cash management control systems and procedures to ensure cost effective cash management and safekeeping of cash;
 - Provide the state with the administrative and financial arrangements to collect revenues;
 - Recommend and manage a contract with a financial institution for redemption of all state warrants presented for payment through the Anchorage Clearing House and the Federal Reserve Bank;
 - Provide the necessary electronic financial capabilities for electronic transmission of funds for the state;
 - Recommend and implement the necessary collateralization agreements to safekeep all state funds on deposit;
 - Maintain and oversee the U.S. Treasury/State of Alaska's agreement governing the timely transfer of federal funds due the state;
 - Project the state's cash flow needs;
 - Determine the amount of cash available for investment in excess of amounts necessary for operations; and
 - Reconcile Treasury bank accounts with the Alaska Statewide Accounting System and with Treasury's accounting records.

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h. Debt Manager

- Serve as staff to the State Bond Committee;
- Serve as staff to the Alaska Municipal Bond Bank Authority;
- Develop, recommend and implement plans of the State Bond Committee to issue and refund general obligation bonds and International Airport System revenue bonds and to enter into lease financing transactions;
- Serve as principal state contact with the bond rating services and the national financial community;
- Prepare fiscal notes and other related analyses on proposed legislation affecting state debt or affecting national bond ratings of the state, agencies, or municipalities;
- Compile and produce the annual Alaska Public Debt publication; and
- Recommend selection and coordinate contracts with the state's bond counsel, financial advisor, and bond trustees.

C. Qualifications

The Commissioner depends on the staff of the Treasury Division in fulfilling collection, investment and control responsibilities. The following minimum requirements have been established to ensure qualified people are hired to fulfill those responsibilities:

- Investment officers within the Portfolio Management Section are required to be Fellows of the Financial Analysts Federation (Fellow) or Chartered Financial Analysts (CFA). If neither a Fellow nor a CFA at the time of hire, the investment officer must qualify for that designation within 5 calendar years following their date of hire.

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- The Cash Manager is required to be a Certified Cash Manager within 24 months of date of hire.

- The State Comptroller is required to be a Certified Public Accountant at the time of hire.

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III. Ethics and Financial Disclosure

A. Ethics

To assure appropriate standards of conduct are met and maintained, all employees of the Treasury Division, as a condition of employment, must acknowledge and abide by the rules of conduct set forth in the Mandatory Agreement for All Treasury Personnel included in [Appendix B](#). This agreement includes addenda that pertain to certain investment officers and to the State Comptroller.

Further: (1) All Treasury staff members are subject to the Alaska Executive Branch Ethics Act, AS 39.52 (Act); (2) all state investment officers in the Portfolio Management and Real Estate Investment Management Sections are required to conform to the applicable provisions of the Code of Ethics and The Standards of Professional Conduct (Code) of the Association for Investment Management and Research (see [Appendix C](#)). To the extent that any provisions of the Code are contradicted by or less restrictive than the Act, the provisions of the Act apply; (3) the state investment officers in the Cash Management Section are subject to the Treasury Management Association Standards of Ethical Conduct (see [Appendix C](#)). To the extent that any provisions of these standards are contradicted by or less restrictive than the Act, the provisions of the Act apply; and (4) the State Comptroller and the Assistant State Comptroller are subject to the Principles of the Code of Professional Conduct established by the American Institute of Certified Public Accountants and to Rule 102 - Integrity and Objectivity - and to Rule 501 - Acts Discreditable - of that same code (see

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[Appendix C](#)). To the extent that any provisions of these principles and rules are contradicted by or less restrictive than the Act, the provisions of the Act apply.

B. Financial Disclosure

The Alaska Conflict of Interest Law, AS 39.50, applies to the Commissioner of Revenue, the Deputy Commissioner of Revenue for Treasury, the State Comptroller and all of Treasury's investment officers. Within 30 days of initial hire and then annually on March 15 (for the prior calendar year), those subject to this Act must file a comprehensive financial disclosure statement with the Alaska Public Offices Commission. The disclosure statement requires a detailed list of the pertinent official's financial assets.

In addition, all members of the ASPIB (including the Commissioner), the members of the Board's Investment Advisory Council, the Deputy Commissioner for Treasury, Treasury's investment officers in the Portfolio Management Section, and the State Comptroller must file transaction disclosure statements whenever they buy or sell equities, marketable debt securities or real estate. AS 37.10.230(b) requires disclosure by members of the ASPIB. The requirement that some staff members similarly disclose has been imposed by the ASPIB.

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IV. Responsibility of Department of Revenue to Assure Proper Amounts of Revenue are Collected and the Proper Amounts of Funds are Expended

A. Revenue Collected

Treasury's responsibilities with respect to revenue collection are focused on providing efficient, cost-effective means for depositing money in the state treasury. Treasury is responsible for carrying out the Department's obligation to:

- collect all state revenue except certain program receipts (AS 44.25.020 and AS 43.05.150);
- provide a means by which the fees charged by various state agencies are to be remitted to the state treasury (AS 37.10.050); and
- apply for and receive money due the state from the federal government (AS 43.05.200).

All of these responsibilities are carried out by Treasury's Cash Management Section. Policies and procedures pertinent to Treasury's cash management function may be found in Section XVI of this publication.

The Department has the legal responsibility to insure that the proper amount of money is collected and deposited into the Public School Trust Fund. AS 37.14.150. The State Comptroller is specifically assigned to carry out this responsibility.

While Treasury is not responsible for insuring that the proper amount of public revenue is actually collected, other units within the Department have those

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responsibilities. The tax audit divisions have the responsibility to enforce the tax laws. AS 43.05.150. The Division of Oil and Gas Audit has a responsibility for auditing oil and gas royalty payments. AS 38.05.036. (The Department of Natural Resources uses these audits to ensure that the state receives the oil and gas royalties to which it is entitled). Finally, the Department is also required to ensure the proper amount of miscellaneous revenue is collected where that responsibility has not been vested in some other state agency (AS 43.05.150).

All of these statutes pertinent to the state's revenue collection responsibility may be found in [Appendix D](#).

B. Funds Expended

The Department of Administration has the overall responsibility for ensuring that state funds are properly expended. (See AS 37.10.010 in [Appendix D](#).) The Department of Revenue is, of course, responsible for maintaining the integrity of its own expenditures under the applicable provisions of the Fiscal Procedures Act. AS 37.05.010-995.

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**V. Brief History of Treasury's Role in the Management of Alaska's
Public Funds**

A. The Alaska Treasury

Prior to Congress's enactment of the Alaska Territorial Organic Act (Act of August 24, 1912, Ch. 387, 37 Stat. 512), the federal government was responsible for providing all government services in the Territory of Alaska. The 1912 Organic Act authorized the establishment of a legislative assembly in the Territory of Alaska and, as a consequence, a Territorial Government with the responsibility for providing many government services.

In 1913, the first Territorial Legislature established the office of the Treasurer of the Territory of Alaska. Ch. 77 SLA 1913. From 1913 to 1930, the Territorial Treasurer was appointed by the Territorial Governor who was, in turn, appointed by the United States Secretary of the Interior. The Territorial Treasurer was responsible for collecting and managing the funds of the territorial government. The Territory's funds were to be deposited in three or more banks in the Territory and "reasonably divided and apportioned" among the banks. § 7 Ch. 77 SLA 1913.

In the trivia department, this 1913 Act required the following:

[T]he Treasurer of the Territory of Alaska shall have a Great Seal of Office, which shall be two and one-half (2 1/2) inches in diameter and bear just within the perimeter of the seal the words, "Great Seal of the Treasurer of the Territory of Alaska," and within the words, a star at the top of the seal, representing the North Star, beneath which is a key. § 8 Ch. 77 SLA 1913.

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The first trust the Territorial Treasurer was required to administer involved Benny Benson, the winner of the contest to design an Alaska flag. In 1927, the American Legion conducted a contest for the design for an Alaska flag. The Territorial Legislature appropriated \$1,000 to send the winning designer to Washington D.C., together with an escort, to present the flag. The escort was to be selected by the Governor from the American Legion or its auxiliary. Ch. 76 SLA 1927. The young man who submitted the winning design, Benny Benson, apparently did not make the trip, and two years later, the Territorial Legislature directed the Territorial Treasurer to deposit the \$1,000 in a trust to pay for Benny Benson's costs at the Alaska Agricultural College and School of Mines. The Legislature authorized the investment of the funds in "United States Bonds or other obligations of the United States." Ch. 51 SLA 1929. Since Mr. Benson did not attend the University, the Territorial Legislature appropriated the money directly to him in 1939. Ch. 52 SLA 1939.

The Territorial Legislature extensively reorganized the executive departments of the Territorial Government in 1929. Ch. 118 SLA 1929. Prior to this reorganization act, the Attorney General was the only Territorial executive chosen by election. The 1929 Act provided for an elected Territorial Treasurer and an elected Territorial Auditor beginning in 1930. This legislation modified slightly the requirement that the Treasurer deposit the Territory's money in three or more of the Territory's banks. The amounts deposited in each bank were to "be apportioned between such banks in proportion to the amount of funds in the Treasury of the Territory and the size of the bank as measured by its capitalization..." § 16 Ch. 118 SLA 1929. The 1929 Reorganization Act reaffirmed the requirement for a Great Seal of Office for the Territorial Treasurer. § 17 Ch. 118 SLA 1929.

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The Territorial Legislature had, in 1923, assigned the Territorial Treasurer the responsibility to be the treasurer of the Alaska Agricultural College and School of Mines. Ch. 88 SLA 1923. Then in 1935, when the University of Alaska was organized to take the place of the Agricultural College and School of Mines, the Legislature transferred that responsibility to the Treasurer of the newly established Board of Regents. Ch. 49 SLA 1935.

In 1945, the Legislature gave the Territorial Treasurer the authority to invest certain Territorial funds in United States bonds.

Whenever there is in excess of one million dollars in unappropriated funds in the Territorial Treasury, the Treasurer is authorized and empowered to invest in interest bearing bonds of the United States of America. Ch. 51 SLA 1945.

This authority was expanded in 1953 to permit the investment of excess funds in the Territorial Treasury in veterans' mortgages.

Whenever there is in excess of one million dollars in unappropriated funds in the Territorial Treasury, the Treasurer is authorized and empowered to invest in interest bearing bonds of the United States of America and to negotiate with and purchase from the Veterans' Affairs Commission preferred commercial paper held by it under the Alaska World War II Veterans' Act and may sell such bonds and sell or transfer back to the Veterans' Affairs Commission such preferred commercial paper that is in his possession or may come into his possession... [T]he Treasurer may likewise invest in said preferred commercial paper any other Territorial funds he is authorized by law to invest. Ch. 140 SLA 1953.

This enactment initiated the investment program by which, over the next twenty-five years, the Territory (and later as the State of Alaska) made substantial investments of its General Fund in Alaska mortgages.

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When Alaska achieved statehood in 1959, the state's executive operations were consolidated under the newly elected Governor pursuant to the Alaska Constitution. The office of Treasurer was abolished (along with its Great Seal of Office) and the Treasurer's responsibilities were assigned to the newly created Department of Revenue. §§ 10, 27 Ch. 64 SLA 1959. Following the recodification of Alaska law in 1962, the statute governing general investment authority of the Commissioner of Revenue with respect to the state treasury, AS 37.10.070, read as follows:

- (a) whenever there is in excess of \$1,000,000 in unappropriated funds in the state treasury, the Department of Revenue may (1) invest the excess in interest-bearing bonds of the United States; (2) negotiate with and purchase from the Department of Commerce of the state preferred commercial paper held by it under the Alaska World War II Veterans' Act (AS 26.15); (3) may sell the bonds and sell or transfer back to the Department of Commerce the preferred commercial paper that is in its possession or may come into its possession.*
- (b) The Department of Revenue may invest in this preferred commercial paper any other state funds it is authorized by law to invest.*

In January 1964, pursuant to the land grant provisions of the Alaska Statehood Act, the State of Alaska selected 1,600,000 acres of federally-owned land on the North Slope bordering on the Beaufort Sea. The state held three competitive oil and gas lease sales in December 1964, July 1965 and January 1967 in which it offered portions of this North Slope land selection; the three lease sales combined covered all of the selected land. About seventy percent of the offered land was leased for bonus bids totaling \$12 million; there were no bids on the lands comprising the other thirty percent.

In January 1968, two of the state's North Slope lessees - Atlantic Richfield Company and Humble Oil and Refining Company - announced that they had discovered the Prudhoe Bay oil and gas reservoir. In September 1969, the state

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reoffered the North Slope lands for which it had received no bids in the three earlier lease sales. It received slightly more than \$900 million in bonus payments to lease this reoffered land. When this unexpected bonanza arrived, state officials concluded that the statutes governing the investment of funds in the state treasury were inadequate. In 1970, the investment authority of the Commissioner of Revenue was repealed and replaced with a set of lengthy, detailed standards.
§ 1 Ch. 206 SLA 1970.

The new investment standards were clearly the product of a political compromise between advocates of "prudent investing" and advocates of "Alaska investing." The major features of the 1970 Investment Act were:

- Investments limited to a legal list;
- Investment in equities permitted;
- Investment policy was to be based on "considerations" of "maximum income and safety as governed by the Prudent Man Rule and the benefit to the private and public sectors of the economy in terms of increased housing and commercial credit, stimulated business activity, increased employment, support of the market for state and local bonds, increased revenue together with the possible inflationary effect of the investment..."
- Investment preference was given to Farmers Home, FHA, VA, State Veterans, and conventional residential mortgages and "other secured loans, if the originating financial institution retain[ed] at least 33 1/3 percent of the mortgage;" and
- Notes and mortgages were to be purchased "at a rate conducive to develop and benefit Alaska and Alaska residents and such rate may be less than the market rate."

§ 1 Ch. 206 SLA 1970. The resulting investment of the state General Fund in mortgages and other Alaska loans is discussed briefly in Section XII (W).

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In 1976, just before oil began to flow to market from the Alaska North Slope, the voters of Alaska amended the Alaska Constitution to create the Alaska Permanent Fund. In the legislative session immediately following the 1976 election, the Legislature enacted interim arrangements for investing and managing the newly created Alaska Permanent Fund. Ch. 6 SLA 1977. This legislation placed the investment responsibility for the Alaska Permanent Fund with the Commissioner of Revenue and limited the fund's investments to fixed income securities.

From 1977 to 1980, a vigorous debate took place concerning the management of the Alaska Permanent Fund. Some legislators advocated investing the Fund primarily as a trust, taking advantage of the best investment opportunities available in the nation's major financial markets. Other legislators believed the Fund should be primarily invested in Alaska to foster the economic development of the state. In the course of the legislative examination of the issue on how best to invest the Permanent Fund, the Legislature examined as well the investment standards and practices pertinent to the state's General Fund and to the state's two major retirement funds - the Public Employees' Retirement System (PERS) and the Teachers' Retirement System (TRS). By 1980, the state had invested \$750 million of its General Fund in Alaska investments - \$700 million in mortgage and business loans, \$40 million in loans to various quasi-public state corporations, and \$9 million in direct loans to Alaskan communities. The picture was much the same for the investment of the money in the two state-managed retirement funds. In 1980, \$263 million (36%) of the \$724 million in the two retirement funds was invested in Alaska mortgages. The percentage of the two retirement funds invested in Alaska mortgages had been even higher two years earlier - 38.5%.

The legislative proponents of a "trust" approach for the Alaska Permanent Fund finally prevailed over the proponents of a "development bank" in 1980. The Fund

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was placed under the management of a newly-established quasi-public corporation headed by a six-member Board of Trustees. § 5 Ch. 18 SLA 1980. By law, the Commissioner of Revenue must be one of the six trustees. The investment standard established for the Permanent Fund was:

The Prudent Investor Rule shall be applied by the board in the management and investment of fund assets. The Prudent Investor Rule as applied to investments of the Fund means that in making investments, the Board shall exercise the judgment and care under the circumstances then prevailing that an institutional investor of ordinary prudence, discretion, and intelligence exercises in the management of large investments entrusted to it not in regard to speculation but in regard to the permanent disposition of funds, considering probable safety of capital as well as probable income. AS 37.13.120(a).²

The Legislature established a detailed "legal list" of permitted investments for the Permanent Fund; the initial list included certain kinds of mortgage and business loans and very high quality public and corporate debt. No investment in corporate equity securities or real estate was permitted. The Legislature instructed the Board of Trustees to give a modest preference to certain Alaska investments:

The board shall invest the assets of the fund in in-state investments to the extent in-state investments are available if the in-state investments:

² This standard of prudence was an adaptation of the standard then separately applicable to the Public Employees' Retirement System (PERS) Fund under AS 39.35.110(c) and to the Teachers' Retirement System (TRS) Fund under AS 14.25.180(c). The first sentence of the standard - the explicit application of the *Prudent Investor Rule* - was new. The remainder of the standard follows word-for-word the same as the amended language adopted later in the same legislative session with respect to the PERS and TRS funds. The following quote reflects the 1980 amendment to the standard applicable to the PERS Fund in § 8 Ch. 122 SLA 1980. In that bill, AS 39.35.110(c) was amended to read (underline indicates addition):

(c) In making investments the commissioner of revenue shall exercise the judgment and care under the circumstances then prevailing which an institutional investor [A MAN] of ordinary prudence, discretion, and intelligence exercises in the management of large investments entrusted to it [HIS OWN AFFAIRS] not in regard to speculation but in regard to the permanent disposition of [HIS] funds, considering [THE] probable safety of capital as well as probable income [FROM THEM AS WELL AS THE PROBABLE SAFETY OF HIS CAPITAL].

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- *have a risk level and expected yield comparable to alternate investment opportunities; and*
- *are included in the list of permissible investments in this section.*
AS 37.13.120 (1).

In that same 1980 legislative session, the Legislature completely revised the law governing the Commissioner of Revenue's authority to invest the General Fund and the two retirement trust funds. Ch. 122 SLA 1980. This major revision of the Commissioner of Revenue's investment authority came about as a consequence of two factors: (1) the Legislature's examination of the investment issues relating to the Permanent Fund; and (2) the Legislature's reaction to its learning of the concentration of General Fund and retirement fund investments in Alaska mortgages.

The standard of prudence made applicable to the Commissioner's investment of the General Fund and the PERS and TRS Funds was virtually identical to the standard adopted with respect to the Alaska Permanent Fund.

The "legal lists" of permitted investments for the General Fund and the two retirement funds were substantially modified in the 1980 legislation. The authority of the General Fund to invest in mortgages was all but eliminated (following the 1980 revisions, the Commissioner could only invest in certain mortgages of the Alaska Rural Rehabilitation Corporation). The authority of the Commissioner to invest the two retirement funds in Alaska mortgages was substantially reduced. The General Fund investment preference for Alaska investments was eliminated, and the authority to invest in Alaska investments at "less than market rate" was also eliminated.

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The 1980 legislation required the Commissioner of Revenue invest the General Fund and the TRS and PERS Funds "at competitive national market rates." §§ 1, 6 and 7 Ch. 122 SLA 1980. This legislation also authorized the Commissioner of Revenue to invest a portion of the two retirement funds in gold bullion.

In 1988, the Legislature once again revised completely the provisions of Alaska law governing the Commissioner of Revenue's authority to invest the General Fund, the PERS and TRS Funds and all the other smaller funds committed to the Commissioner's stewardship (e.g. the Public School Trust Fund, the University of Alaska Endowment Trust Fund, the State Mortgage Insurance Fund, etc.). This legislation similarly modified the investment standards pertaining to the University of Alaska. This 1988 legislation, Ch. 141 SLA 1988, significantly changed the manner in which the Department was obligated to invest the state's money. Until 1988, the investment practices for each of the funds for which the Department was responsible were governed by separate "legal lists" of permitted investments. The 1988 act, HB 547 initially introduced by the House Finance Committee, rewrote and made consistent the investment standards governing all of the investment responsibilities of the Department and of the University of Alaska. The legislation explicitly eliminated the legal lists that pertained to the various funds for which the Commissioner and the University were responsible and modified slightly the articulation of the Prudent Investor Rule adopted with respect to the General Fund and the two major retirement funds eight years earlier.

The bill the House Finance Committee introduced was the work product of the Treasury Division. The bill, as amended in the final enactment, eliminated the legal lists and established the Prudent Investor Rule for funds entrusted to the Commissioner and to the University. [Appendix E](#) contains key documents

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relating to the legislative history of this important change in the standards governing the investment of state funds.

In 1992, following the difficulties the state encountered in 1991 with respect to the investment of state Supplemental Benefits System funds in guaranteed investment contracts with Executive Life Insurance Company, the Legislature created the Alaska State Pension Investment Board to assume fiduciary responsibility with respect to the state's various retirement funds. Ch. 31 SLA 1992. In that legislation, AS 37.10.071(c), the investment standard applicable to almost all of Treasury's investments established in the 1988 major rewrite was amended as follows (underline indicates addition and capitalized and bracketed indicates deletion):

In exercising investment, custodial, or depository powers or duties under this section, the fiduciary of a state fund shall apply the prudent investor rule and exercise the fiduciary duty in the sole financial best interest of the fund entrusted to the fiduciary. Among beneficiaries of a fund, the fiduciaries shall treat beneficiaries with impartiality. [COMMISSIONER SHALL EXERCISE THE JUDGMENT AND CARE UNDER THE CIRCUMSTANCES THEN PREVAILING THAT AN INSTITUTIONAL INVESTOR OF ORDINARY PROFESSIONAL PRUDENCE, DISCRETION, AND INTELLIGENCE EXERCISES IN MANAGING LARGE INVESTMENTS WITH CONSIDERATION FOR THE PURPOSE OF THE FUND, THE INVESTMENT OBJECTIVES, THE CONTINUING DISPOSITION OF THE FUND'S INVESTMENTS, AND THE PROBABLE SAFETY OF THE CAPITAL AS WELL AS THE PROBABLE INVESTMENT RETURNS].

The 1992 changes in AS 37.10.071(c) substituted a general reference to the Prudent Investor Rule for the 1980 Legislature's and the 1988 Legislature's attempt to spell out a detailed articulation of that same rule.

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Three distinguishing elements of the 1988 standard were that prudence be that of:

- an institutional investor;
- a professional; and
- an investor managing large investments.

These elements are not explicitly stated in the 1992 revision, but Treasury believes these elements continue to be incorporated in the prudent investor standard applicable to Treasury. AS 14.25.180(c)'s continuing reference to the "large investments" element of the 1988 standard compels this conclusion. (See the memorandum from Willkie Farr & Gallagher in [Appendix E](#), and [Appendix G](#).)

B. The Two Major Retirement Funds

1. Teachers' Retirement System

The Territorial Legislature established the Teachers' Retirement System (TRS) in 1929 under the supervision of a Teachers' Pension Board consisting of the Territorial Governor, the Territorial Commissioner of Education and the Territorial Treasurer. The system provided a retirement of \$800 per year payable in four quarterly payments to retired teachers fifty-five years or older who had taught for twenty-five or more years of which at least fifteen had to have been in Alaska. Ch. 83 SLA 1929. The Territorial Treasurer was responsible for investing excess TRS assets in one or more of the "Territorial Depositories," United States Government bonds or other government securities.

The Territorial legislature modified the Territorial Treasurer's investment authority pertinent to the TRS Fund in 1945 to make that investment authority parallel to the investment authority pertinent to the Territorial General Fund. §14

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Ch. 17 SLA 1945 and § 19 Ch. 145 SLA 1955. This legislation authorized the investment of the TRS Fund in Alaska veterans' mortgages.

In 1960, the state Legislature revised the investment standards pertinent to the TRS Fund. The revised standards provided for a "legal list" of permitted investments that included corporate stocks and bonds. The revision also imposed the following standard of care on the Commissioner:

In making each and all of such investments the Commissioner of Revenue shall exercise the judgment and care under the circumstances then prevailing which men of ordinary prudence, discretion, and intelligence exercise in the management of their own affairs not in regard to speculation but in regard to the permanent disposition of their funds, considering the probable income therefrom as well as the probable safety of their capital... § 15 Ch. 89 SLA 1960.

The Alaska Legislature revised the applicable "legal list" twelve times between 1960 and 1980. By 1980, Treasury had invested 38% of the TRS Fund in Alaska mortgages.

As discussed in detail above, the Legislature passed important major revisions of the laws relating to the investment of the TRS Fund in 1980, 1988 and 1992. These changes resulted in (1) the elimination of the investment restrictions imposed by a "legal list"; (2) the substitution of the "Prudent Investor Rule" for the "Prudent Person Rule"; and (3) the shift of fiduciary responsibility for the TRS Fund to the ASPIB.

Pursuant to the 1992 legislation, Treasury now provides the staff support for the ASPIB, and the Commissioner of Revenue is a member of that Board.

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2. Public Employees' Retirement System

Various legislatures had several false starts before finally establishing the Alaska Public Employees' Retirement System in 1960. In the summer of 1948, Ralph Rivers, the Territory's elected Attorney General, hired Thomas B. Stewart,³ then a student between his first and second years at the Yale Law School, to draft legislation creating a public employees' retirement system in Alaska. In 1949, the Territorial Legislature passed the legislation drafted by Mr. Stewart. Ch. 41 SLA 1949.

The System covered Territorial employees and the employees of municipalities in the Territory if the pertinent municipality elected to participate in the System. The System and the investment of its funds were under the control of a seven-member board that included the Territorial Attorney General, Auditor, Commissioner of Labor, Welfare Director and the Treasurer together with two public members - an employee representative and a representative of a participating municipality. § 15 Ch. 41 SLA 1949. The Legislature restricted the Fund's investments to a "legal list" of only government-issued, fixed income obligations. § 16 Ch. 41 SLA 1949.

The Territorial Government never fully implemented the System created in the 1949 legislation. In 1951, the Territorial Legislature enacted an alternative arrangement providing for special coverage of employees of Alaska territorial and local governments under Title II of the Federal Social Security Act. Ch. 95 SLA 1951.

³ Thomas Stewart served as (1) the Secretary of the Alaska Constitutional Convention eight years later in 1956; (2) a Territorial and State Legislator in the late 1950's and early 1960's; and (3) as a Superior Court Judge in Juneau from 1966 until 1981.

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Contemporaneously, the Legislature repealed the 1949 Act, and the system returned both the employees' and municipalities' contributions. § 2 & 9 Ch. 102 SLA 1951. The same legislation provided for monthly stipends for six retired beneficiaries of the 1949 Act.⁴ §1 Ch. 102 SLA 1951.

In 1960, the Legislature established the current Public Employees' Retirement System and vested the investment responsibility for the System in the Commissioner of Revenue. Ch. 143 SLA 1960. The legislator principally responsible for this new legislation was Senate State Affairs Committee Chair Thomas B. Stewart. The governing investment standard, the "Prudent Man Rule," was identical to the standard established for the TRS; the "legal list" of permitted investments was virtually the same. Much as the Legislature modified the TRS Fund "legal list" over the next two decades, it amended the PERS "legal list" eleven times between 1960 and 1980. By 1980, Treasury had invested 35% of the Fund in Alaska mortgages.

The 1980, 1988 and 1992 legislative changes discussed with respect to the TRS Fund, were identical in their effect on the PERS Fund.

⁴ The beneficiaries and their monthly stipends were:

Norman Cook -----	152.90
G.W. Gasser-----	198.50
Nils G. Johansson -----	93.67
B.D. Stewart-----	136.58
Ray Stevens -----	66.91
Josie White -----	124.30

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C. Enterprise Funds and the State's Quasi-independent Public Corporations

The Legislature made the Department of Revenue responsible for the investment of funds pertinent to one of the state's first major enterprise operations, the state International Airports. Ch. 88 SLA 1961 (now codified as AS 37.15.410-550).

Since 1970, the Legislature has established a large number of quasi-independent corporations that issue revenue bonds to support and promote various activities. For the most part, these quasi-independent corporations manage their own funds in accordance with policies adopted by their boards of directors and pertinent covenants in the bonds that they issue. Today these corporations include:

- The Alaska Housing Finance Corporation (AS 18.56.010-900);
- The Alaska Industrial Development and Export Authority (AS 44.88.010-900);
- The Alaska Energy Authority (AS 44.83.020-995);
- The Alaska Municipal Bond Bank Authority (AS 44.85.005-.420);
- The Alaska Student Loan Corporation (AS 14.42.100-390);
- The Alaska Medical Facility Authority (AS 18.26.010-900); and
- The Alaska Aerospace Development Corporation (AS 14.40.821-990).

The Commissioner of Revenue serves on the boards of all of these corporations except the Aerospace Development Corporation.

Two additional independent quasi-public corporations enjoy even more independence than the seven listed above. They too manage their own investments, but the Commissioner of Revenue does not serve on their boards. These corporations are:

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- The Alaska Railroad Corporation (AS 42.40.010-990); and
- The Commercial Fishing and Agriculture Bank (CFAB) (AS 44.81.010-350).⁵

The Alaska Legislature has committed the management of three large trusts and one relatively small trust to the Alaska Permanent Fund Corporation. The trusts and their respective 1998 fiscal year end balances are:

The Alaska Permanent Fund (AS 37.13.010-900)	\$ 25 billion
The Alaska Science and Technology Fund (AS 37.17.010-110)	\$130 million
The International Trade and Business Endowment (AS37.17.440)	\$ 5 million
The Mental Health Trust Fund (AS 37.14.001-099 and AS 47.30.056)	\$300 million

The Alaska Permanent Fund Board of Trustees is the fiduciary for the Alaska Permanent Fund. The other three trusts are each governed by an independent board that is responsible for spending the annual income attributable to that trust in accordance with the purposes of the trust. Precisely how the fiduciary responsibility for investing the assets of the trust is divided among the Permanent Fund Board of Trustees on the one hand and the governing boards of the Science and Technology Fund, the International Trade and Business Endowment, and the Mental Health Trust on the other, is not entirely clear. The financial assets of the Science and Technology Fund, the International Trade and Business Endowment, and the Mental Health Trust are commingled with the assets of the Permanent Fund. Consequently, the asset allocations for the investment of those funds are identical to those of the Permanent Fund. Finally, the Science and Technology Fund, the International Trade and Business Endowment, and the Mental Health

⁵ While CFAB was expressly created by state statute in 1979 and was originally capitalized with state funds, it is now treated as an entity wholly separate from the state. Since it is not fiscally dependent upon the state, CFAB's financial affairs are not reflected in the state's Comprehensive Annual Financial Report. The Alaska Railroad's financial affairs are included in the state's Comprehensive Annual Financial Report.

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Trust help pay the operating costs for the Alaska Permanent Fund Corporation based on the market value of the assets in the respective funds.

Unlike the funds under the direct responsibility of the Commissioner of Revenue, the University of Alaska, and the retirement funds, the Legislature has continued to restrict investment of Permanent Fund assets to a “legal list.”

The Commissioner of Revenue serves on the Board of Trustees for the Alaska Permanent Fund but does not serve on the boards for the Science and Technology Foundation nor the Mental Health Trust. However, pursuant to AS 47.30.041, the Commissioner of Revenue, along with the Commissioners of Health and Social Services and Natural Resources, serves as an advisor to the Alaska Mental Health Trust Authority Board.

The statutes governing the general investment authority of the Department are in [Appendix F](#).

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VI. Standards of Care and Loyalty Applicable to the Investment of State Funds

A. Care

This publication documents the framework in which the Department undertakes to fulfill its fiduciary responsibilities for the management of state funds. Most of the funds placed under the care of the Department are trust funds. First, several of the funds entrusted to the Commissioner are expressly denominated as "trust funds," including:

- The Public School Trust Fund;
- The Alaska Children's Trust;
- The Investment Loss Trust Fund; and
- The Alaska Heritage Trust Fund.

Second, for several funds entrusted to the Commissioner, the Legislature has specified that the Commissioner is the "fiduciary" for those funds. Where the care-taker of a fund is characterized as a "fiduciary," the fund is a trust. These funds include:

- The General Fund and Other Non-segregated Investments (the GeFONSI) (includes the state General Fund together with a long list of other state subfunds); and
- The Retiree Health Insurance Fund.

Third, Treasury is the agent for managing several funds for which other entities are specified as the fiduciaries including:

- The four retirement funds and the two plans for which ASPIB is fiduciary; and
- The University of Alaska Endowment Trust Fund and the Alaska Advance College Tuition Savings Fund for which the Board of Regents of the University of Alaska is the fiduciary.

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Finally, there are several funds placed with the Commissioner that have neither the trust label nor an express fiduciary relationship with the Commissioner. These funds include:

- The Constitutional Budget Reserve Fund (CBRF). (The currently unfunded cousin of the CBRF, the Statutory Budget Reserve Fund, is a trust);
- The International Airport Funds; and
- Alaska Student Loan Corporation bond proceeds and collateral receipts.

Treasury employs a single fiduciary investment process and standard for all of the funds entrusted to the Department whether or not the fund is technically denominated as a trust.

Following the American Law Institute's adoption of the Restatement (Third) of Trusts in 1990, the members of the fiduciary community, including the trustees of foundations, endowments and public and private pension funds as well as legal scholars, agreed that the following catalogs the fiduciary duties of the important participants in the investment process for a group of funds similar to those entrusted to the Department of Revenue:

1. Fiduciary Responsibilities of The Primary Fiduciary (Commissioner and staff)
 - Prepare written investment policies and document the investment process in writing. In doing so, the fiduciary ought to:
 - Determine the missions and objectives of each fund;
 - Choose an appropriate asset allocation strategy for each fund;
 - Establish specific investment policies consistent with each fund's objective; and
 - Select investment managers for each fund to implement the investment policy.

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- Diversify assets in light of the risk/return objectives pertinent to the purpose of the fund;
- Use "prudent experts" to make investment decisions;
- Control investment expenses;
- Rigorously monitor the activities of all investment managers and investment consultants;
- Avoid conflicts of interest; and
- For assets held in trust, take actions with respect to those assets for the sole benefit of the trust's beneficiaries.

2. Fiduciary Responsibilities of Investment Managers

- Investment Managers are fiduciarily responsible for the assets placed under their discretion.

3. Fiduciary Responsibilities of Consultants

- Consultants (investment consultants, attorneys, outside auditors and other service providers) have a fiduciary responsibility for the services they are contracted to provide with respect to any particular fund's assets. They are consequently fiduciarily responsible for the quality and accuracy of any service, report information, or recommendations made to the Commissioner or Department.

4. Fiduciary Responsibilities of Custodian Banks

- A master custodian is fiduciarily responsible for the proper safekeeping, valuation, pricing, accounting and reporting of fund assets.

To fulfill its obligations under the modern Prudent Investor Rule, it is extremely important for the Department to carefully follow a well-articulated, written investment process with respect to each fund that it manages and to adopt and

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maintain up-to-date written investment policy statements for each fund. This publication - and the periodic revision of this publication - are intended to fulfill that obligation.

A fiduciary meets the prudent investor standard by establishing, following and frequently reexamining the *process* by which it manages risk, chooses managers, supervises managers, and monitors manager performance.

Following is a summary of the five-step prudent investor process the Department currently employs:

1. Analyze the current situation pertinent to each fund each February and March and more often when prudence so requires.
 - Conduct a fiduciary audit of each fund;
 - Review the legal and administrative constraints pertinent to each fund;
 - Review the assumptions pertinent to contributions and disbursements from each fund;
 - Review the current investment strategies and policies;
 - Conduct an analysis of the current asset allocation and investment activities; and
 - Review the costs of managing the portfolio.
2. Design the optimal portfolio.
 - Propose various optimal asset allocation strategies;
 - Address strategic (long-term) and tactical (short-term) investment strategies against the backdrop of capital markets; and
 - Analyze the investment alternatives based upon the concepts of modern portfolio theory.
3. Formalize the investment policy.
 - Set or modify investment policy and implementation guidelines in the written Investment Policy Statement (IPS);
 - Once the IPS is prepared, follow it rigorously;

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- Reanalyze the pertinent options any time that the Commissioner contemplates allocating assets to an asset class not specified in the IPS; and
 - Rewrite the IPS if the Commissioner decides to invest in a new asset class.
4. Implement the investment policy.
- Where appropriate, consider a number of alternative investment manager structures, focusing on styles or strategies within each broad asset class;
 - Select investment managers;
 - Negotiate account size minimums and fees with appropriate investment managers; and
 - Coordinate custodial and brokerage services;
5. Monitor and supervise the portfolio.
- Provide ongoing supervision of the investment program;
 - Prepare a detailed monthly appraisal of consolidated holdings and portfolio transactions;
 - Prepare periodic performance attribution reports comparing the performance of the portfolio against appropriate benchmarks, stated investment objectives and investment managers of similar style;
 - Check the asset allocation to make sure it conforms to the limits specified in the IPS and rebalance the portfolio if necessary; and
 - Monitor and control investment expenses and costs.

A detailed articulation of this five-step process is set forth in [Appendix G](#).

The five step process and the investment policies and procedures articulated in this publication differ in several substantial ways from an earlier effort by the Department to articulate a clearly defined investment process and a set of written investment policies pertinent to the funds managed by the Department. This earlier effort, a set of regulations together with a set of companion investment policies, occurred in 1990, before the Legislature created ASPIB and at a time when the Commissioner of Revenue was the sole fiduciary for the state's retirement funds. Although the regulations took effect in January 1991, the

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department repealed the regulations in late 1991. A brief overview of the regulations together with a copy of the regulations may be found in [Appendix ZA](#). A copy of the companion investment policies may be found in [Appendix ZB](#).

B. Loyalty

A trustee, when investing funds or otherwise acting on behalf of a trust, must act in the sole best interest of the beneficiaries of that trust. In most instances, this duty of loyalty requires that investment decisions be directed solely toward the goal of earning income for expenditure to further the objective(s) of the trust. A trustee may not invest trust assets to achieve alternative social goals. This general rule is greatly strengthened with respect to most public trusts in Alaska.

AS 37.10.071(c), made applicable to almost all of the funds placed under the fiduciary responsibility of the Commissioner or the ASPIB, requires that all investments for the pertinent funds be made in the "sole financial best interest of the fund." (See August 12, 1998 Memorandum of Advice from the Attorney General in [Appendix O](#).)

[Appendix G](#) contains pertinent material relating to the obligation of loyalty required of the fiduciaries of the public trust funds created by the Legislature.

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VII. Upkeep and Compliance with This Publication

Assuring that the Department (1) follows the policies and procedures set forth in this publication and (2) modifies those policies and procedures when appropriate are key elements in guaranteeing that the Department fulfills its fiduciary responsibilities. The Commissioner assigned responsibility for ensuring that the Department follows these policies and procedures, and for modifying them as necessary, jointly to the Chief Investment Officer and the State Comptroller. (See [Appendix ZH](#) for specific procedures regarding maintenance of this publication.)

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VIII. Delegation of the Commissioner's Responsibility for State Funds

The Prudent Investor Rule as articulated in the Restatement (Third) of Trusts provides that a fiduciary ought to delegate some or all of the specific investment and control responsibilities to "prudent experts."

[Appendix H](#) contains the provision of the Restatement (Third) of Trusts that both mandates and sets the standards for delegation of fiduciary responsibility.

[Appendix H](#) also contains the statute governing the Commissioner's delegation of fiduciary responsibility.

[Appendix I](#) contains the Commissioner's current delegations of investment authority for state funds.

[Appendix J](#) contains the Commissioner's current delegations of monitoring and control responsibility for state funds.

[Appendix ZG](#) contains the Commissioner's current delegations for Cash Manager functions.

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IX. Building Blocks for Treasury's Investment Policies

A. Introduction

The Commissioner of Revenue, acting through the Treasury Division, must develop an investment policy for each of the funds entrusted to the Department. Treasury has developed the policies pertinent to each of these funds using the following key investment concepts:

- Asset Allocation and the Efficient Frontier
- Expected Return
- Risk
- Time and Time Horizon
- Risk Tolerance
- Liquidity

B. Asset Allocation and the Efficient Frontier

With a few minor exceptions, Treasury invests the funds entrusted to the Commissioner in some combination of five investment pools - three of which are fixed income investment pools and two of which are equity investment pools. (See Section X for detailed descriptions of these investment pools.) How does Treasury go about deciding on an investment policy for any particular fund? How does it decide what proportion of any particular fund to invest in each of the available investment pools?

The following paragraphs are copied verbatim from Yale University's 1995 description of The Yale Endowment:

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Investment returns are generated by decisions regarding asset allocation, market timing, and security selection. Portfolio construction must reflect the relative importance of the expected contribution of each source of return.

The most important source of portfolio return stems from policy asset allocation. The process of selecting policy targets involves defining the asset classes that will constitute the portfolio and determining the proportion of funds to be invested in each class. The weights and market returns of a portfolio's various asset classes are the prime determinants of a portfolio's returns.

The second source of return is market timing, defined as deviation from long-term policy targets. For example, assume that the fund's long-term targets are 50 percent stocks and 50 percent bonds. A fund manager who believes stocks are cheap and bonds are expensive might weight the portfolio 60 percent stocks and 40 percent bonds. The return resulting from the overweighting of stocks and underweighting of bonds relative to long-term targets would be the return attributable to market timing.

The third source of return, security selection, is the return generated by active management of the portfolio. If a manager created portfolios that faithfully replicated the markets (i.e., passive portfolios), that manager would be making no active bets. To the extent that a portfolio differs from the composition of the overall market, that portfolio has an active management component. The difference between the returns of the overall market and the active portfolio would be the return attributable to security selection.

Research by Yale School of Management Professor Roger Ibbotson and Brinson Partners' Gary Brinson indicates that more than 90 percent of the variability of institutional fund returns is attributable to asset allocation decisions and less than 10 percent is attributable to market timing and security selection. Significantly, the overwhelming portion of positive contribution to returns stems from asset allocation. Market timing and security selection make marginal, and generally negative, contributions to portfolio returns.

Yale Investment Committee member Charles Ellis argues that market timing is a loser's game, essentially impossible to do on a consistent basis. Ironically, by failing to rebalance to long-term policy targets, many institutional investors engage in market timing, allowing portfolio risk and return characteristics to drift with the markets. An example comes from experience during the October 1987 crash in world equity markets. In the first nine months of 1987 most institutional

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investors simply watched their U.S. equity exposure increase as U.S. equity prices rose and bond prices fell. Of course, by October 1987, equity allocations peaked, just in time to experience a traumatic, more than 20 percent decline. After the crash, not only did institutional investors fail to buy equities, which were now cheaper on a relative basis, but they were net sellers in November and December. By failing to rebalance portfolios to long-term targets, most institutional investors ended up buying high and selling low.

Treasury employs a modeling process based on a statistical technique called, "mean variance analysis," an approach developed by UCLA Professor Harry Markowitz. Using this statistical technique to combine -- with respect to different investment classes -- expected returns, variances of returns and covariances of returns, one can estimate the expected return profiles and standard deviation of various asset allocation alternatives. Treasury employs an independent consulting firm to develop the capital market projections used in this modeling process.

The capital market projections consist of (1) the expected return of the pertinent asset classes; (2) the expected future volatility of the returns for each asset class measured in terms of a statistical benchmark, standard deviation; and (3) the correlations of the returns among the various asset classes. [Appendix K](#) contains a description of the most recent derivation of these capital market projections.

To make the required asset allocation policy decisions, the Commissioner uses the output of this modeling process - namely a series of alternative asset allocations, each of which is the allocation that is projected to achieve the highest return for each of the various levels of projected portfolio volatility (risk) reflected in the series. The series of alternative asset allocations with the highest returns at each level of risk is known as the "efficient frontier." The Commissioner then uses the output of the model in conjunction with the following considerations to make the final asset allocation judgment: (1) the risk tolerance of the pertinent fund; (2) the

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fund's need for protection from inflation; (3) the fund's need for liquidity; and (4) the fund's current income requirements.

Once the Commissioner selects the appropriate asset allocation on the efficient frontier, Treasury defines parameters for the portfolio that will keep the fund within the original risk and return profile. For example, if the allocation to the United States equity market is 60%, Treasury will establish a band to limit the deviation from that U.S. equity exposure target - e.g., plus or minus 5%. In this example, if exposure to U.S. equities exceeded 65% or dropped below 55% of the total portfolio, Treasury would rebalance the equity exposure to 60%. This process insures that the portfolio remains on the efficient frontier.

Treasury carefully considers the impact of trading costs and interim market volatility when establishing the ranges that trigger asset allocation adjustments. To further protect a fund from a high turnover ratio, higher transaction costs, and to avoid interim volatility in the financial markets, Treasury reviews and adjusts the asset allocation of a fund at the close of every month. Five working days after the end of a month, Treasury reviews the asset allocation of every fund Treasury manages. The five-day time period allows Treasury's custodian bank enough time to complete their final reports for the month. If, at that time, it is determined that a fund has assets that exceed stated parameters, Treasury will adjust the asset allocation to the targeted allocation.

The only exception to this adjustment discipline occurs when Treasury determines that a fund must be diversified into a low cost commingled fund that does not allow daily trading. Where Treasury uses a commingled fund that does not authorize daily trading, Treasury will make the portfolio adjustment on the next available trading day.

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C. Expected Return

As explained above, the expected return for each asset class in which Treasury plans to invest some portion of a fund is a key ingredient in determining the optimal asset allocation for that fund. Expected returns are not a mysterious concept; "expected returns" are precisely what their name suggests. The material in [Appendix K](#) explains the derivation of Treasury's current return expectations.

D. Risk

1. Definitions

There are many different ways to define the term "risk." Before turning to the very specific definition used by Treasury, here are several definitions of "risk" from financial management manuals and glossaries:

Any chance of loss.

Gertner, Trustees Handbook, International Foundation of Employee Benefit Plans

The variability of returns from an investment. The greater the variability (i.e., of dividend fluctuation or of security price), the greater the risk. Since investors are generally averse to risk, investments with greater inherent risk must promise higher expected yields.

Scott, Wall Street Words

Measurable possibility of losing or not gaining value. Risk is differentiated from uncertainty, which is not measurable.

Downes and Goodman, Barron's Dictionary of Finance and Investment Terms

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Refers to the probability and magnitude of a loss. In the investment arena, the volatility of an investment return, measured by standard deviation... becomes a well-accepted measurement of risk...

Rieve and Lummer, Pension Investment Handbook

2. How Does Treasury Define and Measure Risk When Making Investment
Decisions for the Funds it Manages?

Treasury uses the following operational definition of risk: risk is the variability of returns on a particular "set" of investments.⁶ That "set" may be a particular asset, a particular

⁶ Risk has four major sources, not all of which may apply to every asset class or portfolio.

a) Credit Risk

Credit risk arises from a debt issuer's willingness and ability to pay the interest and principal of a fixed income instrument as it becomes due. Credit risk varies greatly from issuer to issuer and usually reflects the relative certainty of the issuer's ability to pay. Low credit risk implies a high degree of certainty that the issuer will make all payments in full and on time.

b) Residual or Equity Risk

Equity investments are not investments with set cash flows or terminal values. Equity investments are a percentage ownership in a company. These investments are the residual interest in the net income, after corporate taxes, and the residual value of the company's assets after the creditors are paid. Uncertainty about the future profitability of a company and/or to its current or future liquidation value creates the risk in equity investments.

c) Exchange Rate Risk

Exchange rate risk arises from fluctuations in the relative exchange rates between foreign currencies and the U.S. dollar. These risks arise only on investments payable or valued in foreign currencies. Exchange rates vary daily and reflect a number of factors including economic productivity, relative inflation rates and trade balances.

d) Market Risk

Market risk arises from the market's valuation of a fixed income investment at any time prior to its maturity or at any time for all other investments. This valuation reflects the market participants' consensus judgments about a number of factors needed to value any particular investment. These judgments may or may not turn out to be correct; they may change suddenly; and they may be different from the judgments used to make the investment. The valuation of a fixed income investment reflects the market participants' perception of the credit risk, the remaining time to maturity of the investment, the coupon rate, and the interest rate similar securities currently earn. The value of an equity security reflects the market participants' perception of the current and future profitability of the company, the dividend payment rate, the liquidation value of the company, and the future expected price of the security. The current valuation also reflects the probable return on the security relative to alternative investment options. Finally, in some instances, the current valuation of an equity security reflects current perceptions of exchange rate risks.

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asset class or a particular portfolio of investments. Returns include income (interest and dividends) as well as net appreciation (realized and unrealized capital gains and losses).

When risk is defined as the "variability of returns," it is measured in statistical terms. That measure is most often expressed in terms of an estimated standard deviation. What does it mean when we say that we expect a particular asset class (e.g., short-term fixed income instruments) to have a "return of 4% and a risk of 3% over the next year?" It means that - based upon the statistical analysis of the historical performance of the asset class and current market expectations - we expect that the standard deviation (variability) of the return on that investment class over the next year will be plus or minus 3% from the expected return of 4%. To state the same thing in more pedestrian terms - two thirds of the time, we expect a return from this asset class over the next year to be between 1% (4% minus 3%) and 7% (4% plus 3%). The applicable statistical analysis also tells us to expect that one-sixth of the time, the return over the next year will be over 7%, and one-sixth of the time, the return will be less than 1%.

In the previous example, an investment had an expected return of 4%. Statistically, the possibility of a 7% return represented the same amount of "risk" as the possibility of a 1% return. In a practical sense, however, the 7% return is not a risk that bothers us. The "risk" that concerns us is the "risk" of low or negative returns.

There are many other ways of expressing the results of the statistical analysis that Treasury employs to measure risk. For example, we can express the analysis in terms of the probability that a particular asset class will have a zero return or less, an 8% return or less, an 8% return or more and so forth.

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When it comes time to measure the "risk" of a portfolio that includes more than one asset class, the statistical analysis becomes more complex. This is so because different asset classes behave differently. Sometimes the market forces that decrease the returns on one asset class in the portfolio simultaneously increase the returns on another asset class in the portfolio. Consequently, we must use both the estimated standard deviation of return on each asset class in the portfolio and the estimated correlation coefficient between the performance of each of those asset classes to derive the "risk" (standard deviation in the variability of return) for the entire portfolio. The differing performance of asset classes provide what we often refer to as, "the benefits of diversification." Treasury measures risk at the portfolio level to account for the benefits of diversification. Individual investments or investments in a particular asset class may seem risky in isolation but could lower the overall risk at the portfolio level.

Treasury must consider the level of risk and the nature of the risks being accepted when developing the investment policy for each individual fund. The amount of risk a particular investment policy entails can change with market conditions. Treasury annually evaluates the risk levels of all investment policies and recommends changes as appropriate.

3. How Does Treasury Specifically Categorize Risk?

Treasury evaluates the riskiness of various investments or investment strategies using a spectrum of terms that range from "low" risk to "high" risk with reference to the estimated probability of a loss over the next one year period. The categories are:

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Risk categories	Probability of a loss over next one year period
Low risk	< 1%
Moderate risk	1 - 5%
Moderately high risk	5 - 10%
High risk	>10%

E. Time and Time Horizon

"Risk" is a measure of the expected variability or volatility of the return on an asset class or a particular investment portfolio over time. Experience tells us that, over long periods of time, actual investment results will average out close to the expected result for a particular asset class or portfolio. In any one year, actual results may vary significantly from the expected results. The expected magnitude of that variance is usually measured by the standard deviation from the expected investment returns. However, if the estimated average return is accurate, then over a long period of time, actual investment results will be very close to the estimated returns no matter how risky the investment policy. The critical point is that the riskier the investment policy, the longer the time horizon before this averaging out process is likely to bring the actual results in line with the expected results.

What does this phenomenon mean for Treasury's investment policy for any particular fund? If the state intends to spend a fund's money in the near future, Treasury cannot rely upon time to reduce the risk of one bad year causing an unacceptable shortfall. Similarly, if the state does not need the money for many

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years, Treasury can rely on time to average out returns so that one bad year is of less concern.

Time's ability to moderate the risk of an investment policy makes it a critical factor in the development of a fund's investment policy. All other things considered, the longer the time before the state needs money from a fund, the more aggressive the investment policy can be. A more aggressive investment policy will have higher expected returns and higher risk. Taking a higher risk means a much greater chance of a loss in the short-term and a much greater chance of a robust return over the long-term.

"Time horizon" is the term Treasury uses to specify when the state is likely to use the money from a particular fund.

When specifying the time horizon for a particular fund, Treasury considers when cash will be needed, not how long a fund will be in existence. A particular fund may be expected to exist for many years but if a significant portion of the money currently held in a fund could be used in the near term, Treasury considers it to have a short time horizon. Furthermore, a fund may not have a single time horizon. While a fund is a single accounting entity, Treasury may consider it the sum of several blocks of money, each with a different time horizon. In such a case, Treasury may develop an investment policy that effectively sums several different policies, with each of the individual policies being appropriate for different portions of a fund with different time horizons.

Treasury uses the following time horizon specifications in making and articulating its investment policies:

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Time horizon specification	Estimated time period before State will need funds
Very short time horizon	less than 6 months
Short time horizon	6 months to 1 year
Intermediate time horizon	1 to 4 years
Moderately long time horizon	4 to 8 years
Long time horizon	over 8 years

F. Risk Tolerance

Another term often used in conjunction with "risk" and "time horizon" in the development of investment policies is "risk tolerance." "Risk tolerance" is a measure of an investor's tolerance for variability in returns in exchange for the likelihood of higher long-term compensation. For purposes of developing investment policies for state funds, Treasury categorizes risk tolerance as follows:

Low risk tolerance	Unwilling to risk material short-term volatility because of the immediate need for the invested funds. Minimizing exposure of principal to loss is very important.
Moderate risk tolerance	Willing to assume an average amount of market risk and volatility to achieve higher returns.
Moderately high risk tolerance	Willing to assume an above average amount of risk, volatility and loss of principal to take advantage of higher return opportunities.
High risk tolerance	Willing to risk significant short-term volatility and principal loss for the possibility of large gains in the long-term.

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G. Liquidity

"Liquidity" refers to the ease and efficiency with which an investment or class of investments can be converted to money. The greater the liquidity of an investment, the easier it is to convert the investment to money. Factors that affect the liquidity of an investment or class of investments are: (1) the size of the marketplace, (2) the typical difference between the sale and purchase price, and (3) the complexity of the investment.

The larger the market place for any investment, the more likely a seller will be able to find a willing buyer at all times. The presence of willing buyers and sellers is critical for a liquid market. If there are too few participants in a market, a seller may not be able to find a willing buyer at the current market price. In order to convert the investment to money, the seller may have to accept a lower sales price or take more time to sell the investment. When this occurs, the seller will probably lower the price in the marketplace through their efforts to sell their investment.

For any given investment, the markets establish a normal difference between the asking price and the offering price. The smaller this difference, the greater the efficiency, and the lower the cost of buying and selling an investment, usually referred to as the "transaction cost." The lower the transaction costs, the greater the liquidity of an investment.

When describing the complexity of an investment, the two ends of the complexity spectrum are usually referred to as "simple" and "complicated." Complicated investments are generally less liquid than simple investments. Complicated investments require the prospective buyer to perform a series of analytical steps

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and make consequent judgments to value the investment. The more complicated the investment, the longer it can take to make all the necessary judgments. The longer it takes to buy or sell an investment, the lower its liquidity. Further, since more judgments are necessary to value a complicated investment, there is a greater likelihood that the seller will determine different valuations than those of the prospective buyer. The riskier the investment, the more reluctant the would-be buyer and, consequently, the less liquid the investment.

An investment manager can convert a highly liquid investment into money or another investment quickly and efficiently. Therefore, liquidity increases flexibility in the investment management process. Less liquid investments and asset classes generally have higher expected rates of return than comparable more liquid assets. Whether Treasury will sacrifice liquidity for higher expected return depends on the specific purposes and needs of each particular fund.

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X. Investment Pools

A. Authority to Pool and Reasons to Pool

Alaska Statute 37.10.071 provides the authority for Treasury to pool investments (see [Appendix L](#)), and Treasury has used this authority in two different ways.

First, it has used the authority to combine, for investment purposes, all the assets of many funds into the General Fund and Other Non-segregated Investments (the GeFONSI). The GeFONSI is made up of the assets of two classes of state funds: (1) funds with similar risk and return objectives, and (2) funds that must return all their earnings to the state General Fund (additional information about the GeFONSI is contained in Section XII(A)). The state then accounts for the pool participants' aggregate investment in the GeFONSI but does not attribute individual investments of the commingled portion of the GeFONSI to any particular pool participant.

Second, Treasury has used its investment pooling authority to provide investment options as follows: 1) three different fixed income mutual fund-like pools, 2) a domestic equity investment pool managed by State Street Global Advisors, and 3) one international equity investment pool actively managed by Lazard Asset Management. Treasury can then invest some or all of a particular state fund in one or more of these options to accomplish the investment asset allocation policy pertinent to that fund.

Using the GeFONSI and the investment pools increases investment efficiency in three ways. First, combining individual funds' cash inflows and outflows to offset

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each other reduces the amount of available cash that Treasury must keep on hand to support daily operations of the state. Treasury can thus increase the return on funds not needed for daily cash operations. Second, pooling investments significantly reduces the accounting, budgeting and administration required of state agencies to administer a large number of small programs and funds. Finally, by pooling funds the state can achieve benefits from economies of scale on the various funds the Department of Revenue invests including: (1) investment options that could not otherwise be practically provided for individual small funds; (2) internal cost reduction; and (3) improved negotiating leverage on fees.

B. The GeFONSI

The commingled portion of the GeFONSI includes almost all of the assets of the General Fund together with the assets of a long list of other smaller funds. The Department of Revenue is responsible for investing the GeFONSI, and the Department of Administration maintains the official accounting records for this fund. The Department of Administration separately accounts for the assets for each of the smaller funds included in this commingled investment pool. The Department of Revenue is responsible for calculating and allocating the monthly investment earnings to the GeFONSI participants in accordance with the provisions of a Memorandum of Understanding (MOU) between the Departments of Administration and Revenue. An example of this MOU is shown in [Appendix R](#) of this publication. The most recent modifications to this MOU are on file in Treasury's Asset Accounting Section.

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C. The Fixed Income and Equity Investment Pools

The Department of Revenue has established three fixed income investment pools (not including the investment pools established solely for the fund participants (trust funds) for which the Alaska State Pension Investment Board is the fiduciary - See Section XIV) to efficiently invest the assets Treasury manages. These three pools are: (1) Short-term Fixed Income Investment Pool; (2) Intermediate-term Fixed Income Investment Pool; and (3) Broad Market Fixed Income Investment Pool. Treasury also participates in two pooled domestic equity collective funds managed by State Street Global Advisors. Treasury also maintains an international equity investment pool actively managed by Lazard Asset Management. These investment vehicles cover most of the spectrum of risk and return options available in the mainstream domestic and international investment market. Treasury can invest the assets of a fund participant in any combination of these investment options to meet that fund's unique investment objectives.

D. Periodic Evaluation of Available Investment Pools

Periodically, Treasury reevaluates its menu of investment pools. Should Treasury create a second GeFONSI for those funds with longer time horizons currently invested in the GeFONSI? Doing so would make Treasury's management job more complex and would be difficult to implement within the constraints imposed by the state's accounting system (AKSAS). So far, Treasury has concluded that the additional costs of establishing an Enhanced Return GeFONSI outweigh the additional benefits. However, Treasury's consideration of this issue in 1998 prompted an increase in the risk/return profile of the investment policy for the Intermediate-term Fixed Income Investment Pool.

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Because contemporary studies of capital markets tell us there are likely to be substantial diversification benefits from including other asset classes in the asset allocation policies for some of the funds Treasury manages, Treasury has examined the costs and benefits of establishing pools for additional asset classes. For example, Treasury considered adding an international equity investment pool in 1997, 1998 and again in 1999. In 1997 and 1998, Treasury concluded that, for the funds that might invest in this proposed pool, the projected diversification benefits were outweighed by the likely costs. In 1999, Treasury concluded that an international equity investment pool would be appropriate for at least one of the Treasury-managed funds. Consequently, Treasury established an actively managed State of Alaska International Equity Investment Pool investment option (see Section XI for additional information).

Treasury has also periodically considered the costs and benefits of developing a pool for the real estate asset class and concluded that the additional cost burden could not justify investing non-retirement fund assets in that asset class.

In March 2000, Treasury reviewed the liquidity needs of participants in the Broad Market Fixed Income Investment Pool and determined that the performance benchmark should be changed from the Lehman Brothers Govt./Corporate Index to the Lehman Brothers Aggregate Index. (The new benchmark takes effective 4/1/00.) Details and the Commissioner’s concurrence are shown in [Appendix ZO](#).

Version Control

Revision Date	Effective Date	Summary of Changes	Find it in Version
7/18/99	7/1/99	Following periodic evaluation of available investment options, Treasury updates this section to include the new international equity collective funds investment option.	1.2

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3/20/00	4/1/00	Treasury changes the performance benchmark for the Broad Market Fixed Income Investment Pool from the Lehman Brothers Govt./Corp. Index to the Lehman Brothers Aggregate Index to better match liquidity requirements.	1.3
3/28/00	4/1/00	Treasury updates this section to reflect selection of Lazard to actively manage international equity investments.	1.3

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XI. Investment Policies Pertaining to Treasury's Investment Pools

A. Short-term Fixed Income Investment Pool

1. Description and History

The Short-term Fixed Income Investment Pool (Short-term Pool) is a convenient, economical medium for investing short-term, risk averse funds. This pool was created July 1, 1994. The pool is managed directly by the Treasury Division's investment staff. The investments in this pool have generally varied between \$500 million and \$1 billion. When the Permanent Fund Corporation transfers the funds to pay Permanent Fund Dividends each October, the balance in this pool increases briefly to about \$1.5 billion.

This is the only one of the investment pools created for money in the state Treasury in which money from the various retirement trust funds is also invested. Treasury established a separate core fixed income pool in which Treasury invests money from all the pertinent retirement funds; the Alaska Retirement Fixed Income Investment Pool. However, all the very short-term investment requirements of the various retirement trust funds are met through this Short-term Fixed Income Investment Pool including: 1) the temporary investment of funds just received from participating employers or just awaiting disbursement to eligible beneficiaries and 2) the investment of cash held by the retirement systems' external managers.

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The pool maintains the general characteristics of a money market pool. Treasury's income objective for the pool is to earn the highest possible return while meeting significant liquidity requirements and taking very low principal risk. The money Treasury invests in this pool has a short time horizon.

2. Investment Policy

Treasury invests the funds in this pool in a broad range of short-term fixed income investments. Under the Prudent Investor Rule, Treasury constructs the pool's portfolio with a low risk tolerance. Individual fixed rate securities will be limited to 14 months to maturity or expected average life for amortizing securities. Floating rate securities will be limited to three years to maturity or three years average life for amortizing securities. Investments include instruments with a long-term credit rating of at least "A3" or equivalent and instruments with a short-term credit rating of at least "P1" or equivalent.⁷ Investments for this pool are limited to:

- Money market investments comprising:
 - Repurchase agreements collateralized only by U.S. Treasury obligations, including bills, notes, and bonds, and only when the collateral carries a market value equal to or greater than 102% of the amount of the repurchase agreements, and only when the custodial bank appointed by Treasury will take custody of the collateral;
 - Commercial paper rated at least Prime-1 by Moody's Investor Services, Inc. and A-1 by Standard and Poor's Corporation; and
 - Negotiable certificates of deposit and bankers acceptances; provided that an issuing bank must have total assets in excess of \$5 billion.
 - United States Treasury obligations including bills, notes, bonds, and other debt obligation issued by the United States Treasury, and backed by the full faith and credit of the U.S. Government.

⁷ [Appendix ZC](#) contains an explanation of the credit rating designations and labels pertaining to fixed income securities such as commercial paper, bonds, notes, bills and asset backed securities.

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- Other full faith and credit obligations of the U.S. Government.
- Securities issued or guaranteed by agencies and instrumentalities of the U.S. Government, but not explicitly backed by the full faith and credit of the U.S. Government.
- Obligations of foreign governments, sovereign states, supranational entities, and their instrumentalities denominated in U.S. dollars.
- Investment grade corporate debt securities comprising:
 - Corporate debt issued in the U.S. capital market by U.S. companies;
 - Euro-dollar debt (that is, U.S. dollar-denominated securities issued outside the U.S. capital markets by U.S. companies or by foreign issuers); and
 - Yankee debt (that is, U.S. dollar denominated obligations issued in the U.S. capital market by foreign issuers).
- Investment grade Asset-Backed Securities.
- Mortgage-Backed Securities (MBS's) and Collateralized Mortgage Obligations (CMO's) comprising:
 - Agency MBS investments issued by Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, or the Government National Mortgage Association;
 - CMO investments securitized by agency MBS's issued by Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, or the Governmental National Mortgage Association; provided that permissible CMO investments include only sequential class CMO's or type I planned amortization class CMO's.

Investment in this pool is ideal for fund participants needing to invest part or all of their money with the following characteristics:

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Risk Tolerance	Low. The estimated probability of a loss over a one-year period is less than 1%. The daily investment results reflect daily changes in the market value of the pool's investments. It is possible to have a loss on a single day based on the changes in market value of the pool's assets.
Investment Objectives	Minimizing exposure of principal to loss is very important.
Current Income	Daily earnings credit. The earnings of the pool include interest and changes in the market value of the investments held in the pool. There is no distinction between current income and capital gains.
Inflation Protection	Little need for significant long-term inflation protection. The pool should earn a positive real rate over the near-term but could earn less than inflation over time while meeting its other objectives.
Liquidity	Need for significant liquidity. The pool can accommodate major withdrawals and contributions (exceeding \$50,000,000) in the normal operating environment. The Pool can accommodate much larger withdrawals with very little advance notice.
Time Horizon	Very short to short time horizons. The short time horizon effectively limits the risk taken in this pool.
Treasury's performance benchmark for the Short-term Fixed Income Investment Pool is:	
100%	Three-Month U.S. Treasury Bill - the market measure for risk-free, extremely liquid investments.

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3. Legal Constraints and Special Circumstances

Treasury uses shares of the Short-term Pool to satisfy interfund liabilities within the state's accounting system. The net asset value of a share in the pool is always one dollar per share. The total net asset value of all the shares in the pool must reflect the current market value of all the assets in the pool. Failure to follow this convention would make it inappropriate for Treasury to use these shares for payment between fund participants because investment earnings would shift among various funds. Treasury permits a particular pool participant to overdraw the Short-term Pool if that fund has investments in other investment pools that would cover the overdraft condition in a very short time. This overdraft provision allows fund participants to maintain minimum investments in the Short-term Pool while still meeting obligations to other funds.

B. Intermediate-term Fixed Income Investment Pool

1. Description and History

The Intermediate-term Fixed Income Investment Pool (Intermediate-term Pool) is an efficient investment option for fund participants that require less liquidity than the Short-term Pool provides and that can tolerate slightly more principal risk (credit risk plus market risk) to achieve higher returns over time. Like the Short-term Fixed Income Investment Pool, it was created on July 1, 1994 and is also managed by Treasury's investment staff. The amount of money invested in this pool has fluctuated between \$1 billion and \$3 billion.

For this pool, Treasury seeks to earn the highest possible income while meeting liquidity requirements and taking moderately high principal risk. The money

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Treasury invests in this pool has an intermediate time horizon, a more limited need for liquidity than the money invested in the Short-term Pool, a limited need for inflation protection, and can be invested at a moderate risk level.

The interest rate risk for this pool, as measured by duration, will generally be close to that of the Merrill Lynch 1-5 year Government Index. The Merrill Lynch 1-5 year Government Index has produced significantly higher returns than very short-term investments like those held in the Short-term Fixed Income Pool, but has, over time, experienced higher volatility of returns.

2. Investment Policy

Treasury invests the funds in this pool in a broad range of intermediate-term fixed income investments. Under the Prudent Investor Rule, Treasury constructs the pool's portfolio with a moderately high risk tolerance. Investments include instruments with a long-term credit rating of at least "Baa3" or equivalent and instruments with a short-term credit rating of at least "P1" or equivalent.

Investments for this pool are limited to:

- Money market investments comprising:
 - Repurchase agreements collateralized only by U.S. Treasury obligations, including bills, notes, and bonds, and only when the collateral carries a market value equal to or greater than 102% of the amount of the repurchase agreements, and only when the custodial bank appointed by Treasury will take custody of the collateral;
 - Commercial paper rated at least Prime-1 by Moody's Investor Services, Inc. and A-1 by Standard and Poor's Corporation; and
 - Negotiable certificates of deposit and bankers acceptances; provided that an issuing bank must have total assets in excess of \$5 billion.

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- United States Treasury obligations including bills, notes, bonds, and other debt obligation issued by the United States Treasury, and backed by the full faith and credit of the U.S. Government.
- Other full faith and credit obligations of the U.S. Government.
- Securities issued or guaranteed by agencies and instrumentalities of the U.S. Government, but not explicitly backed by the full faith and credit of the U.S. Government.
- Obligations of foreign governments, sovereign states, supranational entities, and their instrumentalities denominated in U.S. dollars.
- Investment grade corporate debt securities comprising:
 - Corporate debt issued in the U.S. capital market by U.S. companies;
 - Euro-dollar debt (that is, U.S. dollar-denominated securities issued outside the U.S. capital markets by U.S. companies or by foreign issuers); and
 - Yankee debt (that is, U.S. dollar denominated obligations issued in the U.S. capital market by foreign issuers).
- Investment grade Asset-Backed Securities.
- Mortgage-Backed Securities (MBS's) and Collateralized Mortgage Obligations (CMO's) comprising:
 - Agency MBS investments issued by Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, or the Government National Mortgage Association;
 - CMO investments securitized by agency MBS's issued by Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, or the Governmental National Mortgage Association; provided that permissible CMO investments include only sequential class CMO's or type I planned amortization class CMO's.

Investment in this pool is ideal for fund participants needing to invest part or all of their money with the following characteristics:

Risk Tolerance	Moderately high. The estimated probability of a loss over a one-year period is between 5% and 10%. The daily investment
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results reflect daily changes in the market value of the pool's investments. Losses are likely over the short-term based on the changes in market value of the pool's assets.

Investment Objectives	Willing to assume an average amount of market risk, volatility and principal loss to achieve higher returns.
Current Income	Daily earning credit. The earnings of the pool include interest and changes in the market value of the investments held in the pool. There is no distinction between current income and capital gains.
Inflation Protection	Moderate need for long-term inflation protection. The pool should earn a positive real rate over an intermediate time horizon while meeting its other objectives.
Liquidity	Need for moderate liquidity. The pool can accommodate withdrawals and contributions (exceeding \$5,000,000) in the normal operating environment. The pool can accommodate much larger withdrawals, \$50,000,000 or more, with very little advance notice.
Time Horizon	Intermediate time horizon. The intermediate time horizon allows a more aggressive investment policy with higher expected returns than the Short-term Pool.

Treasury's performance benchmark for the Intermediate-term Investment Pool is:

100% Merrill Lynch 1-5 year Government Index.

C. Broad Market Fixed Income Investment Pool

1. Description and History

The Broad Market Fixed Income Investment Pool is an efficient investment option for fund participants requiring less liquidity than the Short-term or Intermediate-term Pools provide and that can take more principal risk (credit risk plus market

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risk) in exchange for higher expected returns over time. This pool, administered by Treasury's investment staff, was also created July 1, 1994. Prior to 1997, it had about \$100 million invested in it - all from the Public School Trust Fund, the University of Alaska Trust Fund and the Alaska Children's Trust. With the development of a more aggressive investment policy for the Constitutional Budget Reserve Fund (CBRF) in early 1997 (Section XII(B), the amount invested in this pool increased to an amount in excess of \$1 billion. In September 1999, Treasury revised the Constitutional Budget Reserve Fund asset allocation which brought the amount invested down to approximately \$200 million.

The money Treasury invests in this pool has a long time horizon and a limited need for liquidity, and requires some inflation protection.

In March 2000, Treasury reviewed the liquidity needs of participants in the Broad Market Fixed Income Investment Pool and determined that the performance benchmark should be changed from the Lehman Brothers Govt./Corporate Index to the Lehman Brothers Aggregate Index. (The new benchmark takes effective 4/1/00.) Details and the Commissioner's concurrence are shown in [Appendix ZO](#).

The interest rate risk for this pool, as measured by duration, approximates that of the Lehman Brothers Aggregate Index. This index has had negative annual returns in recent years, but it has also had higher returns, on average, than intermediate-term investments together with higher volatility of those returns.

2. Investment Policy

Treasury invests the funds in this pool in a broad range of fixed income investments. Under the Prudent Investor Rule, Treasury constructs the pool's

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portfolio with a high risk tolerance. Investments include instruments with a long-term credit rating of at least Baa3 or equivalent and instruments with a short-term credit rating of at least P1 or equivalent. Investments for this pool are limited to:

- a. Money market investments comprising:
 - Repurchase agreements collateralized only by U.S. Treasury obligations, including bills, notes, and bonds, and only when the collateral carries a market value equal to or greater than 102% of the amount of the repurchase agreements, and only when the custodial bank appointed by retirement funds will take custody of the collateral;
 - Commercial paper rated at least Prime-1 by Moody's Investor Services, Inc. and A-1 by Standard and Poor's Corporation; and
 - Negotiable certificates of deposit and bankers acceptances; provided that an issuing bank must have total assets in excess of \$5 billion.
- b. United States Treasury obligations including bills, notes, bonds, and other debt obligations issued by the United States Treasury, and backed by the full faith and credit of the U.S. Government.
- c. Other full faith and credit obligations of the U.S. Government.
- d. Securities issued or guaranteed by agencies and instrumentalities of the U.S. Government, but not explicitly backed by the full faith and credit of the U.S. Government.
- e. Securities issued or guaranteed by municipalities in the United States.
- f. Obligations of foreign governments, sovereign states, supranational entities, and their instrumentalities denominated in U.S. dollars.
- g. Investment grade corporate debt securities comprising:

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- Corporate debt issued in the U.S. capital markets by U.S. companies;
 - Euro-dollar debt (that is, U.S. dollar-denominated securities issued outside the U.S. capital markets by U.S. companies or by foreign issuers); and
 - Yankee debt (that is, U.S. dollar denominated obligations issued in the U.S. capital markets by foreign issuers).
- h. Asset-backed Securities (ABS)
- i. Agency and non-agency mortgage-backed securities backed by loans secured by residential, multifamily and commercial properties including, but not limited to pass-throughs, collateralized mortgage obligations (CMO's), project loans, construction loans, and adjustable rate mortgages.

Investment in this pool is ideal for fund participants needing to invest part or all of their money with the following characteristics:

Risk Tolerance	High. The estimated probability of a loss over a one year period is approximately 11.16%. The daily investment results reflect daily changes in the market value of the pool's investments. Losses are likely over the intermediate-term based on the changes in market value of the pool's assets.
Investment Objectives	Willing to risk significant short-term volatility and principal loss for the possibility of large gains in the long-term.
Current Income	Daily earnings credit. The earnings of the pool include interest and changes in the market value of the investments held in the pool. There is no distinction between current income and capital gains.
Inflation Protection	Moderate need for long-term inflation protection. The pool should earn a positive real rate over an intermediate time horizon while meeting its other objectives.
Liquidity	Need for moderate liquidity. The pool can accommodate withdrawals and contributions (exceeding \$5,000,000) in the

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normal operating environment. The Broad Market Fixed Income Pool can accommodate much larger withdrawals, \$25,000,000 or more, with advance notice.

Time Horizon Moderately long to long time horizon. The long time horizon allows a more aggressive investment policy with higher expected returns than the Intermediate-term Pool.

Effective April 1, 2000, Treasury's performance benchmark for the Broad Market Fixed Income Investment Pool is:

100% Lehman Brothers Aggregate Index.

3. Legal Constraints and Special Circumstances

Treasury anticipates that several unexpendable trust funds will participate in this pool. Treasury must distinguish income from net appreciation to meet the legal restrictions pertinent to several of those trust funds.

D. Domestic Equity Investment Pool

1. Description and History

The Domestic Equity Investment Pool is an efficient investment option for fund participants that do not have high liquidity needs and that can take high residual or equity risk in exchange for higher expected returns over time. Money in the pool that is invested by Treasury is invested in a passively managed index fund operated by State Street Global Advisors in Boston Massachusetts: the State Street Global Advisors Russell 3000 Index Common Trust Fund. When investing in this Trust, the State does not own the individual securities, but instead, much like an investment in a mutual fund, it owns shares of the Trust.

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The selection of the particular index for investment of money managed by Treasury has evolved over time. From 1991 to 1997, the state invested in a trust fund that tracked the Standard & Poors 500 index. In October 1997, Treasury invested in a second trust fund so that the two trust funds combined replicated the Russell 3000 index. Finally, in May 2000, Treasury transferred all money invested in the Domestic Equity Investment Pool to State Street's Russell 3000 Trust Fund, except for the University of Alaska Trust money which is still invested in the S&P 500.

The rationale for passive management of the securities in the Domestic Equity Investment Pool is explained in [Appendix M](#). The rationale for selection of the Russell 3000 Index is explained in [Appendix N](#).

2. Investment Policy

Treasury invests money in this pool in State Street's Russell 3000 Index Common Trust Fund. According to the Frank Russell Company, this index represents approximately 98% of the investable U.S. equity market. Consequently, the risk characteristics of the Domestic Equity Investment Pool approximates the risk of the broad U.S. equity market.

Investment in this pool is ideal for funds needing to invest part or all of their money with the following characteristics:

Risk Tolerance	High. The estimated probability of a loss over a one year period is approximately 30%. Losses are likely over the intermediate-term based on the changes in market value of the pool's assets. The estimated probability of a loss over a five-year period is 10%.
Investment Objectives	Willing to risk significant short-term volatility and principal loss for the possibility of large gains in the long-term.

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Current Income	Not a particularly high priority. The total earnings of the common trust are calculated daily and are credited to common trust participants on a monthly basis. The total earnings of the common trust include dividends and net appreciation. In calculating anticipated return, there is no distinction between current income and net appreciation. However, the ability to separately account for net appreciation is required for any trust that may invest in the common trust.
Inflation Protection	High need for long-term inflation protection. The Domestic Equity Investment Pool should earn a positive real rate of return over a long time horizon while meeting its other objectives.
Liquidity	Limited liquidity required. The Domestic Equity Investment Pool can accommodate withdrawals and contributions (exceeding \$5,000,000) in the normal operating environment. The Domestic Equity Investment Pool can accommodate much larger withdrawals, \$25,000,000 or more, with advance notice.
Time Horizon	Long. This time horizon allows a more aggressive investment policy with higher expected returns than any of the fixed income investment pools.

Treasury's performance benchmark for the common trust is:

100% Russell 3000 Stock Index.

3. Legal Constraints and Special Circumstances

Treasury anticipates that several unexpendable trust funds will participate in this pool. Treasury must distinguish dividends from net appreciation to meet the legal restrictions pertinent to several of those trust funds.

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E. S&P 500 Tobacco-free Common Trust Fund

1. Overview

This common trust was used for the Alaska Children's Trust from November 1996 until the summer of 1998. As a consequence of an Attorney General's opinion (see [Appendix O](#)), Treasury has invested the money in the Domestic Equity Investment Pool described earlier in this Section.

F. State of Alaska (SOA) International Equity Investment Pool

1. Description and History

The SOA International Equity Investment Pool is an efficient investment option for fund participants requiring limited liquidity that can take high residual or equity risk in exchange for higher expected returns over time. The pool is currently managed by Lazard Asset Management in New York, New York. Treasury expects returns on the SOA International Equity Investment Pool to exceed those of the Morgan Stanley Capital International Europe, Australia and Far East (EAFE) Index.

Treasury originally considered international equities in 1997. Treasury evaluated the expected volatility and the correlation of international equities with other asset classes together with the costs associated with managing and monitoring an international equity portfolio. Treasury concluded that international equities were not warranted. Treasury reevaluated international equities in 1998 and came to the same conclusion.

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In 1999, Treasury concluded that international equities were warranted in portfolios with a long-term investment time horizon. Unlike the passively managed domestic equity common trust funds, Treasury concluded that an actively managed international equity portfolio will provide higher expected returns and less volatility than a passively managed portfolio. The analysis and rationale supporting the decision to select Lazard Freres Asset Management to actively manage the SOA International Equity Investment Pool can be found in [Appendix ZL](#) to this publication.

2. Investment Policy

The capital market assumptions of the international equity allocation are based on the expected return volatility and correlation assumptions of the EAFE Index. Treasury invests the money in an actively managed portfolio to achieve higher returns and lower volatility than the Index.

Investment in this pool is ideal for funds needing to invest part or all of their money with the following characteristics:

Risk Tolerance	High. The estimated probability of a loss over a one year period is approximately 33%. Losses are likely over the intermediate-term based on the changes in market value of the portfolio's underlying assets. The estimated probability of a loss over a five-year period is approximately 15%.
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Investment Objectives	Willing to risk significant short-term volatility and principal loss for the possibility of large gains in the long-term.
Current Income	Not a particularly high priority. The total earnings of the SOA International Equity Investment Pool are calculated daily and are credited to participants on a monthly basis. The total earnings of the portfolio include dividends and net appreciation. In calculating anticipated return, there is no distinction between current income and net appreciation. However, the ability to separately account for net appreciation is required for any trust that may invest in this pool.
Inflation Protection	High need for long-term inflation protection. The common trusts should earn a positive real rate of return over a long time horizon while meeting its other objectives.
Liquidity	Very limited liquidity required. The SOA International Equity Investment Pool can accommodate withdrawals and contributions (exceeding \$1,000,000) only with advance notice.
Time Horizon	Long. This time horizon allows a more aggressive investment policy with higher expected returns than any of the fixed income investment pools.

Treasury's performance benchmark for the common trusts is:

100% Morgan Stanley Capital International Europe, Australia and Far East Stock Index. (EAFE)

3. Legal Constraints and Special Circumstances

Treasury anticipates that several unexpendable trust funds will participate in this investment option. Treasury must distinguish dividends from net appreciation to meet the legal restrictions pertinent to several of those trust funds.

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Version Control

Revision Date	Effective Date	Summary of Changes	Find it in Version
7/18/99	7/1/99	Revised risk tolerance on Domestic Equity Collective Funds. Added new section on International Equity Collective Funds.	1.2
3/28/00	4/1/00	Treasury updates this section to reflect selection of Lazard to <u>actively manage international equity investments</u> .	1.3
3/28/00	4/1/00	Revised section pertaining to International Equity Collective Funds: now the actively managed SOA International Equity Investment Pool.	1.3
5/17/00	5/17/00	Domestic Equity Investment Pool, formerly Domestic Equity Collective Funds, policy revised.	1.4
8/7/00	5/1/00	Short-term Fixed Income Investment Pool: Individual fixed rate securities limited to 14 months to maturity or expected average life for amortizing securities. Floating rate securities limited to three years to maturity or three years average life for amortizing securities.	1.6

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**XII. Investment Policies Pertaining to Funds under the Direct
Responsibility of the Commissioner of Revenue**

**A. General Fund and Other Non-segregated Investments (GeFONSI) -
Investment Policy Statement**

1. Overview

As explained earlier in this publication, the Commissioner of Revenue is responsible for all deposits and investments of the state's money except where the Legislature has delegated that responsibility to other individuals or boards responsible for separate subdivisions or component units of the state. Treasury has the responsibility for managing all of the state's money except money held by the following component units:

- Alaska Permanent Fund Corporation
- Alaska Energy Authority
- Alaska Housing Finance Corporation
- Alaska Industrial Development and Export Authority
- Alaska Mental Health Trust Authority
- Alaska Municipal Bond Bank Authority
- Alaska Science and Technology Foundation (includes the International Trade and Business Endowment Fund)
- Alaska Railroad Corporation
- Alaska Student Loan Corporation
- University of Alaska

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All of the money Treasury is responsible for investing is held in either a treasury pool known as the GeFONSI⁸ or one of several other segregated treasury pools. Each treasury pool is held in a unique fund⁹ in the Statewide Accounting System (AKSAS).

2. History

- 1959. At or near the time Alaska achieved statehood, Treasury establishes a commingled treasurer's pool called the General Investment Fund to hold the cash and investments of various governmental funds.
- July 1, 1985. The state installs its new Statewide Accounting System (AKSAS).¹⁰ Prior to 1985, the state maintained three systems to track state funds: (a) Treasury kept a series of manual ledgers to track invested balances, (b) Finance kept a batch system that tracked fund balances, and (c) Finance kept a manual system that tracked state warrants. One purpose of AKSAS was to replace these three systems.

⁸ This treasurer's pool was known as the General Investment Fund until July 1994 when the Revenue Commissioner gave it a more descriptive name – the General Fund and Other Non-segregated Investments.

⁹ The term “fund” is used in many ways in legislation, in this publication and by pertinent state government officials. In governmental accounting, however, the term “fund” has a very precise, technical meaning. In order to account for restrictions imposed by the governing legislative body on the utilization of a state or municipal government's financial resources, the applicable accounting conventions required by the Governmental Accounting Standards Board (GASB) rely on fund accounting. Under the GASB rules, a fund is a “fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations.” National Council on Governmental Accounting, *Statement 1: Governmental Accounting and Financial Reporting Principles* (Chicago: Municipal Finance Officers Association of the United States and Canada, 1979), p. 2.

¹⁰ AKSAS is designed to incorporate sophisticated file management technology, highly flexible management reporting facilities, on-line data entry/inquiry and streamlined procedures to provide minimum processing turn-around time and high quality, timely management and financial information for the State of Alaska. The design is based on three major concepts: (a) maintain the detailed financial data available at the time transactions are recorded to provide ready access to transactions and reporting flexibility, (b) provide additional reporting structures beyond the required statewide budget structure and the funds to accommodate regulatory, financial and management reporting requirements, and (c) streamline the transaction processing flow through on-line data entry/error correction and transaction certification.

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- July 1994. Treasury establishes the GeFONSI, a treasury pool which participates in the newly created Short- and Intermediate-term Fixed Income Investment Pools.

3. Facts and Figures

a. History of Investment Earnings Allocation Methods

Actual Paid Under MOU

FY	Balances Used	Rates Used	GAAP Requirement for State CAFR Presentation
93	Month end Balance	Pro rata share of GeFONSI earnings ¹¹	Lower of cost or market (LCM) ¹²
94	Daily Balance	180-Day T-Bill ¹³	LCM
95	Daily Balance	180-Day T-Bill	LCM
96	Daily Balance	180-Day T-Bill	LCM
97	Daily Balance	180-Day T-Bill	LCM, but the state implemented GASB No. 31 early which presents invested assets at fair (market) value
98	Daily Balance	GeFONSI Mark to Market Daily Rate	Fair (market) value

¹¹ Per Memorandum of Understanding dated October 2, 1992 effective September 1, 1992. Earnings are defined as realized gains or losses, accrued income [refers to interest rather than income], amortization of premiums, and accretion of discounts.

¹² Invested assets are reported at cost unless the market value is materially less at fiscal year end.

¹³ Specifically, the rate was derived from the Bond Yield Equivalent resulting from the weekly 180-day Treasury Bill auction for the previous week.

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b. Performance Results

Fiscal Year	Rate of Return
92	6.92%
93	4.37%
94	3.12%
95	7.06%
96	5.47%
97	6.22%
98	6.62%
99	5.02%
00	5.29%

4. Management

a. How a Treasury Pool Works

The Division of Finance in the Department of Administration (Finance) has established almost 150 separate funds (GASB funds) to account for the various programs established by the pertinent legal authorities (for the most part, the Alaska Legislature). The General Fund is the most visible of these funds; most state government activity is paid through this fund.

Finance has established a series of treasury pools¹⁴ to facilitate cash flow and warrant clearings through AKSAS. Treasury pools are not GASB funds under generally accepted accounting principles. Rather, they are entities established by Finance to hold and account for cash and investments for the 150 separate GASB funds. The balance sheets for each of the GASB funds, in turn, reflect the invested assets for that GASB fund in a separate account.

¹⁴ Technically, these treasury pools are called “treasurer’s pools.”

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AKSAS is configured so that each of the state's 150 GASB funds will be invested in only one treasury pool. A treasury pool may hold the assets of more than one GASB fund. However, if a treasury pool holds the assets of a GASB fund, it must hold all of the investments of that GASB fund. Treasury's investment policies for each of the GASB funds must accommodate this constraint imposed by AKSAS.

As explained in Section X (B), most of the assets in the GeFONSI are treated as a commingled investment pool. Using a commingled investment pool maximizes the earnings potential for most of the pools' participants by providing smaller funds the opportunity to participate in investment opportunities that would otherwise be unavailable to them and by providing economies of scale.

Funds from each of the major operating fund categories recognized by GASB - governmental funds, proprietary funds, and fiduciary funds (other than non-expendable trusts) - are invested in the commingled portion of the GeFONSI.¹⁵

¹⁵ Governmental funds are expendable; money in governmental funds are received and expended with no expectation that the money will be returned through user or departmental charges. Proprietary funds are commercial-type funds used to account for the ongoing operations conducted by the government that are similar to those conducted by private business; they include both enterprise funds that provide services to individuals outside state government and internal service funds that provide services from one government agency to another. Finally, fiduciary funds are used to account for expendable and non-expendable assets held by the government in a trust capacity or as an agent for other entities.

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As described more fully below, Treasury has concluded that the commingled portion of the GeFONSI as a whole has a moderate risk tolerance, a short time horizon and a high need for liquidity. Consequently, the entire commingled portion is invested in Treasury's Short- and Intermediate-term Fixed Income Investment Pools.¹⁶

¹⁶ The GeFONSI is also comprised of the following non-commingled investments and clearing accounts:

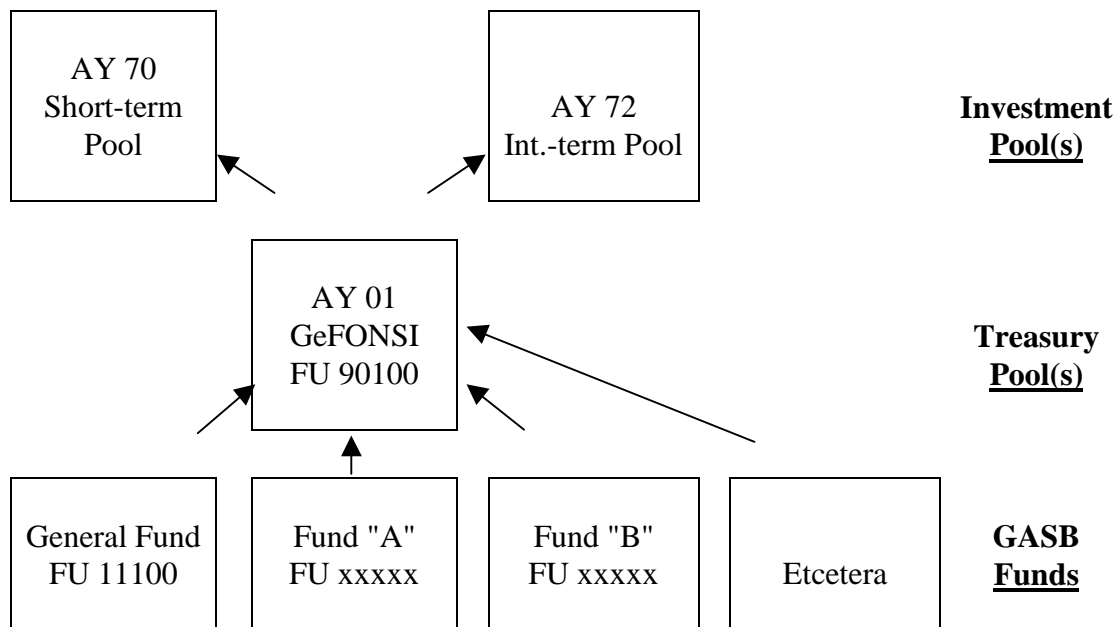
- i. Cash and Certificates of Deposit for Compensating Balances.** To cover the costs of certain banking services provided to the Treasury Division, the General Fund holds interest-free certificates of deposit with one or more servicing bank. See AS 37.10.075(d). These balances also include daily deposits in Alaska, Washington and Canadian banks that are transferred to the state's clearing bank for redemption of state warrants.
- ii. Settlement Accounts.** These include transactions and settlements that have not been fully allocated in the state's accounting records.
- iii. Mortgage-related Assets.** The General Fund owns mortgage-related assets as described in Section XII(M) of this publication.

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The relationship between the pertinent GASB funds, the treasury pools, and their related accounts at the custodian bank is shown in the following table.

Relationship Between the Pertinent GASB Funds, the Segregated Treasury Pool and their Related Investment Pool



b. Composition of the GeFONSI

The GeFONSI typically has a balance of about \$1 billion; the General Fund is the largest investor in the GeFONSI with a typical invested balance in the range of \$150 to \$350 million. Focusing on one moment in time, GeFONSI held a balance of \$911 million at the close of business on January 21, 1997. More than 100 participants had money invested in the GeFONSI at that time.

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The major participants, by fund types, in the commingled fund portion of the GeFONSI on January 21, 1997 were:

<u>Participants in the GeFONSI</u>			
	Fund Types	Number of Funds with Money Invested on 1/21/97	1/21/97 Investments \$(Millions)
General Fund Group - General Fund	Governmental	1	312
General Fund Group - Other Subfunds	Governmental	37	296
Special Revenue Funds	Governmental	7	27
Capital Project Funds	Governmental	6	10
Debt Service Fund	Governmental	0	0
Enterprise Funds	Proprietary	17	120
Internal Service Funds	Proprietary	4	13
Trust and Agency Funds	Fiduciary	9	126
Treasury "funds" *	N/A	11	(2)
Component Units	Various	7	9

* As explained elsewhere in this section, Treasury funds are not funds as defined by the Governmental Accounting Standards Board. These particular funds are the clearing accounts of the 18 separately invested Treasury funds.

[Appendix P](#), "A Day in the Life of the GeFONSI," contains additional information about the GeFONSI and its participants at one particular moment in time, January 21, 1997. [Appendix Q](#) contains a set of detailed schedules describing all of these participants whose cash is invested in the GeFONSI.

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c. Earnings Allocation Policy

Whether a GeFONSI participant receives investment earnings depends on applicable state or federal legislation, court decree or a formal opinion issued by the state's Attorney General. The Department of Administration, Division of Finance interprets the applicable statutes according to their procedures set forth in [Appendix ZP](#). Each participant can be classified into one of three categories as follows:

- Type 1: Some of the individual funds whose assets are invested in the GeFONSI are legally entitled to automatically receive the earnings attributable to the investment of those assets.
- Type 2: Other funds invested in the GeFONSI are entitled to receive the earnings attributable to the investment of their assets if the Legislature chooses to appropriate the earnings to those funds. If the Legislature does not so appropriate, then the General Fund receives the earnings from those assets.
- Type 3: Treasury computes and separately accounts for investment earnings but credits those earnings to the state's general fund.

The specific arrangements pertaining to the distribution of GeFONSI investment earnings have been memorialized in a series of Memoranda of Understanding (MOU) between the Departments of Revenue and Administration beginning in 1986. A sample MOU may be found in [Appendix R](#). Designated persons in the Department of Administration, Division of Finance, transmit changes to participant classification through updates to Attachment C of the MOU. Treasury staff retains updates to the MOU with attachments in a permanent file within the Accounting Section.

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Under the MOU effective July 1, 1993 to June 30, 1997, each fund invested in the GeFONSI (other than the General Fund) that was entitled to the earnings on its invested assets initially received an amount based on the bond equivalent yield of the 180-Day Treasury Bill established at the weekly U.S. Treasury auction. In November 1997, administrators for one of the participating funds, the Exxon Valdez Settlement Fund, questioned the validity of using this proxy rate of return. (See [Appendix ZM](#)). The Revenue Commissioner requested the state attorney general's opinion regarding the matter. (See [Appendix S](#).) In reply, the attorney general determined that funds involving a trust¹⁷ or custodial relationship should have received their actual daily rate of return while their assets were invested in the GeFONSI during FY 1994 through 1997. (See [Appendix ZZ](#).) Though not intended to be a comprehensive review of funds participating in the GeFONSI during FY 1994 through FY 1997, the state's attorney specifically indicated the following funds fall under a trust or custodial relationship:

- Oil Restoration Fund (Fund 11140)¹⁸
- Exxon Valdez Settlement Fund (Fund 33070)
- Deposits, Suspense and Miscellaneous Trust Account (Fund 32010)¹⁹
- Public Advocacy Trust (Fund 32012)
- Wage and Hour Trust (Fund 32011)
- Alaska Aerospace Development Corp. Revolving Fund (Fund 21643)
- Alaska Aerospace Development Corp. Federal Grant Fund (Fund 21649)

¹⁷ According to the attorney general opinion number 663-98-0298 dated October 26, 2000, "a Trust is...a fiduciary relationship with respect to property, subjecting a person by whom title to property is held to equitable duties to deal with property for the benefits of another person, which arises as [a] result of manifestation to intention to create it."

¹⁸ "By plea agreement, the Oil Restoration Fund, consisting of approximately \$50 million, was established as a segregated fund. U.S. v. Exxon, No. A90-9015 CR (D.C. Alaska). The state was obligated to use the money for a specific purpose, and the plea agreement expressly provided for the payment of interest on the recovery after the money was placed in state custody."

¹⁹ "This general category includes a mixture of funds and accounts. Some of the sub-funds do not raise liability for income allocation decisions. Trust or custodial relationships are present in the permanent fund dividend trust accounts, the Alaska Heritage Endowment, Cooke Memorial Trust, the Department of Law Trust Account, and the Unlicensed Vessel Operators Retirement Fund."

Section XII:

General Fund and Other Non-segregated Investments (GeFONSI)

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- Alaska Student Loan Corporation Revolving Loan Fund (Fund 82000)
- Mental Health Trust (Fund 34045)
- Mental Health Trust Income Settlement (Fund 34046)

Effective July 1, 1997, the Departments of Revenue and Administration entered into a new Memorandum of Understanding that modified the earnings allocation method used to distribute investment earnings to GeFONSI participants. Under the modified procedure, Treasury allocates investment earnings to eligible GeFONSI participants (other than the General Fund) using the actual daily rate of return for the commingled portion of the GeFONSI. The actual daily earnings rate includes income plus net appreciation (i.e., total return).²⁰

d. Treasury Pools other than the GeFONSI

While the invested assets of most of the state's 150 GASB funds are held by the GeFONSI, the invested assets of selected GASB funds are held in segregated treasury pools. These GASB funds are:

- Constitutional Budget Reserve Fund - Main
- Constitutional Budget Reserve Fund - Subaccount
- Public School Trust (Principal)
- Public School Trust (Income)
- Alaska Children's Trust (Principal)
- Alaska Children's Trust (Income)
- Investment Loss Trust Fund
- Alaska Advance Tuition Savings Fund*
- International Airports Revenue Fund (ex the Reserve and Replacement Account)

²⁰ Where the applicable statutes specify that a GeFONSI participant is entitled to its "interest" earnings, Treasury has interpreted the definition as *total return*. That is, the participant receives income (interest and dividends, if any) plus net appreciation (realized and unrealized gains and losses). This interpretation was first applied in FY 1998 when Treasury began to use the actual daily rate of return to allocate investment earnings.

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- International Airports Reserve and Replacement Account
- International Airports Series 1999A AMT Bond Construction Fund
- International Airports Series 1999B Non-AMT Bond Construction Fund
- International Airports Series 1999C AMT Bond Construction Fund
- Alaska Student Loan Corporation Trust Fund*
- Alaska Student Loan Corporation Pledged Loan Payment Trust Fund*
- Public Employees' Retirement Trust
- Teachers' Retirement Trust
- Judicial Retirement Trust
- National Guard and Naval Militia Retirement Trust
- Supplemental Benefits System Trust
- Retiree Major Medical Insurance Fund
- Retiree Long-term Care Fund
- Exxon Valdez Oil Spill Investment Fund
- Power Cost Equalization Endowment Fund

*Treasury has limited responsibility for some University of Alaska and Alaska Student Loan Corporation funds. These component units are individually responsible for investing most of their own money. (See Section XV for tables reflecting the relationship between the pertinent GASB funds and the segregated treasury pools.)

e. Cash Flows

With declining oil revenues and the corresponding decrease in available cash, a cash flow situation arises from time to time where the General Fund faces a cash deficiency.

Because of the continuing decline in oil revenue, cash flow deficiencies have occurred every year since FY 94.

This problem has been amplified by the relatively recent creation of the many subfunds that make up the General Fund Group. Prior to 1985, most unrestricted revenue flowed directly into the General Fund where it was available to pay day-to-day costs of operating state government. This is no longer the case. Over time, the Legislature has created more than 50 cash pools as subfunds of the General Fund. (See Appendices [P](#) and [Q](#).) The

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effect of these actions has diverted cash historically destined for the General Fund to cash pools that may not be readily available to pay day-to-day state operating costs.

Also contributing to cash deficiencies is the fact that the inflow of unrestricted cash receipts does not mirror the cash outflow. Revenue flows into the state treasury at a relatively constant rate with peaks occurring at the end of each month, quarter, and fiscal year. Expenditure rates vary considerably. The expenditures for the first quarter of each fiscal year are much higher than the revenue for the same period. If the General Fund does not have a large cash balance at the beginning of the fiscal year or if other sources of funds are not available, the state annually faces multiple cash deficiencies before the end of the first quarter of the fiscal year.

Treasury, the Governor's Office of Management and Budget (OMB), and the Division of Finance in the Department of Administration (Finance), have jointly developed a Cash Deficiency Operating Plan. (A copy of the Cash Deficiency Operating Plan may be found in [Appendix DA](#).) That plan primarily focuses on the Constitutional Budget Reserve Fund as a source of money to make up for cash deficiencies in the General Fund.

However, twice during the 1990's, Finance did turn to the other subfunds in the GeFONSI to cover a cash shortfall in the General Fund. The first of these actions resulted in a negative balance for the General Fund and OMB requested that Finance not repeat the action. The second occurred as a result of the legislature placing a cap on CBR borrowing during FY 99.

Under the provisions of the Cash Deficiency Operating Plan, Finance requests that Treasury move money from the Constitutional Budget Reserve Fund to the General Fund whenever the balance in the General Fund is below \$100 million for four to five consecutive business days and the cash flow projection produced by Treasury's Cash

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Management Section indicates that the balance will remain below \$100 million for the immediate future. The amount moved is a multiple of \$50 million, and that amount is determined on the basis of the monthly cash flow projection developed by the Cash Management Section.

If the General Fund balance exceeds \$200 million, and is expected to continue to exceed \$200 million for a period of 30 consecutive days, then Finance requests that Treasury move money from the General Fund to the Constitutional Budget Reserve Fund in \$10 million increments. Again, the amount moved is determined on the basis of the Cash Management Section's cash flow projections.

The Legislature must specifically authorize using the Constitutional Budget Reserve Fund to cover General Fund cash deficiencies. If, in any year, the Legislature should fail to authorize the use of the Constitutional Budget Reserve Fund for this purpose, the Cash Deficiency Contingency Plan calls for Treasury, Finance, and OMB to endeavor to use other funds in the General Fund Group to cover the shortfall, or issue revenue anticipation notes.

In evaluating the state's cash flow needs and cash management procedures, there are a number of additional facts that are important to keep in mind. The amount of outstanding warrants and electronic payments on any given day that must be covered by the General Fund varies from \$7 million to \$100 million. On an average business day, \$3 million to \$20 million in warrants are presented for payment. Each morning, Treasury's cash manager sums (1) the state warrants presented to Alaska banks during the previous business day; (2) the state warrants that have been cleared through the Federal Reserve Bank's system; and (3) the funds that the state plans to electronically transfer to others during that business day. That amount is netted against the day's anticipated cash receipts

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so that the responsible Treasury Investment Officer can plan on either investing the surplus or securing sufficient cash to cover the deficit.

5. Investment Policy

[Appendix U](#) contains the statutes applicable to the investment of GeFONSI. The General Fund, directly and indirectly (through funds or subfunds whose earnings go directly to the General Fund) constitutes the largest element of the GeFONSI. When developing the investment policy for the GeFONSI, the Department carefully considered the relationship between the General Fund and the Constitutional Budget Reserve Fund (CBRF). (See Section XII(B) - Investment Policy Statement: Constitutional Budget Reserve Fund).

Treasury currently invests the commingled portion of GeFONSI assets with the following in mind:

Risk Tolerance	Moderate. Much of the money in the underlying GASB funds has been appropriated and a material loss could affect the state's or an agency's ability to fulfill its obligations. However, most of these GASB funds are not entitled to investment earnings and therefore, the principal is not subject to capital gains or losses.
Investment Objectives	Minimal exposure to principal loss. Maximize current income within moderate risk tolerance. Minimal inflation protection needed. High liquidity requirement.
Time Horizon	Short to intermediate. Treasury expects much of the money in the pool to be spent in less than one year.

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Other Constraints Ongoing review of the nature and objectives of pool participants can change nature of pool or result in withdrawal of some pool participants.

Significant intramonth cash flows require normalization of the pool's investment balances when evaluating compliance with investment policy bands.

Effective April 1, 2000, Treasury's investment policy for the GeFONSI is:

38% ± 8% Short-term Fixed Income Investment Pool
62% ± 8% Intermediate-term Fixed Income Investment Pool

The investment policy has a plus or minus 8% band for each investment pool in the allocation to avoid the expense of continually rebalancing the GeFONSI's investments.

Effective April 1, 2000, Treasury's performance benchmark for the commingled fund portion of the GeFONSI is:

38% Three-month U.S. Treasury Bill
62% 1-5 Year Merrill Lynch Government Index

The investment policy of GeFONSI must be reasonable when compared both to a low risk policy and the policy of the CBRF that serves as the immediate reserve for the General Fund. A comparison of the three pertinent investment policies follows:

	<u>Low Risk Policy</u>	<u>Treasury's Policy for the Commingled Fund Portion of the GeFONSI</u>	<u>Treasury's Policy for the CBRF Two-Year Shortfall Fund</u>
Investment policy:			
% Short-term Fixed Income Investment Pool	78%	38%	25%
% Intermediate-term Fixed Income Investment Pool	22%	62%	75%
Expected return	5.36%	5.37%	5.44%
Probability of a loss over a one year period	0.01%	2.00%	3.90%

Effective: 10/26/00

XII: A-16

Section XII:

General Fund and Other Non-segregated Investments (GeFONSI)

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6. Ongoing Review of Funds Participating in the GeFONSI

The day-to-day needs of the state's General Fund, with its short time horizon, significantly influence the investment policy applicable to the GeFONSI. However, the GeFONSI holds the cash assets of at least three types of fund participants with longer time horizons than the General Fund. They are:

- Fund participants that are highly likely to maintain minimum large balances for the foreseeable future (e.g., the Oil and Hazardous Substance Release Response Account, the Alaska Marine Highway Fund, the Fish and Game Fund, the Agricultural Revolving Loan Fund, and the Commercial Fish Revolving Loan Fund);
- Fund participants with large balances that are likely to be spent down to a zero balance over a definite, intermediate time horizon (e.g. the Power Cost Equalization Endowment Fund, the Oil Restoration/Exxon Valdez Criminal Fine Fund, the Alyeska/Exxon Valdez Settlement Fund, and the Power Project Fund); and
- Small trust fund participants whose principal balance must be preserved (e.g., the Alaska Heritage Endowment Fund and the Margaret Nick Cooke Memorial Trust).

The Treasury Division considered three options to enhance the return from the funds with longer time horizons:

- Initiate a second GeFONSI using a more aggressive asset allocation among the extant Treasury investment pools or domestic equity collective funds;
- Establish a second, more aggressively invested Intermediate-term Fixed Income Investment Pool in which all of the assets of some of the funds with longer time horizons would be invested; or
- Leave participation in the GeFONSI undisturbed, but adopt a more aggressive investment policy for the extant Intermediate-term Fixed Income Investment Pool and, consequently, a more aggressive policy for the entire GeFONSI .

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In February 1998, Treasury recommended the third option; the Commissioner accepted that recommendation. [Appendix T](#) contains the analysis supporting Treasury's recommendation.

7. Control and Reporting Requirements Pertinent to the Commingled Fund Portion of the GeFONSI

AS 37.10.071(a)(8) requires the Commissioner to maintain accounting records for the GeFONSI in accordance with generally accepted accounting principles. This responsibility has been delegated to the State Comptroller.

AS 37.10.071(a)(9) requires the Commissioner to engage an independent certified public accountant to perform an annual audit of the financial condition of GeFONSI and the pertinent investment transactions. To fulfill this requirement, the State Comptroller contracts with an independent certified public accountant to perform the annual audit.

Version Control

Revision Date	Effective Date	Summary of Changes	Find it in Version
9/11/99	9/1/99	Treasury updates cash deficiency operating plan following updated projections for FY 2000 General Fund borrowing from the Constitutional Budget Reserve Fund.	1.2
4/1/00	4/1/00	Performance results added to Facts & Figures section	1.3
3/7/00	4/1/00	Treasury updates 2000 capital market assumptions and changes asset allocation policy accordingly. Target policy was 30% Short-term Fixed Income Investment Pool, 70% Intermediate-term Fixed Income Investment Pool.	1.3
4/24/01	10/26/00	Treasury adds state's attorney general opinion no. 663-98-0298 dated October 26, 2000 regarding the investment earnings allocation methodology for certain funds participating in the GeFONSI during FY 1994 through FY 1997.	1.8

Effective: 10/26/00

XII: A-18

Section XII:

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B. Constitutional Budget Reserve Fund - Investment Policy Statement

1. Overview

The state must deposit in a Constitutional Budget Reserve Fund (CBRF) all money received by the state after July 1, 1990 as a consequence of the resolution of disputes about the amount of mineral lease bonuses, royalties or taxes.

The Legislature may appropriate funds from the CBRF to fund the operations of state government only under certain conditions. If, at any time, the amount of funds from other sources available to the Alaska Legislature for appropriation is less than the amount appropriated to fund state government for the previous fiscal year, then the Legislature may appropriate from the CBRF on a simple majority vote. When the amount of funds from other sources exceeds the amount appropriated for the previous fiscal year, the Legislature may appropriate from the Fund for any public purpose with a three-fourths vote of the members of each house.

The Alaska state constitutional provision governing the operation of the CBRF requires the state's general fund to repay the money that has been appropriated from the CBRF if and when there is a surplus in the general fund at the end of any fiscal year. The general fund does not pay interest on the money it has "borrowed" from the CBRF.

Treasury's investment policies for the CBRF have changed over the years as balance and the expected uses of the CBRF have changed. A significant change occurred this year when the 21st Legislature created a special subaccount in the CBRF in order to "yield higher returns than might be feasible to obtain with other money in the budget reserve fund." The legislature directed that "In establishing or modifying the investment policy for the subaccount in the constitutional budget reserve fund, the commissioner of revenue

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shall assume that those funds will not be needed for at least five years. Income earned on money in the subaccount shall be retained in the subaccount by the department.”

AS 37.10.430(c).

Treasury, according to the constitution, credits to the CBRF the amount earned by the investment of the money in the CBRF. That is, the main account of the CBRF retains its investment earnings and the subaccount of the CBRF retains its investment earnings.

[Appendix V](#) contains the constitutional and statutory provisions applicable to the CBRF.

2. History

- November 1990. Voters of Alaska adopt an amendment to the Alaska State Constitution creating the CBRF. Article IX, 17 - See [Appendix V](#).
- 1992-1994. Litigation over meaning of key terms in the constitutional provision.
- 1994. Legislature attempts to define "administrative proceedings involving taxes" and "money available for appropriation." 1 Ch. 5 SLA 1994. AS 37.10.410-420.
- April 1994. Alaska Supreme Court decision in *Hickel v. Halford* 872 P.2d 171 defining scope of "dispute" and "administrative proceedings."
- May 1994. Alaska Supreme Court decision in *Hickel v. Cowper* 874 P.2d 922 defining meaning of "amount available for appropriation."
- 1996. Legislature modifies definition of "administrative proceedings involving taxes." 5 Ch. 108 SLA 1996. See [Appendix V](#).
- 1996. Legislature grants commissioner discretion to transfer management of all or a portion of CBRF to Alaska Permanent Fund Corporation. 1 Ch. 41 SLA 1996. AS 37.10.430. See [Appendix V](#).
- 1997. Commissioner of Revenue decides to manage and invest all of CBRF through the Treasury Division, and Commissioner adopts Reserves Policy for the state.

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- 1997. Commissioner adopts investment policy for CBRF based on three separate purposes of CBRF:
 - Fund to implement the state's Reserves Policy to cover anticipated and unanticipated shortfalls in the next two fiscal years' budgets;
 - Fund to provide a transition to a long-term fiscal plan; and
 - Fund to act as long-term reserve account to cover unanticipated budget shortfalls well into the future.
- June 1997. Legislature appropriates money from the CBRF for the first time from the CBRF to pay for CBRF equity investment management fees.
- July 1998. Because of anticipated heavy use of CBRF in short to medium term to balance state budgets, Commissioner modifies investment policy and eliminates consideration of using a portion of the CBRF to act as long-term reserve account.
- December 1998. Treasury reviews the Department of Revenue's Fall oil revenue forecast and the Office of Management and Budget's updated expenditure forecast. Treasury determines that the CBRF will be exhausted within five years to meet revenue shortfalls. Commissioner modifies investment policies and eliminates all equity investments.
- July 1999-September 1999. Treasury recommends and Commissioner accepts an investment policy recognizing a two-year investment horizon for the entire balance of the CBRF. Very large draws on CBRF to balance FY 98 and FY 99 budgets, together with a projected \$600 million to \$1.0 billion draw to balance FY 00 budget, reduces the anticipated time horizon for the balance of fund. Commissioner concludes this change is appropriate no matter how the public votes in the September 14, 1999 special election relating to the state's long-range finances. Similarly, the Commissioner concludes that the higher oil prices experienced in the late spring and summer of 1999 should not alter this proposed policy.
- April 2000. Treasury recommends and Commissioner accepts an investment policy that recognizes a balance in the CBRF in excess of the state's two year reserve requirement and the state's cash flow needs. Higher than anticipated oil prices and a significant settlement increased the balance of the CBRF enough to cause the change in the investment policy
- July 2000. A significant change in the legislation relating to the fund caused Treasury to recommend significant changes to the investment policy of the fund. Treasury recommended and the commissioner accepted an investment policy that recognized a

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distinction for the newly created subaccount of the fund, the likely life of the fund, and the role of the balance of the fund in filling the reserve requirements of the State. (Related decision document in [Appendix Y](#).) (Earlier versions of these decision documents are maintained in permanent files in Treasury's Asset Accounting Section. Revised documents relating to those policy decisions may be found in Appendices [W](#) and [X](#).)

3. Facts and Figures

Fund Cash Flow History by Fiscal Year

**Alaska's Public Finances
Constitutional Budget Reserve Fund, Main Account
(\$millions)**

	Settlement Contributions ^(a)	Investment Income ^(b)	Net Loans to General Fund	Balance Available to Loan GF at Year End ^(c)
FY 91	291	6	-	297
FY 92	247	19	-	563
FY 93	914	57	(849)	685
FY 94 ^(d)	437	61	(569)	614
FY 95	1,543	122	(285)	1,994
FY 96	586	111	(173)	2,518
FY 97	570	167	(83)	3,172
FY 98	343	369	(325)	3,559
FY 99	56	114	(1,101)	2,628
FY 00	448	115	^(e) (357)	^(f) 2,734
FY 01 (Proj.)	100	128	117	^(g) 2,679
FY 02 (Proj.)	45	133	(515)	2,342
FY 03 (Proj.)	45	107	(717)	1,777
Total	5,625	1509	(\$4,857)	

Data sources:

- (a) Department of Revenue, Income and Excise Audit Division, Mineral Payments Report (ties in total through FY99).
- (b) Derived (by formula).
- (c) State of Alaska Comprehensive Annual Financial Report (ending balance less the outstanding receivable from the state's general fund).
- (d) Although the table above is based on cash flows, it does not reflect the timing of the \$1,006,038,474 legislative appropriation (Ch 14, SLA 1994) resulting from an Alaska Supreme Court order to restore the CBRF for certain settlement payments deposited to the state's general fund from FY 1990-1994.
- (e) FY00 includes draw to finalize FY99 budget (42mm).
- (f) Reflects \$100 million transfer to Power Cost Equalization Endowment Fund.
- (g) Reflects \$400 million transfer to CBRF subaccount on July 1, 2000.

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**Alaska's Public Finances
Constitutional Budget Reserve Fund, Subaccount
(\$millions)**

	Settlement Contributions ^(a)	Investment Income ^(b)	Net Loans to General Fund	Balance Available to Loan GF at Year End ^(c)
FY 00	0	0	0	0
FY 01 (Proj.)	400	34	0	434
FY 02 (Proj.)	0	37	0	471
FY 03 (Proj.)	0	40	0	511
Total	400	111	0	

4. Investment Policy

For the main account of the CBRF (excluding the subaccount that has a five-year time horizon), Treasury recognizes the State's current two-year reserve requirement, General Fund cash flow borrowing needs, money in excess of that which might be needed within two years and the Investment policy of the GeFONSI. At this time, the current high oil prices and the balance in the CBRF support a somewhat more aggressive policy for the money in the main account of the CBRF than had been the case in recent years.

Treasury would invest the main account of the CBRF with the following in mind:

- Risk Tolerance Moderately high. Fund should not be needed for several years.

- Investment Objectives Moderately high exposure of principal to loss in return for higher expected longer-term returns.
 Limited current income requirement.
 Moderate inflation protection needed.
 Moderate liquidity requirement.

- Time Horizon Intermediate.

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Effective July 1, 2000, Treasury's investment policy for the main account of the CBRF would be:

- 25% ± 8% Broad Market Fixed Income Investment Pool
- 65% ± 8% Intermediate-term Fixed Income Investment Pool
- 10% ± 8% Short-term Fixed Income Investment Pool

Treasury's performance benchmark for the main account of the CBRF is:

- 25% Lehman Brothers Aggregate Bond Index
- 65% Merrill Lynch 1-5 year Government Index
- 10% Three-month U.S. Treasury Bill

Treasury would invest the subaccount of the CBRF with the following in mind:

- Risk Tolerance** High. The legislature has expressly provided guidance by instructing the Commissioner to use at least a five year time horizon in establishing an investment policy for the subaccount.
- Investment Objectives** High exposure of principal to loss in return for higher expected longer-term returns.
Limited current income requirement.
Inflation protection needed.
Moderate liquidity requirement.
- Time Horizon** Long.

Effective July 1, 2000, Treasury's investment policy for the subaccount of the CBRF would be:

- 42% ± 7 Broad Market Fixed Income Investment Pool
- 41% ± 7 Domestic Equity Investment Pool
- 17% ± 5 International Equity Investment Pool

Treasury's performance benchmark for the main account of the CBRF is:

- 42% Lehman Brothers Aggregate Bond Index
- 41% Russell 3000 Stock Index
- 17% Morgan Stanley Capital International Europe, Australia, and Far East Stock Index

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5. Control and Reporting Requirements

On or before March 15 each year, AS 37.10.430 requires Treasury to prepare a report to the Legislature comparing beginning and ending balances in the CBRF for the immediately preceding calendar year together with comparative nominal, real and realized returns for the CBRF, the Permanent Fund and the general fund. The State Comptroller in the Treasury Division is responsible for compiling this information and preparing and distributing the required report.

The Alaska Legislature made AS 37.10.071 directly applicable to the CBRF. Accordingly, the Commissioner, through the State Comptroller, maintains accounting records for the Fund in accordance with generally accepted accounting principles (as would be required by AS 37.10.071(a)(8)) and engages an independent certified public accountant to perform an annual audit of the financial condition of the Fund and the pertinent investment transactions (as would be required by AS 37.10.071(a)(9)).

Version Control

Revision Date	Effective Date	Summary of Changes	Find it in Version
8/19/99	9/1/99	CBRF - elimination of Transition Fund and Long-term Reserve Fund, modification to investment policy of Two-year Shortfall Fund including asset allocation.	1.2
3/7/00	4/1/00	Treasury updates 2000 capital market assumptions and changes asset allocation policy accordingly. Target policy was 15% Short-term Fixed Income Investment Pool, 85% Intermediate-term Fixed Income Investment Pool.	1.3
4/7/00	4/10/00	Treasury revises asset allocation after receiving a \$416.3 million settlement from an oil tax dispute in early April 2000. Asset allocation was 25% Short-term Investment Pool, 75% Intermediate-term Investment Pool.	1.4
1/29/01	7/1/00	Treasury revises asset allocation when the 21st Legislature creates a special \$400 million "subaccount" in the CBRF effective July 1, 2000 and establishes a new \$100 million Power Cost Equalization Endowment Fund.	1.7

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C. Public School Trust Fund - Investment Policy Statement

1. Overview

The Public School Trust Fund (originally the Public School Permanent Fund) is a non-expendable trust fund, the income of which is dedicated to the benefit of Alaska's public schools.

2. History

- March 15, 1915. Congress creates Alaska Public School Permanent Fund by reserving sections 16 and 36 of each surveyed township in Territory of Alaska for support of public schools. Territory authorized to lease lands and required to deposit all lease proceeds in a permanent trust fund. Income from trust fund dedicated to public schools of Alaska.
- 1958 and 1959. Statehood Act terminates Alaska's rights to additional school lands. At statehood, the lands already in the Trust, totaling just over 105,000 acres, transferred to the state. DNR assumed management.
- 1976. In response to Legislative Budget and Audit Committee criticism of DNR's school land lease rate determinations, legislature requires State Board of Education to approve new Trust land transactions.
- 1978. Legislature passes comprehensive legislation dealing with federally created land-based trusts. Ch. 182 SLA 1978. (See Section XII(E) introduction regarding University of Alaska Trust Fund and Section XII(N) regarding Alaska Mental Health Trust.) With respect to the Public School Trust:
 - All lands in Trust redesignated state general grant lands;
 - The Public School Fund established;
 - The money in the Public School Permanent Fund transferred to the Public School Fund;
 - One half of one percent (0.5%) of the income from all state general grant lands and from the federal public land revenue shared with the State of Alaska (state land revenue) dedicated to the Public School Fund;

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- A Public School Advisory Board consisting of the Commissioner of Education, three members of the Board of Education, and the Commissioner of Revenue was created to prepare long range investment plans for the Fund; and
 - Commissioner of Revenue designated official custodian and given responsibility to: (1) receive contributions, (2) collect investment earnings, and (3) invest the principal of the Fund following review by the Advisory Board.
- 1978. \$7.8 million transferred from Public School Permanent Fund to Public School Fund.
 - 1980. Alaska National Interest Lands and Conservation Act (ANILCA) authorizes a grant of 75,000 acres of land to State of Alaska as follows:

In full and final settlement of any and all claims by the State of Alaska arising under the Act of March 4, 1915 (38 Stat. 1214), as confirmed and transferred in section 6(k) of the Alaska Statehood Act, the state is hereby granted seventy-five thousand acres which it shall be entitled to select until January 4, 1994, from vacant, unappropriated, and unreserved public lands. In exercising the selection rights granted herein, the state shall be deemed to have relinquished all claims to any right, title, or interest to any school lands which failed to vest under the above statutes at the time Alaska became a state. Lands selected and conveyed to the state under this subsection shall be subject to the provisions of subsections (j) and (k) of the Alaska Statehood Act.

- August 13, 1985. Attorney General's office issues informed opinion to the effect that perpetual dedication of 0.5 percent of state land revenue will eventually violate dedicated fund prohibition of Alaska Constitution, Article IX, § 7. (See [Appendix AA](#)).
- 1988. Legislature revises state investment statutes comprehensively (Ch. 141 SLA 1988). For School Trust this means:
 - Name changed to Public School Trust Fund;
 - Advisory Board's responsibility to prepare long range investment plans and authority to approve investments repealed; and
 - Commissioner made the fiduciary of the Trust. See governing statutes (AS 37.14.110-170) in [Appendix Z](#).
- November 27, 1995. Memorandum from contract attorney to Attorney General and Commissioner of Revenue on dedicated funds problem. ([Appendix AA](#)).

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- 1980-1998. State selects the additional 75,000 acres granted by ANILCA. State receives income from these lands. Income not invested with the Trust but with the GeFONSI.
- 1998. State sued for breach of School Trust in Kasayulie case. (See [Appendix AA](#) for a paper dated March 1984 by E. Dean Coon, Associate Professor of Education at the University of Alaska, Fairbanks, entitled The Alaska Public School Fund: A Permanent Fund for Education. This paper contains a history of the Trust through 1983.)
- February 2000. Treasury examines the Public School Trust Fund's distribution history and develops a payout model employing a rolling five-year smoothing methodology. The fiduciary (Commissioner of Revenue) adopts the payout methodology.

3. Facts and Figures

a. Fund Balances

Fiscal Year	Contributions from DNR Lands	Statutory Net Income ⁴	Distributions	State of Alaska Comprehensive Annual Report Ending Balance
Opening balance from Public School Permanent Fund				7,800,000
1978	732,000	561,000	(561,000)	8,532,000
1979	1,308,000	695,000	(695,000)	9,840,000
1980	7,142,000	629,000	(629,000)	16,982,000
1981	7,470,000	1,752,000	(1,781,000)	24,423,000
1982	7,994,000	3,153,000	(3,942,000)	31,628,000
1983	9,450,000	-	-	41,078,000
1984	9,217,000	15,625,000 ¹	-	65,920,000
1985	7,121,000	6,769,000	-	79,810,000
1986	6,578,000	8,029,000	(16,836,000)	77,581,000
1987	3,262,000	10,112,000	(10,122,000)	80,833,000
1988	6,470,000	6,358,000	(7,527,000)	86,134,000
1989	4,333,000	8,091,000	(8,991,000)	89,567,000
1990	5,208,000	8,694,000	(7,189,000)	96,280,000
1991	8,331,000	8,417,000	(6,983,000)	106,045,000
1992	6,637,000	15,998,000	(7,758,000)	120,922,000
1993	5,748,000	7,971,000	(8,394,000)	126,247,000

Effective: 4/1/00

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Fiscal Year	Contributions from DNR Lands	Statutory Net Income ⁴	Distributions	State of Alaska Comprehensive Annual Report Ending Balance
1994	3,987,000	7,201,000	(8,533,000)	128,902,000
1995	8,764,000	11,448,000 ²	(6,898,000)	142,216,000
1996	6,150,000	9,101,000	(5,473,000)	151,994,000
1997	5,482,000	7,731,000	(11,917,000)	211,534,000 ³
1998	4,047,000	8,497,000	(9,297,000)	249,373,000 ³
1999	2,608,000	8,997,000	(7,278,000)	272,651,000

¹ Includes a \$10,175,000 prior period adjustment for prior years' investment income recorded in the General Fund.

² Includes a \$3,059,000 prior period adjustment for prior years' dividend income recorded as unrealized gains/losses by Treasury (and therefore not in the CAFR).

³ Includes \$58 million and \$35 million in capital gains in FY 97 and FY 98, respectively. FY 97 was the first year that assets were recorded at fair value in the state CAFR. Prior to FY 97, statutory "income" did not include unrealized capital gains/losses.

⁴ Statutory net income is comprised of interest and dividends, not net appreciation. AS 37.14.110.

b. History of Payout Methodologies

This section describes the payout methodologies applied to the Public School Trust Fund since inception. The Commissioner of Revenue is to determine the net income of the fund in a manner that preserves the distinction between principal and income and excludes capital gains or losses realized on principal.

In compliance with the above intent, the Treasury Division regularly transfers distributable income (interest and dividends net of amortization or accretion) to the Income Assets account. Treasury does not transfer either realized or unrealized capital gains to the Income Asset account.

Each year, during the fall budget preparation cycle, Treasury provides an estimate to the Department of Education and Early Development (DEED, formerly DOE - Department of Education) of the amount of Income Assets they can include in the DEED budget request for the following year.

Following is a timeline of the methodologies used to determine the amount of the income assets available for appropriation:

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1978–1986	There is no documentation regarding how the amount available was calculated or who determined the amount to be included in DEED’s budget. However, it should be noted that during this period, the trust’s distributable income was recorded in the general fund, and the appropriation came from the general fund, not the trust. In 1983, the Legislative Audit Division found that this action did not properly segregate the trust assets. Over the period 1983-1985, there were no appropriations to DEED from trust income as the audit was completed and all distributable income earned but not previously appropriated (from 1978-1982) was apparently accounted for. In 1986, the Legislature appropriated all the distributable income earned from 1985 plus any income from prior years that had not already been appropriated to DEED.
1987–1997	<p>From at least 1989, Treasury began to project the balance they believed would be available from the trust for inclusion in DEED’s budget. Following is the formula that Treasury used each September:</p> <p>Actual assets available at the end of the most recent fiscal year + Projected distributable income for the current fiscal year - Current fiscal year’s appropriation = Projected assets available at the end of the current fiscal year for appropriation to next fiscal year</p> <p>In using this methodology, Treasury attempted to distribute income fully as it was earned. Treasury did not attempt to reduce the volatility of the cash flows to DEED caused by changing market conditions or the effects of changes in asset allocation. This methodology also resulted in large changes on cash flow caused by prior period accounting adjustments.²¹</p>
1998-1999	Treasury first incorporated smoothing into their annual projections.
1997-1998	During the fall 1997 and 1998 budget cycles, Treasury adjusted the estimate for the FY 1999 and 2000 budgets by one-third of the difference between the assets that they had estimated would be available for the current year and the actual assets that <i>were</i> available.
1999	Treasury began discussing a payout methodology based upon the market value of the trust. In the interim, for purposes of providing an estimate for the DEED FY 01 budget, Treasury used the average income earned for the most recently completed five fiscal years, that is, 1995-1999.
2000	Treasury completed its review of the payout methodology. The new policy

²¹ This in fact happened in 1997. Treasury added a \$3 million adjustment to correct 1994-1996 dividends to the 1997 cash flow to DEED. This increase in the amount available to DEED for 1997 was followed by a significant drop the following year.

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	pays out 4.75% of the last 5 years' average beginning market value of the principal. Treasury staff created an interactive model to stress-test the effect of the payout rate on the available Income Assets. The following assumptions can be changed individually or simultaneously: asset allocation, expected returns, expected yields and the payout rate.
--	---

c. Payments to Support State Education Programs

**Public School Trust Fund Past and Projected Payments to
Support State Education Programs**

Fiscal Year	Payout
	Actual: (in millions)
1994	8.5
1995	6.8
1996	5.4
1997	11.9
1998	9.3
1999	7.1
2000	7.6
2001	8.4156
	Estimate: (in thousands)
2002	11,812.8
2003	12,677.3
2004	13,294.7
2005	13,843.6
2006	14,431.3
2007	15,132.2

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4. Management

The applicable statutes require that Treasury account for the Fund in a manner that distinguishes between "principal" and "income." Treasury has achieved this objective by establishing a "principal account" and an "income account" for the Fund.²² The principal must be preserved; the income may be spent. AS 37.14.110 provides that income includes only interest and dividends; capital gains and losses remain with the principal. AS 37.14.140 requires that Treasury invest the income held in the income account until it is appropriated and expended.

AS 37.14.170 establishes the investment objectives for the Trust:

The commissioner of revenue is the fiduciary of the trust fund and shall invest the fund to provide increasing net income over long-term periods to the fund's income beneficiaries. The commissioner may invest the money in the fund on the basis of probable total rate of return to promote the long-term generation of income. In managing the trust fund, the commissioner shall:

- (1) consider the status of the fund's capital and the income generated on both a current and a probable future basis;*
- (2) determine the appropriate investment objectives;*
- (3) establish investment policies to achieve the objectives; and*
- (4) act only in regard to the financial interests of the fund's beneficiaries.*

The investment objective is to provide "increasing net income over long-term periods to the Trust's income beneficiaries." Treasury believes this provision requires an investment policy that is most likely to yield increasing *real*, or inflation adjusted, income over long-term periods. (See [Appendix AB](#) for the application of this conclusion to the development of the Trust's investment policy.)

²² The two accounts are actually funds within the state's accounting system that roll up to one fund that represent the Public School Trust Fund. The principal fund is FU 34011. The income fund is FU 34012.

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To fulfill the Legislature's policy requiring increasing the real or inflation adjusted income over long-term periods, a substantial proportion of the Trust must be invested in the equity market.

Monthly, Treasury transfers income (only dividends and interest and *not* net appreciation) produced by the principal assets of the Trust to a separate income account within the Trust where it is held pending appropriation by the Legislature.

The Trust requires separate investment policies for the principal assets of the Trust and the income assets of the Trust. Once appropriated, the income assets are available for expenditures that support the state public school system. Income on fixed income investments includes interest and dividends, but not net appreciation which must be retained in the principal assets account. (AS 37.14.110(c)) Realized and unrealized capital gains and losses must be retained in the principal assets account (AS 37.14.240(a)).

In 1997, a change in accounting standards affected the amount of income to be transferred from the principal assets to income assets. Under GASB Statement No. 31 (effective for financial statements for periods beginning after June 15, 1997 although the state chose early implementation beginning in 1997), amortization (of premiums) and accretion (of discounts) are now classified as unrealized gains or losses. Prior to the change, Treasury transferred amortization and accretion from the principal assets to the income assets. With implementation of GASB Statement No. 31, the reclassification to unrealized gains or losses (which must remain with the principal assets) negatively impacts cash flow from the principal assets to the income assets. To fulfill the intent of AS 37.14.110 - that is, to adequately protect the principal corpus - Treasury continues to transfer an amount equal to amortization and accretion from the principal assets to income assets.

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A detailed justification for the asset allocation and the investment policy for the principal assets of the Public School Trust Fund may be found in [Appendix AB](#).

5. Investment Policy

a. Principal Assets

Treasury's long-term investment objective for the Public School Trust Fund is to preserve the purchasing power of the Trust's principal. This policy has been established to increase the real and inflation adjusted value of the current principal by .33% per year without regard to the possibility of continuing contributions from the dedication of state land revenue. Further, the investment policy is designed to produce the maximum income for the Trust's beneficiaries consistent with the policy of growing the principal. ([Appendix AB](#) contains more details of the analysis used to derive the investment policy for the principal assets of this Trust.)

Treasury invests the Public School Trust Fund principal assets with the following in mind:

Risk Tolerance	High. The principal of the Trust cannot be spent. Short-term principal losses can be tolerated.
Investment Objectives	Willing to tolerate high exposure to principal loss for possibility of large gains in the long term. Maximize current income subject to constraints on inflation protection and distinction between income and net appreciation. Significant inflation protection needed. Relatively low liquidity requirement.
Time Horizon	Long.

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Other Constraints The principal of the Trust cannot be spent. Treasury must separate interest and dividend income from net appreciation.

Effective April 1, 2000, Treasury's investment policy for the Public School Trust Fund principal assets is:

55% ± 5% Broad Market Fixed Income Investment Pool
45% ± 5% Domestic Equity Collective Funds

Effective April 1, 2000, Treasury's performance benchmark for the Public School Trust Fund principal assets is:

55% Lehman Brothers Aggregate Index
45% Russell 3000 Index

b. Investment Policy - Income Assets

Treasury invests the Public School Trust Fund income assets with the following in mind:

Risk Tolerance Low. The Legislature can appropriate the money at any time.

Investment Objectives Low exposure of principal to loss.
 Emphasis on liquidity and safety of principal. Income is secondary objective.
 Minimal inflation protection needed.
 High liquidity requirement.

Time Horizon Short.

Treasury's investment policy for the Public School Trust Fund income assets is:

100% Short-term Fixed Income Investment Pool

Treasury's performance benchmark for the Public School Trust Fund income assets is:

100% Three-Month U.S. Treasury Bill

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6. Control and Reporting Requirements

AS 37.14.160(3) requires the Commissioner of Revenue to maintain accounting records that distinguish between the principal and income of the Trust. The accounting records are maintained by the State Comptroller. The State Comptroller sends quarterly financial statements to the Public School Advisory Board within 30 days following the end of each quarter.

AS 37.10.071(a)(9), made applicable by AS 37.14.160(1) and AS 14.25.080(c), require an annual independent audit of the Public School Trust Fund. The State Comptroller contracts with an independent certified public accountant to perform an annual audit of the Trust. Within 90 days after the completion of the audit, the State Comptroller transmits a copy of the audit report to the Public School Advisory Board. Alternatively, the audit report may be distributed at the next scheduled board meeting.

By September 30 of each year, the State Comptroller sends the Department of Education a projection of the balance expected to be available in the income assets on the following July 1, the start of the next fiscal year. The Department of Education then uses this projection to construct their budget request relating to the state's elementary and secondary foundation program.

AS 37.14.160(4) requires the Commissioner of Revenue to provide reports to the Public School Fund Advisory Board on the condition and investment performance of the Trust. Treasury receives year-end performance measurement reports relating to this Trust from an external consultant within 90 days after the end of the fiscal year. The State Comptroller is responsible for contacting the Board Chair to arrange for Treasury's presentation of the annual performance measurement report and the annual audit report. The applicable statutes do not specify who is to provide staff support for the Board.

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Unless the Board directs otherwise, the Treasury Division will maintain pertinent records relating to the Trust and minutes of the meetings of the Board.

While the Commissioner is the sole fiduciary for this trust fund and, as such, responsible for the asset allocation judgments for the Fund, it is the policy of the Department to consult with the Public School Fund Advisory Board at least once a year to review the asset allocation options and to consult with the Board before making any substantial changes in asset allocation policy.

7. Treasury Funding

Each year Treasury includes a portion of the income from the Public School Trust Fund as a funding source for the Division's annual budget. The Trust is charged for the actual costs of investment management fees and performance measurement costs, if any.

Treasury also allocates a portion of the Division's personnel costs and custodial costs to the Trust.

Version Control

Revision Date	Effective Date	Summary of Changes	Find it in Version
5/15/99	4/1/99	Updated IPS to include 1999 capital market assumptions.	1.2
3/7/00	4/1/00	Treasury updates year 2000 capital market assumptions and revises asset allocation policy for principal assets accordingly. Target allocation was 56% for the Broad Market Fixed Income Investment Pool and 44% for Domestic Equity Collective Funds.	1.3
3/7/00	4/1/00	Treasury adds history of income payout methodology.	1.3

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D. Alaska Children's Trust - Investment Policy Statement

1. Overview

The Alaska Children's Trust is a trust fund the income of which is dedicated to funding community-based programs and projects for the prevention of child abuse and child neglect.²³ The Trust provides individual grants of up to \$50,000 per year matched by funds from other sources to fund these programs and projects.

2. History

- 1988. Legislature establishes Alaska Children's Trust (Ch. 19 SLA 1988). Commissioner of Revenue made fiduciary. Fund raising and grant making authority vested in Alaska Children's Trust Board.
- 1990. Fund raising and grant making responsibilities reassigned to Alaska Commission on Youth and Children (Ch. 16 SLA 1990).
- 1993. Fund raising and grant making moved again - this time to the Alaska Human Relations Commission (E.O. No. 84 1993).
- 1996. Fund raising and grant making moved yet again - this time to the reconstituted Alaska Children's Trust Board. Board consists of the governor (or the Governor's designee), the Commissioners (or their designees) of Health and Social Services and Education, and four public members appointed by the Governor. In appointing the four public members, the Governor must give preference to persons with experience and expertise in children's prevention programs or private sector finance. See [Appendix AC](#) for the pertinent statutes.

²³ Up to \$150,000 of the principal of the Trust may be used each year to cover the expenses of the Alaska Children's Trust Board.

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3. Facts and Figures

Until 1996, there were no funds in the principal of the Trust. In conjunction with the attention generated by the 1996 Executive Order, private individuals and businesses contributed \$11,000 and the Legislature appropriated \$6,000,000 to the principal of the Trust.

Total invested assets in the Alaska Children's Trust at June 30 have been:

Fiscal Year	Earnings	Fair Value
1997	911,129	6,929,174
1998	1,551,614	8,256,661
1999	1,025,208	9,270,385
2000	591,657	9,755,460

4. Management

The applicable statutes require Treasury to account for the Trust in a manner that distinguishes between "principal" and "income." Treasury has achieved this objective by establishing a "principal account" and an "income account" for the Trust.²⁴ The income may be spent; the principal must be preserved except that \$150,000 of the principal may be used by the Board each year to cover the administrative expenses of the Board. AS 37.14.240(a) provides that capital gains and losses remain with the principal; consequently, income includes only interest and dividends. AS 37.14.240(c) requires Treasury to reinvest the realized net income not yet appropriated and expended.

²⁴ The two accounts are actually funds within the state's accounting system that roll up to one fund that represent the Trust. The principal fund is FU 34051. The income fund is FU 34052.

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AS 37.14.240 establishes the investment objectives for the Trust:

AS 37.14.240. Fund Utilization. (a) Except as provided in (d) of this section, the principal of the trust and any capital gains or losses realized on the principal shall be retained perpetually in the trust for investment as specified in AS 37.14.210, and may not be used for the awarding of grants.

(b) The net income of the trust may be appropriated only for the following purposes:

(1) the awarding of grants;

(2) obtaining private and federal grants for the trust;

(3) soliciting contributions, gifts, and bequests for the trust; and

(4) reimbursement to the Department of Revenue for the costs of establishing the trust.

(c) Realized net income that has not been appropriated, or that has been appropriated but not expended, shall be invested until appropriated and expended.

(d) Up to \$150,000 per year may be appropriated from the principal of the trust for the administrative expenses of the board relating to AS 37.14.200 - 37.14.270.

The investment objective is to provide "increasing net income over long-term periods to the Trust's income beneficiaries." Treasury believes this provision requires an investment policy that is most likely to yield increasing real or inflation adjusted income over long-term periods. (See [Appendix AD](#) for the application of this conclusion to the development of the Trust's investment policy.)

To fulfill the Legislature's policy requiring increasing the real or inflation adjusted income over long-term periods, a substantial proportion of the Trust must be invested in the equity market.

Monthly, Treasury transfers income (only dividends and interest and not net appreciation) produced by the principal assets of the Trust to a separate income account within the Trust where it is held pending appropriation by the Legislature.

The Trust requires separate investment policies for the principal assets of the Trust and the income assets of the Trust. Once appropriated, the income assets are available for

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expenditure for community-based grants to programs that prevent child abuse and neglect. Realized and unrealized capital gains and losses must be retained in the principal assets account (AS 37.14.240(a)).

In FY 97, a change in accounting standards affected the amount of income to be transferred from the principal assets to income assets. Under GASB Statement No. 31 (effective for financial statements for periods beginning after June 15, 1997 although the state chose early implementation beginning in 1997), amortization (of premiums) and accretion (of discounts) are now classified as unrealized gains or losses. Prior to the change, Treasury transferred amortization and accretion from the principal assets to the income assets. With implementation of GASB Statement No. 31, the reclassification of amortization and accretion negatively impacts cash flow from the principal assets to the income assets. To fulfill the intent of AS 37.14.110 - that is, to adequately protect the principal corpus - Treasury continues to transfer an amount equal to amortization and accretion from the principal assets to income assets.

The principal of the Alaska Children's Trust is not protected from legislative appropriation if the Legislature decides it wishes to so appropriate. The Public School Trust Fund, the University of Alaska Trust Fund, and the Mental Health Trust Fund were all originally established by the Congress and some or all of the principal of those funds is protected from appropriation by the Legislature as a matter of federal law. The Alaska Children's Trust is a creation of the Alaska Legislature; as a consequence, the Legislature has the legal authority to unmake what it has made.

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5. Investment Policy

a. Investment Policy - Principal Assets

Treasury invests the Alaska Children's Trust principal assets with the following in mind:

Risk Tolerance	High. The principal of the Trust cannot be spent. Short-term principal losses can be tolerated.
Investment Objectives	Willing to tolerate high exposure to principal loss for the possibility of large gains in the long term. Maximize current income subject to constraints on inflation protection and distinction between income and capital gains. Significant inflation protection needed. Relatively low liquidity requirement.
Time Horizon	Long.
Other Constraints:	Only \$150,000 of the principal of the Trust can be spent annually. Treasury must separate income from net appreciation.

The investment policy has a plus or minus 5% band for each investment pool in the allocation to avoid the expense of continually rebalancing the Trust's investments.

Effective April 1, 2000, Treasury's investment policy for the Alaska Children's Trust principal assets is:

55% ± 5%	Broad Market Fixed Income Investment Pool
45% ± 5%	Domestic Equity Collective Funds

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Effective April 1, 2000, Treasury's performance benchmark for the Alaska Children's Trust principal assets is:

55% Lehman Brothers Aggregate Index
45% Russell 3000 Index

A detailed justification for the asset allocation and the investment policy for the principal assets of the Alaska Children's Trust may be found in [Appendix AD](#).

b. Investment Policy - Income Assets

Treasury invests the Alaska Children's Trust income assets with the following in mind:

Risk Tolerance	Low. The Legislature can appropriate the money at any time.
Investment Objectives	Low exposure of principal to loss. Emphasis on liquidity and safety of principal. Income is secondary objective. Minimal inflation protection needed. High liquidity requirement.
Time Horizon	Short.

Treasury's investment policy for the Alaska Children's Trust income assets is:

100% Short-term Fixed Income Investment Pool

Treasury's performance benchmark for the Alaska Children's Trust income assets is:

100% Three-Month U.S. Treasury Bill

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6. Control and Reporting Requirements

AS 37.14.210(6) requires the Commissioner of Revenue to maintain accounting records that distinguish between the principal and income of the Trust. The accounting records are maintained by the State Comptroller. The State Comptroller sends quarterly financial statements to the Alaska Children's Trust Board within 30 days following the end of each quarter.

AS 37.14.210(7) requires the Commissioner to engage an independent certified public accountant to perform an annual audit. To fulfill this requirement, the State Comptroller contracts with an independent certified public accountant to perform the annual audit.

The Commissioner must provide reports to the Alaska Children's Trust Board on the condition and investment performance of the Trust (AS 34.14.210(9)). Treasury receives year-end performance measurement reports for this Trust from an external consultant within 90 days following the end of the fiscal year. The State Comptroller is responsible for contacting the Chair of the Alaska Children's Trust Board to arrange for Treasury to present the annual performance measurement report and the annual audit report.

While the Commissioner is the sole fiduciary for this Trust, and, as such, responsible for the asset allocation judgments for the Trust, it is the policy of the Department to consult with the Alaska Children's Trust Board at least once a year to review the asset allocation options and to consult with the Board before making any substantial changes in asset allocation policy.

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7. Treasury Funding

Each year Treasury includes a portion of the income from the Alaska Children's Trust as a funding source for the Division's annual budget. The Trust is charged for the actual costs of investment management fees and performance measurement costs, if any. Treasury also allocates a portion of the Division's personnel costs and custodial costs to the Trust.

Version Control

Revision Date	Effective Date	Summary of Changes	Find it in Version
3/7/00	4/1/00	Treasury updates year 2000 capital market assumptions and revises asset allocation policy for principal assets accordingly. Target allocation was 56% for the Broad Market Fixed Income Investment Pool and 44% for Domestic Equity Collective Funds.	1.3
11/24/00		Updated Facts & Figures section	1.6

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E. University of Alaska Endowment Trust Fund - Investment Policy Statement

1. Overview

On April 11, 1997, the Governor signed into law an amendment to the statutes governing this trust fund that replaces the Commissioner as the fiduciary of this trust with the Board of Regents of the University of Alaska. The University is now responsible for the management of this trust.

2. Management

Treasury continues to manage a portion of the University of Alaska Endowment Trust Fund under a reimbursable services agreement with the University. Those funds are invested in the Short-term Fixed Income Investment Pool, Broad Market Fixed Income Investment Pool, and the S&P 500 Common Trust Fund (domestic equity). The amount invested in the respective investment vehicles is at the direction of the Fund's fiduciary, the University of Alaska.

[Appendix AE](#) is a brief history of the University of Alaska Endowment Trust.

[Appendix AF](#) is a history of the University of Alaska's federal land grant.

[Appendix AG](#) contains the statutes applicable to the University of Alaska Endowment Trust Fund immediately before and after the fiduciary responsibility for that fund was transferred from the Commissioner of Revenue to the Board of Regents.

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3. Facts and Figures

Total invested assets in the University of Alaska Trust Fund (AY 12) at June 30, have been:

Fiscal Year	Earnings	Fair Value
1988	876,149	12,350,020
1989	1,542,147	13,937,132
1990	1,096,492	14,987,113
1991	1,599,228	16,857,519
1992	2,256,244	20,348,691
1993	2,780,762	23,945,420
1994	(239,000)	30,768,996
1995	4,252,942	33,737,988
1996	2,808,357	34,313,493
1997	4,521,477	36,992,531
1998	7,765,441	37,611,838
1999	5,688,652	44,764,490
2000	1,970,508	41,793,998

Version Control

Revision Date	Effective Date	Summary of Changes	Find it in Version
11/24/00		Updated Facts & Figures section	1.6

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F. Investment Loss Trust Fund - Investment Policy Statement

1. Overview

The Legislature established the Investment Loss Trust Fund in 1991 to indemnify then-current and former state employees against anticipated losses in their interests in the state Supplemental Benefits System (Plan) occasioned by the apparent insolvency of the Executive Life Insurance Company of California (Executive Life). Executive Life had issued guaranteed investment contracts to the Plan and individual annuities to three hundred members. In April 1991, California state regulators took over Executive Life raising considerable uncertainty about the value of the Plan assets and the individual annuities.

2. History

- 1991. The Alaska State Legislature establishes the Investment Loss Trust Fund as an expendable trust to hold harmless both current participants in the Plan and former participants who had become annuity holders with Executive Life. The Commissioner of Revenue is the fiduciary of this Trust (See the governing statute, AS 37.14.300, in [Appendix AH](#)). The Fund was originally capitalized with \$138.1 million appropriated from the General Fund and the Statutory Budget Reserve Fund. Subsequent payments from the conservator of Executive Life and recoveries from certain third parties that together total almost \$150 million have made it possible to reduce the balance in the Trust significantly.
- 1991 - early 1993. Treasury manages the Trust.
- 1993 - November 1994. T. Rowe Price manages the Trust for Treasury for slightly more than a year.
- November 1994. Treasury once again manages the Trust.

Effective: 5/15/99

XII: F-1

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3. Facts and Figures

A court order requires the state to maintain certain balances in the ILTF. \$4.0 million must remain in the Trust to guarantee the annuity contracts of former Plan participants who became individual annuity holders with Executive Life. These annuitants currently hold annuity contracts with Aurora Life Insurance Company, a company created by the California Insurance Commissioner from the assets of Executive Life. The required Trust balance of \$4.0 million covers roughly half the amount of the anticipated obligation of Aurora. The \$4.0 million required Trust balance results from the Settlement Agreement in *Maupin et al. v. State et al.*, 3AN-91-6006 Civil, a class-action lawsuit that was initiated against the state over the Executive Life Contracts by the individual beneficiaries of the Plan.

The state may legally withdraw any remaining balance in the Trust for other purposes. As of June 30, 2000, excluding \$2.3 million appropriated during the 2000 legislative session, the last date for which an analysis has been done, the remaining balance was \$123,460.02.

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Total invested assets in the ILTF at June 30, have been:

Fiscal Year	Earnings	Fair Value
1994	(29,747)	150,157,024
1995	18,342,068	130,128,230
1996	8,129,039	13,246,631
1997	526,830	16,937,468
1998	655,544	8,152,595
1999	398,746	6,845,127
2000	429,018	8,057,434

4. Investment Policy

Treasury invests the Investment Loss Trust Fund very conservatively because the money held in the Trust might be needed on very short notice. Treasury has invested with the following in mind:

Risk Tolerance	Low. Funds may be needed on very short notice.
Investment Objectives	Very low exposure to principal loss. Modest current income requirement. Little inflation protection needed. High liquidity requirement.
Time Horizon	Short.

Treasury's investment policy for the Investment Loss Trust Fund is:

100% Short-term Fixed Income Investment Pool

Treasury's performance benchmark for the Investment Loss Trust Fund is:

100% Three-Month U.S. Treasury Bill

Effective: 5/15/99

XII: F-3

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5. Control and Reporting Requirements

AS 37.10.071(a)(8) (applicable as a consequence of AS 37.14.300(a)) requires the Commissioner to maintain accounting records for these funds in accordance with generally accepted accounting principles. The Commissioner delegated this to the State Comptroller.

AS 37.10.071(a)(9) (also applicable as a consequence of AS 37.14.300(a)) requires the Commissioner to engage an independent certified public accountant to perform an annual audit of the financial condition of the funds and the pertinent investment transactions. To fulfill this requirement, the State Comptroller contracts with an independent certified public accountant to perform the annual audit.

6. Treasury Funding

Each year, Treasury includes a portion of the income from the Investment Loss Trust Fund as a funding source for the Division's annual budget. The Trust is charged for the actual costs of investment management fees and performance measurement costs, if any. Treasury also allocates a portion of the Division's personnel costs and custodial costs to the Trust.

Version Control

Revision Date	Effective Date	Summary of Changes	Find it in Version
11/24/00		Update to Facts & Figures Section	1.6

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**G. Alaska Advance College Tuition Savings Fund - Investment Policy
Statement**

The Alaska Advance College Tuition Payment Fund (ACT) was created by statute in 1990 as part of a law establishing a program of advance payment contracts for tuition at the University of Alaska or for tuition expenses at qualified institutions nationwide. The fund consists of cash contributions by individuals or voluntary withholding through the permanent dividend check-off program to purchase tuition credits in advance for named beneficiaries.

In their second session, the 21st Legislature expanded and revamped the state's postsecondary tuition savings programs. Statutory changes to the ACT Fund resulted in modifying the fund's name and reassigning fiduciary responsibilities effective March 16, 2000. AS 14.40.803 renamed the fund to the Alaska Advance College Tuition Savings Fund. AS 14.40.805 was repealed and AS 14.40.809(b) reassigns fiduciary responsibilities from the Revenue Commissioner to the Board of Regents of the University of Alaska.

The University of Alaska Vice President of Finance indicated that the Board of Regents will likely transfer invested assets of ACT during the first quarter of 2001 to an external service provider for consolidated recordkeeping and investment management. The Treasury Division will continue to manage the invested assets of the fund during this short transition period under the existing asset allocation policy.

The Department of Revenue remains responsible for providing voluntary withholding through the permanent fund dividend check-off program under AS 14.40.807.

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The investment policy statement, no longer valid as of March 16, 2000, is located in [Appendix ZS](#).

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H. International Airports Funds - Investment Policy Statement

1. Overview

There are three funds and one related account relevant to the international airports revenue bonds. Revenue officials are responsible for managing the money in all but one of the funds.

a. Construction Fund

Administration officials deposit proceeds from bond sales into this state-managed fund, where they remain until they are used to build airport facilities (AS 37.15.420).

b. Revenue Fund (excluding the Repair and Replacement Reserve Account)

State officials (primarily those in Transportation) deposit gross revenue from airport operations at the two airports (Anchorage and Fairbanks) into this state-managed fund (AS 37.15.430).

c. Repair and Replacement Reserve Account

The State Bond Committee requires a minimum balance of \$500,000 in this state-managed reserve account, and requires its investment in obligations maturing within five years from the date of investment. (Resolution 68-4, Section 5.04 and Resolution 93-5, Section 20.1(c)).

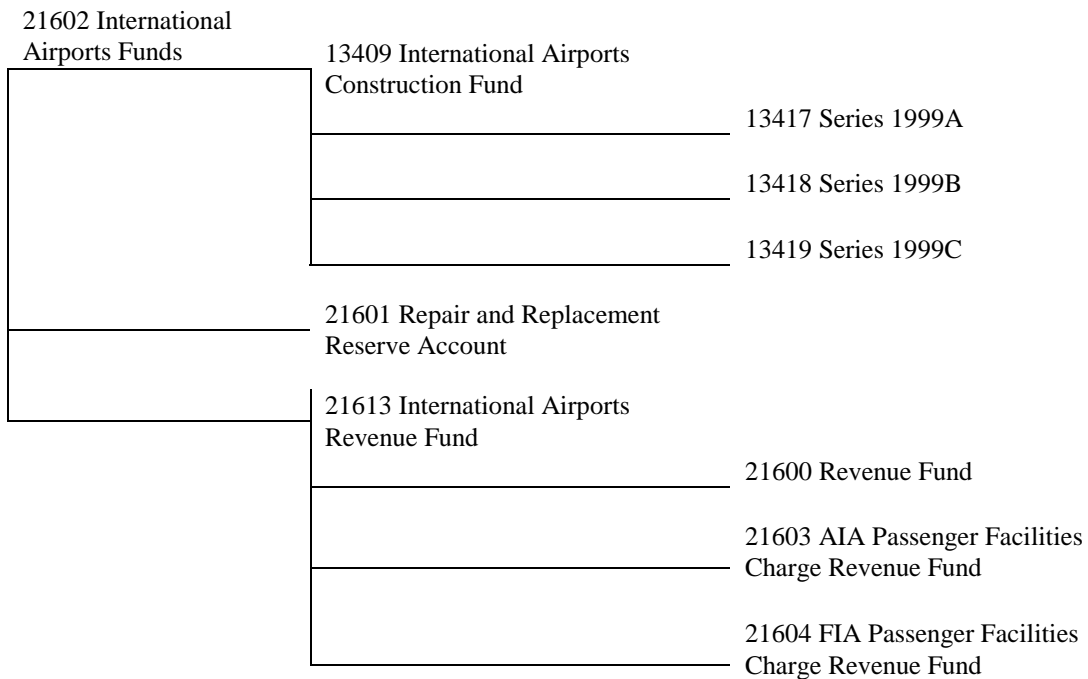
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Beginning October 2000, the Revenue Fund also contains receipts from passenger facility charges collected at the Anchorage and Fairbanks International Airports. The International Airports System staff deposit these receipts into two separate subfunds of the International Airports Revenue Fund (Fund 21613).²⁵

The State Bond Committee requires a minimum balance of \$500,000 in this state-managed reserve account, and requires its investment in obligations maturing within five years from the date of investment. (Resolution 68-4, Section 5.04 and Resolution 93-5, Section 20.1(c)).

²⁵ The fund structure in the statewide accounting system (AKSAS) is as follows:



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d. Redemption Fund

To ensure timely payment of interest and principal on the outstanding revenue bonds, Revenue officials oversee the annual transfer of money from the Revenue Fund to the Redemption Fund (AS 37.15.440). The contract trustee responsible for ensuring that the state fulfills its obligations to pay the bondholders manages this fund.

2. History

- 1961. Ch. 88, SLA 1961 (now codified as AS 37.15.410-550)²⁶ (see [Appendix AL](#)) established an enterprise fund called the International Airports Revenue Fund to facilitate issuing revenue bonds for construction at the Anchorage and Fairbanks International Airports. Though the state has created a plethora of independent corporations and authorities since 1970 to finance and operate state enterprises, the International Airports, while operated as an enterprise, have remained the responsibility of the Department of Transportation and Public Facilities.

²⁶ The 1961 legislation was adopted as a Temporary and Special Act. Ch. 88 SLA 1961. In 1972, the Legislature repealed the 1961 Temporary and Special Act and readopted the pertinent provisions as part of the Alaska Statutes. Ch. 149 SLA 1972.

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- 1968. The State Bond Committee, established under AS 37.15.110, is responsible for making arrangements to issue International Airports revenue bonds. The first of these bonds was issued in 1968 pursuant to a Master Resolution of the State Bond Committee, Resolution 68-4. That resolution has governed, at least in part, all subsequent issues of the state's international airports' bonds.

Resolution 68-4 set forth terms and conditions applicable to each of the three groups of funds pertinent to the bonds and created a trust obligation with respect to each.²⁷ The resolution specified precisely how the Revenue Fund could be invested and, inasmuch as the resolution became part of the covenant between the state and the bondholders, it established the framework for the Revenue Fund's investment policy.²⁸

The 1968 resolution also required the state to establish an International Airports Repair and Replacement Reserve Account of \$500,000 in the Revenue Fund. It required that the Reserve Account be invested only in obligations maturing within five years from the date of investment. (Section 5.04 of the Resolution.) Under the resolution, Revenue Fund (excluding the Repair and Replacement Reserve Account) investments were restricted to:

- Direct obligations of the United States of America.
- Obligations where both principal and interest are guaranteed by the United States.
- Obligations issued by federal land banks or federal intermediate credit banks established under the Federal Farm Loan Act.
- Bonds or debentures of the Federal Home Loan Bank.
- Obligations of the Federal National Mortgage Association.

²⁷ Section 5.02(a)(1), (2), and (3) of Resolution 68-4 required the State to establish an "Interest Fund," "Retirement Fund" and a "Bond Reserve Fund" in the International Airports Bond Redemption Fund. The legal lists of permitted investments for the "Interest Fund," the "Retirement Fund" and the "Bond Reserve Fund" are set forth in the first paragraph of Section 5.04 of Resolution 68-4. Treasury delegates responsibility to the trustee for managing these three funds that make up the Bond Redemption Fund. The trustee ensures that the State meets its obligation to the bondholders. Section 5.04 of Resolution 68-4. Initially, the Trustee was the Bank of America. Section 7.01 of Resolution 68-4.

²⁸ The legal list of investments pertinent to the International Airports Construction Fund is set forth in Section 3.03(c) of State Bond Committee Resolution 68-4 as amended by Resolution 98-8. Whenever there is money in this fund, Treasury is directly responsible for it.

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- Debentures and consolidated debentures issued by the Central Bank of Cooperatives.

- 1968-1995. After the state issued the first International Airports revenue bonds in 1968 (\$7,000,000), there were half a dozen more bond sales by 1986. The state retired some of the bonds early, and, in 1993, the State Bond Committee arranged to issue \$50,445,000 in bonds to refinance all of the outstanding International Airports Revenue Bonds. The 1993 refinance bonds were authorized by State Bond Committee Resolution 93-5, which amended Resolution 68-4. This resolution expressly modified the list of investments permitted for the Bond Redemption Fund and, by implication, the list of investments permitted for the Revenue Fund (excluding the Repair and Replacement Reserve Account). (See Sections 17.1 and 20.1(c) of Resolution 93-5 and Sections 5.02 and 5.03 of Resolution 68-4.)

[Appendix AL](#) contains the full list of permitted investments from Section 17.1 of Bond Committee Resolution 93-5. These permitted investments govern the investments made by the trustee with respect to the Bond Redemption Fund (and the Interest Fund, the Retirement Fund and the Bond Reserve Fund that are part of the Redemption Fund) and by Treasury with respect to the Revenue Fund and the Repair and Replacement Reserve Account in the Revenue Fund.

Each of the applicable bond resolutions requires the Department of Transportation Commissioner to set fees, charges and rentals for the use of facilities at the International Airports at a level sufficient to provide adjusted net revenues at least equal to 130 percent of debt service. In 1986, the state executed new rate and fee arrangements with air carriers using the airports. The parties extended the agreements both on July 1, 1990 and on July 1, 1995, for five years. The rents and fees include airline terminal building rental rates, landing fees, international terminal docking fees, passenger landing bridge fees, and charges relating to federal inspection services. The agreements also establish procedures for review and adjustment of airline rents and fees for each fiscal year to insure that revenues are sufficient to meet operations and terminal expenses together with the debt service requirements for the bonds.

- 1998. The Legislature authorized the first airport construction bonds in more than a decade. The \$179 million project will fund major renovations and expansion at the Anchorage International Airport. The project, which will span several years, prompted Treasury officials to review investment policy for the long-dormant International Airports Construction Fund. The state issued \$19,265,000 in bond anticipation notes in July 1998 to fund design and initial

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construction work. In January 1999, the state issued bonds totaling \$179,175,000. The bond proceeds will be used to retire the anticipation notes and fund the Anchorage International Airport expansion.

- 1999. The State Legislature, through Ch. 80, SLA 99, increases the aggregate principal amount of airport revenue bonds that can be issued under Ch. 88, SLA 1961. The State Bond Committee passes Resolution 99-7 (a supplement to Resolution 99-1) to issue \$25 million Series 1999C revenue bonds for cash flow purposes for specific airside projects at the Anchorage International Airport.
- October 2000. The International Airports System begins to collect passenger facility charges at the Anchorage and Fairbanks International Airports. Annual receipts are expected to be about \$5 million.

3. Facts and Figures

a. Debt Service Coverage

Each of the applicable bond resolutions requires the Transportation Commissioner to set fees, charges and rentals for the use of facilities at the International Airports at a level sufficient to provide adjusted net revenues at least equal to 130 percent of debt service. Adjusted net revenues of the International Airports have consistently provided the required debt service coverage.

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**International Airports System Revenue Bonds
Debt Service Coverage**

Fiscal Year	Net Revenue \$ (Millions)	Debt Service \$ (Millions)	Ratio Net Revenues to Debt Service
1983	7.7	2.4	3.23
1984	9.1	1.5	6.16
1985	20.1	6.0	3.42
1986	22.4	5.5	4.10
1987	20.1	6.9	2.90
1988	28.9	8.3	3.47
1989	30.9	8.6	3.59
1990	21.4	8.6	2.49
1991	18.1	8.6	2.10
1992	12.0	8.6	1.41
1993	10.5	7.6	1.38
1994	10.6	2.8	3.79
1995	15.6	5.6	2.79
1996	17.9	5.7	3.14
1997	19.7	5.7	3.46
1998	20.7	5.7	3.65
1999	16.3	5.7	2.86
2000	18.7	4.8	3.90

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b. Fund Balances

Historical quarter-end balances of invested assets in the International Airports Revenue Fund (AY 04) and Repair and Replacement Reserve Account (AY 05) are as follows:

		<u>Fair Value</u>
		\$ (Millions)
March	1995	69.7
June	1995	72.2
September	1995	80.2
December	1995	81.5
March	1996	80.6
June	1996	80.2
September	1996	84.7
December	1996	83.3
March	1997	86.1
June	1997	84.2
September	1997	93.3
December	1997	94.3
March	1998	94.6
June	1998	93.8
September	1998	88.7
December	1998	91.1
March	1999	87.7
June	1999	85.0
September	2000	84.9
December	2000	85.3
March	2000	86.6
June	2000	87.3

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Total invested assets in the Revenue Fund (AY 04) at June 30 have been:

Fiscal Year	Earnings	Fair Value
1993	3,132,439	70,498,476
1994	1,970,317	67,295,982
1995	4,415,799	71,715,998
1996	4,385,226	79,730,677
1997	4,958,405	85,374,994
1998	5,617,713	93,246,564
1999	4,709,560	84,450,497
2000	4,291,842	86,721,893

Total invested assets in the Repair and Replacement Reserve Account (AY 05) at June 30 have been:

Fiscal Year	Earnings	Fair Value
1993	18,513	493,976
1994	17,339	491,295
1995	28,405	505,446
1996	28,234	532,158
1997	27,492	527,461
1998	27,785	527,875
1999	24,822	524,907
2000	29,022	553,929

Total invested assets in the AIA Series 1999A AMT Construction Fund (AY 14) at June 30 have been:

Fiscal Year	Earnings	Fair Value
1999	2,820,139	163,244,204
2000	7,513,696	137,375,244

Total invested assets in the AIA Series 1999B Non-AMT Construction Fund (AY 20) at June 30 have been:

Fiscal Year	Earnings	Fair Value
1999	814,008	12,904,437
2000	434,306	6,892,954

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Total invested assets in the AIA Series 1999C AMT Construction Fund (AY 18) at June 30 was:

Fiscal Year	Earnings	Fair Value
2000	999,883	25,020,562

4. Management

This section contains policies and procedures for managing the International Airports funds (except the Redemption Fund.)

a. General Management - Construction Fund

Department of Administration officials deposit all bond and anticipation note proceeds into the Construction Fund. Until these proceeds are used for airport projects, Treasury invests the unexpended cash balances according to the policies set forth in Section 5.

b. General Management - Revenue Fund

State officials (primarily those in Transportation) deposit all revenue, fees, charges, and rentals derived from state ownership, lease, use, and operation of the two airports or any related facilities and improvements pertinent to the two airports into the International Airports Revenue Fund. Beginning in October 2000, the Revenue Fund also contains receipts from passenger facility charges. These receipts are held in two subfunds, one for Anchorage airport receipts and another for Fairbanks airport receipts. The invested assets of both subfunds are held in the GeFONSI (as described earlier in this document) which matches their investment risk profile and time horizon. The Revenue Commissioner is the fiduciary for this fund, subject to

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investment restrictions established by the State Bond Committee and any municipal bond insurance company restrictions that may be applicable.

Bonds issued to finance improvements at the two airports have a first lien on the gross revenue deposited into the Revenue Fund from airport operations.

After the Department of Revenue oversees the transfer of all required money to the Redemption Fund, all remaining funds in the Revenue Fund are referred to as surplus revenues and are available to:

- Pay the normal and necessary costs of maintaining and operating the airports.
- Pay renewal, replacement and extraordinary repair costs at the airports.
- Redeem bonds prior to maturity.
- Acquire, construct, or install necessary additions or improvements.
- Pay costs relating to the ownership, use and operation of the airports.
- Maintain other reserves required by the applicable operating agreements.
- For any other purpose permitted by statute.

The Revenue Fund maintains a significant balance and the investment earnings on that balance are a significant revenue source for the airport system. The Department of Transportation considers these investment earnings in negotiating fees with the airlines. Airport management and airline representatives want to keep fees as stable and as low as practical. Relatively stable investment earnings assist the airport system and the airlines in meeting that goal.

All the airport systems' revenue and expenses flow through the Revenue Fund. This includes normal operating transactions and most repair and maintenance projects. This subjects the Revenue Fund to the possibility of relatively significant cash inflows and outflows.

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The permitted investments list in Resolution 93-5 restricted investments in such a manner that the Revenue Fund could not participate in any of the investment pools operated by the Department of Revenue. Treasury staff, after consulting with the responsible Transportation officials in developing an appropriate investment policy, invested the Revenue Fund to meet the investment limitations, provided the necessary liquidity and produced relative high current income. Following the contractual amendments with the Municipal Bond Investors Assurance Corporation in January 1999, Treasury modified the list of permitted investments list so that the Revenue Fund could participate in one or more of the Treasury investment pools. State Bond Committee Resolution 98-6 expressly permits Treasury to invest the Construction Fund in Treasury's investment pools.

c. General Management - Repair and Replacement Reserve Account

The Repair and Replacement Reserve Account, a subaccount of the Revenue Fund, must contain a \$500,000 minimum balance. Should the balance fall below \$500,000, responsible officials in the Department of Transportation adjust the balance to the required amount in accordance with the applicable bond covenants. Beginning June 2001, Treasury Division annually transfers investment earnings of the Repair and Replacement Account to the Revenue Fund so that the account will end the fiscal year with exactly \$500,000.

d. General Management - Redemption Fund

By December 31 of each year, the State Bond Committee must certify to the commissioners of Revenue and Transportation the amounts needed in the ensuing calendar year to be paid out of the Revenue Fund into the Redemption Fund and into the Repair and Replacement Account. This certification includes the last date or

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dates upon which the state can make such payments (Section 5.05 of the Resolution 68-4).

The Department of Revenue Debt Manager oversees the transfer of money from the Revenue Fund to the Redemption Fund according to the established payment schedule.

Treasury officials do not expect material investment earnings in the International Airports Revenue Bond Redemption Fund because of the relatively small amount of money held in the Fund and the short time the Trustee holds money in the Fund.

5. Investment Policy

This section outlines the investment policy for the International Airports Construction Fund, Revenue Fund, Repair and Replacement and Reserve Account, and the Revenue Bond Redemption Fund.

a. Construction Fund

Bond Anticipation Notes

AS 37.15.300-390 authorizes the State Bond Committee to issue bond anticipation notes in anticipation of issuing authorized bonds for the Anchorage Airport project. Acting on that authority, the State Bond Committee adopted Resolution 98-8 to issue two series of revenue bond anticipation notes in the principal amounts of \$14,300,000 1998A (Non-Alternative Minimum Tax (AMT)) and \$4,965,000 1998B (AMT) to provide interim financing for the Anchorage Airport Project. In July 1998, the state issued the notes. International Airports System Revenue Bonds Series 1999A and 1999B later retired these revenue anticipation notes.

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International Airports System Revenue Bonds Series 1999A and 1999B

AS 37.15.410 - 15.550 authorizes the State Bond Committee to issue bonds for the redevelopment and improvement of the Anchorage International Airport. Acting on that authority and based on Resolution No.68-4, as restated by Resolution 99-1, the State Bond Committee issued Alaska International Airports System Revenue Bonds in the principal amounts of \$162,500,000 Series 1999A (AMT) and \$16,675,000 Series 1999B (non-AMT) dated January 15, 1999 (received February 10, 1999). These bond proceeds retire the revenue anticipation notes previously issued in July 1998.

Section 8.07 of Bond Resolution 99-1 established the permitted investments for the 1999A and 1999B bond proceeds. The IRS code subjects the investment earnings of the bond proceeds to the yield arbitrage restriction rules. According to International Airport Systems, the construction projects covered by these bond proceeds are projected to have the following cash flow starting in calendar year 1999 (see detailed cash flow schedule in [Appendix AM](#)).

- A 40% draw on the funds within 24 months.
- A 70% draw on the funds within 36 months.
- All funds are expended within 72 months.

The airport project manager in the Department of Transportation provided a seven-year cash outflow forecast as follows:

(expressed in \$ thousands)

1998	1999	2000	2001	2002	2003	2004
\$1,800	\$17,762	\$44,823	\$45,589	\$20,853	\$16,557	\$8,616

The project manager will provide updated cash flow forecasts semi-annually.

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Based on the current capital market assumptions, Treasury invests the Fund's assets with the following in mind:

Risk Tolerance	Moderate. Much of the money in the fund will be expended over an intermediate time horizon. Material loss could affect the project obligations.
Investment Objectives	Moderate exposure of principal loss for possibility of higher return over time. High liquidity requirement.
Time Horizon	Intermediate. Much of the money is expected to be spent in less than five years.
Other Constraints	State Bond Committee Resolution 99-1 restricts the types on investment instruments. Ongoing monitor of the construction cash flow schedule. Yield arbitrage restriction.

From February 10, 1999 to May 15, 1999, Treasury managed the Construction Fund assets in the Short-term Fixed Income Investment Pool pending final confirmation by the State Bond Committee on the proper investment policy.

Effective May 15, 1999, Treasury's investment policy for the Construction Fund (AMT and non-AMT portion) is:

25%	+ 8%	Short-term Fixed Income Investment Pool
75%	± 8%	Intermediate-term Fixed Income Investment Pool

The investment policy has a plus or minus 8% band for each investment pool in the allocation to avoid the expense of continually rebalancing the Fund's investments.

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Effective May 15, 1999, Treasury's performance benchmark for the Construction Fund (AMT and non-AMT portion) is:

25% Three-month U.S. Treasury Bill
75% Merrill Lynch 1-5 Government Index

International Airports System Revenue Bonds Series 1999C

The State Bond Committee, through Resolution 99-7 shown in [Appendix AS](#), authorized the issuance of additional Alaska International Airports System Revenue Bonds in the principal amount of \$25,000,000 (Series 1999C). The bond issue is expected to close October 9, 1999 with associated proceeds arriving October 13, 1999.

According to International Airport Systems, the construction projects covered by these revenue bond proceeds are projected to start in April 2001 and end in October 2003 (see project schedule in [Appendix AT](#)).

The airport project manager in the Department of Transportation provided a cash outflow forecast as follows:

(expressed in \$ thousands)

1999	2000	2001	2002	2003
\$703	\$3,208	\$5,030	\$9,003	\$7,040

Section 148 of the IRS tax code subjects the investment earnings of the Series 1999C revenue bond proceeds to the yield arbitrage restriction rules. There are extenuating circumstances that may extend the project starting time one or two additional years.

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Section 8.07(a) and Section 11.07(a) of the State Bond Committee's Resolution 99-1 establish the permitted investments for the 1999C bond proceeds. Proceeds may be invested in any of the investment pools operated by the Department of Revenue. Section 11.07 requires that net proceeds from the Series 1999C issue be deposited into the Construction Fund and authorizes a separate account to track interest and investment earnings thereon.

Based on the current capital market assumptions, Treasury invests the Series 1999C revenue bonds held in the Construction Fund with the following in mind:

Risk Tolerance	Moderate. Much of the money in the fund will be expended over an intermediate time horizon. Material loss could affect the project obligations.
Investment Objectives	Moderate exposure of principal loss for possibility of higher return over time. High liquidity requirement.
Time Horizon	Intermediate. Much of the money is expected to be spent in less than four years.
Other Constraints	State Bond Committee Resolution 99-1 restricts the types on investment instruments. Ongoing monitor of the construction cash flow schedule. Yield arbitrage restriction.

Effective October 13, 1999, Treasury's investment policy for the Series 1999C revenue bonds held in the Construction Fund is:

25%	± 8%	Short-term Fixed Income Investment Pool
75%	± 8%	Intermediate-term Fixed Income Investment Pool

The investment policy has a plus or minus 8% band for each investment pool in the allocation to avoid the expense of continually rebalancing the Fund's investments.

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Effective October 13, 1999, Treasury's performance benchmark for the Series 1999C revenue bonds held in the Construction Fund is:

25% Three-month U.S. Treasury Bill
75% Merrill Lynch 1-5 Government Index

- b. Revenue Fund (excluding the Repair and Replacement Reserve Account and the two Passenger Facility Charge Revenue Funds)

The State Bond Committee in section 3.03 of Bond Resolution 99-1 established the permitted investments for the Revenue Fund.

Treasury invests the Revenue Fund assets with the following in mind:

Risk Tolerance	Moderate. Stability of income is important. Losses would have to be covered by increased airport fees, charges and rentals or reduced service.
Investment Objectives	Willing to tolerate moderate exposure to principal loss for possibility of somewhat higher returns. Maximize current income subject to constraints. Modest inflation protection is important. Modest liquidity requirement to ongoing needs of the airport system.
Time Horizon	Intermediate.
Other Constraints	State Bond Committee Resolution 99-1 restricts the types of investment instruments.

Treasury invested the Revenue Fund in a broad range of short and intermediate term securities specifically allowed under the permitted investments list in Bond Resolution 93-5. Subsequent State Bond Committee adoption of Bond

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Resolution 99-1 allows Treasury to invest the fund in the fixed income investment pools managed by the Treasury Division. Participation in these investment pools allows the Revenue Fund to minimize transaction and administrative expenses.

From February 10, 1999 to May 15, 1999, Treasury managed the Revenue Fund assets in short-term fixed income investments pending final confirmation by the State Bond Committee on the proper investment policy.

Effective May 15, 1999, Treasury's investment policy for the Revenue Fund is:

15%	± 8%	Short-term Fixed Income Investment Pool
85%	± 8%	Intermediate-term Fixed Income Investment Pool

The investment policy has a plus or minus 8% band for each investment pool in the allocation to avoid the expense of continually rebalancing the Fund's investments.

Effective May 15, 1999, Treasury's performance benchmark for Revenue Fund is:

15%	Three-month U.S. Treasury Bill
85%	Merrill Lynch 1-5 Government Index

c. **Repair and Replacement Reserve Account**

Prior to June 2001, Treasury invested the \$500,000 Repair and Replacement Reserve Account in six-month U.S. Treasury Bills that were held to maturity unless funds were needed in the interim. Bond covenants applicable to the Series 1999A and 1999B revenue bonds allow the Repair and Replacement Reserve Account to participate in any of the Treasury Division's investment pools, although those covenants also stipulate that investments must mature within five years from the date

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of investment. This additional stipulation essentially limits investments to pools that hold no investments maturing after five years.

Risk Tolerance	Low. Funds may be needed on very short notice.
Investment Objectives	Very low exposure to principal loss. Modest current income requirement. Little inflation protection needed. High liquidity requirement.
Time Horizon	Short.
Other Constraints	Outstanding bond covenants stipulate that investments of the Repair & Replacement Reserve Account mature within five years from the date of investment.

Effective May 31, 2001, Treasury's investment policy for the Repair & Replacement Reserve Account is:

100% Short-term Fixed Income Investment Pool

Effective May 31, 2001, Treasury's performance benchmark for the Repair & Replacement Reserve Account is:

100% Three-Month U.S. Treasury Bill

d. Bond Redemption Fund

Assets in the Bond Redemption Fund are managed by the assigned trustee.²⁹

Treasury officials do not expect material investment earnings in the International Airports Revenue Bond Redemption Fund because of the relatively small amount of money held in the Fund and the short time the Trustee holds money in the Fund.

²⁹ Seattle First National Bank, the Trustee appointed to manage the Bond Redemption Fund following the adoption of Resolution 93-5, has been succeeded by First Trust of Washington.

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e. Investment Income Allocation

All interest or other income earned on investments of the International Airports Revenue Bond Redemption Fund and the Revenue Fund (including the Repair and Replacement Account and the Anchorage and Fairbanks International Airports Passenger Facilities Charge Funds within the Revenue Fund) becomes part of the respective fund or account.³⁰ AS 37.15.430(b). Resolution 99-7, Section 11.07 requires that net proceeds from the Series 1999C revenue bond, along with interest and investment earnings thereon, be accounted for separately within the Construction Fund. Beginning June 2001, Treasury Division annually transfers investment earnings of the Repair and Replacement Account to the Revenue Fund so that the account will end the fiscal year with exactly \$500,000.

6. Reporting Requirements

The State Comptroller maintains the custodial and accounting records for the invested assets of the funds noted in this section except the Redemption Fund which is managed by an assigned trustee. The State Comptroller sends reports of invested assets and income to the International Airports officials monthly as per the August 25, 1998 Memorandum of Understanding between the Departments of Transportation, Revenue and Administration included in [Appendix AL](#). The State Comptroller also transmits a monthly activity report for the Anchorage and Fairbanks International Airports' Passenger Facility Charge Revenue Funds showing daily

³⁰ Investment earnings for the two Anchorage and Fairbanks International Airports Passenger Facility Charge Revenue Funds must be accounted for separately according to Federal Aviation Administration regulations.

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balances and earnings while held in the GeFONSI. All funds as noted, except the Redemption Fund, are included in Treasury's annual independent audit.

7. Treasury Funding

Each year Treasury includes the International Airports Funds as a funding source in its annual budget. If managed outside the GeFONSI, a fund is charged for the actual costs of investment management fees and performance measurement. Treasury also allocates a share of the Division's personnel costs and custodial costs to the funds.

Version Control

Revision Date	Effective Date	Summary of Changes	Find it in Version
8/27/99	10/13/99	Treasury updates investment policy to include new bond issue (Series 1999C) for the Anchorage International Airport expansion project.	1.2
9/20/00	10/1/01	Treasury updates Investment Policy Statement to include two new subfunds of the International Airports Revenue Funds established by the Department of Transportation and Public Facilities to account for receipts from passenger facility charges.	1.7
5/24/01	5/31/01	Beginning June 2001, the Repair and Replacement Account participates in the Short-term Fixed Income Investment Pool; it no longer holds its own underlying investments. Treasury Division annually transfers investment earnings of the Repair and Replacement Account to the Revenue Fund so that the account will end the fiscal year with exactly \$500,000.	1.8

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I. Alaska Housing Finance Corporation Special Pledged Fund - Investment Policy Statement

1. Overview

On April 15, 1997, the Alaska Housing Finance Corporation completed the process of refinancing all of its remaining Insured Mortgage Bonds and General Housing Mortgage Bonds thereby ending the life of this fund. The fund's investment policy statement and related material may be found in [Appendix AN](#). They are preserved there for the purpose of maintaining institutional memory.

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J. Alaska Student Loan Corporation Funds - Investment Policy Statement

1. Overview

The Department of Revenue has two distinct sets of investment responsibilities for Alaska Student Loan Corporation (ASLC) funds. The loan program itself, administered by the Alaska Commission on Postsecondary Education, enables Alaska residents to attend colleges, universities, trade and vocational schools.

First, the Treasury Division must invest unloaned ASLC funds that are not indentured to the corporation's bonds (approximately \$20 million of the corporation's \$600 million in assets are not indentured to the Corporation's bonds). Treasury invests these funds in the GeFONSI. (See section XII (A).)

Second, under terms of a custodian/depository agreement between ASLC, the bond trustee (First Trust National Association) and the Department of Revenue (see [Appendix FF](#) effective September 11, 1998 which supercedes [Appendix FE](#)), the department must:

- Hold and invest certain bond proceeds or other funds indentured to ASLC bonds until disbursed to borrowers.
- Receive, hold and invest for brief periods of time the payments made on loans indentured to ASLC bonds.

This custodian/depository agreement is one of several elements comprising the trust indenture dated May 1, 1988 by which, together with supplemental indentures, ASLC is able to issue student loan revenue bonds. The custodian/depository agreement is found in [Appendix FE](#).

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2. History

- 1971 - 1987. The state has provided a substantial student loan program since the 1971-1972 academic year. The Legislature initially funded the program with General Fund appropriations. By 1987 the Legislature provided almost \$300 million in General Fund appropriations, enabling the program to fund 125,000 student loans totaling just over \$500 million.
- April 1988. The Legislature established the Alaska Student Loan Corporation to take over the loan program. The corporation assumed the assets and liabilities of the state's two major loan funds: the Scholarship Revolving Loan Fund and the Teacher Scholarship Loan Fund. The corporation is governed by a five-member Board of Directors, with two members from the Alaska Commission on Postsecondary Education together with the commissioners of Revenue, Administration, and Commerce and Economic Development.
- 1988 - 1996. Since the beginning of 1988, ASLC has received General Fund appropriations of about \$35.8 million and has secured the rest of the funds it has needed by issuing revenue bonds secured pledged by student loan repayments. Between 1988 and 1996, the corporation issued almost \$400 million in bonds and made loans totaling about \$509 million.

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3. Facts and Figures

Total invested assets in the ASLC Revolving Student Loan Fund (FU 82000) at June 30, have been:

Fiscal Year	Earnings	Fair Value
1989	1,226,579	2,969,573
1990	183,534	2,041,777
1991	140,905	1,908,118
1992	105,370	1,976,986
1993	84,236	2,447,273
1994	99,849	3,189,727
1995	294,365	7,069,675
1996	420,505	8,733,443
1997	419,184	8,151,095
1998	682,019	10,747,127
1999*	666,014	12,079,845
2000	702,134	13,206,804

Total invested assets in the ASLC Master Student Loan Fund (AY 15) at June 30, have been:

Fiscal Year	Earnings	Fair Value
1989	158,360	1,713,171
1990	TBA	TBA
1991	578,347	2,647,319
1992	501,206	7,658,406
1993	200,211	2,798,821
1994	336,644	6,822,646
1995	446,725	3,497,952
1996	609,984	5,125,257
1997	509,995	5,111,164
1998	492,864	7,731,621
1999*	491,920	6,724,950
2000	690,079	17,625,824

* Effective May 1999, ASLC assets are reported at amortized cost, an option allowed under GASB Statement No. 31.

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Total invested assets in the ASLC Series A Student Loan Funds (AY 16) at June 30, have been:

Fiscal Year	Earnings	Fair Value
1989	297,047	927,014
1990	TBA	TBA
1991	TBA	TBA
1992	120,598	1,376,201
1993	233,266	2,860,481
1994	254,728	2,979,295
1995	495,679	2,668,233
1996	381,700	4,865,179
1997	709,722	7,032,565
1998	1,097,199	12,298,265
1999*	979,453	12,933,218
2000	830,532	3,367,171

* Effective May 1999, ASLC assets are reported at amortized cost, an option allowed under GASB Statement No. 31.

4. Management

a. Financial Structure

The corporation's fund structure is complex. First, all of the payments on loans originally financed with proceeds of ASLC bond issues are pledged to make the principal and interest payments on ASLC bonds. By 1997, the loans made from the proceeds of these bonds comprised almost half of the corporation's \$500 million loan portfolio. For accounting and investment purposes, these loans are reflected in the Series Student Loan Fund (series refers to each of the respective bond issues used to obtain funds for student loans). Total loans outstanding in the Series Student Loan Fund at the end of each of the nine fiscal years 1990 through 1996 were:

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Fiscal Year	Series Student Loan Fund Outstanding Loans \$ (millions)
1990	103
1991	130
1992	138
1993	171
1994	198
1995	231
1996	246

Second, most of the loans placed in the ASLC portfolio when the Legislature established the corporation in 1988 became assets of the Master Student Loan Fund. In addition, the trustee (First Trust National Association) may transfer certain surplus funds, not needed for bond payments or reserves, to the corporation to make additional loans. The corporation must request the transfer from the trustee and must meet certain minimum debt-coverage ratio requirements established in the indenture.

These loans, made with "recycled" bond proceeds and "recycled" original contributed capital (loans and appropriations) are held in the Master Loan Fund. The principal and interest payments made on loans from this fund are pledged to the bonds that ASLC has issued and to the operation of the corporation. The total loans outstanding in the Master Student Loan Fund at the end of each of the seven fiscal years 1990 through 1996 were:

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Fiscal Year	Master Student Loan Fund Outstanding Loans \$ (millions)
1990	346
1991	333
1992	329
1993	298
1994	276
1995	246
1996	240

The ASLC pledged the principal and interest payments on student loans made from the Series Student Loan Fund to the trustee to make principal and interest payments on ASLC student loan revenue bonds and to maintain certain required reserve funds. As well, the principal and interest payments on student loans made from the Master Student Loan Fund are pledged to ASLC student loan revenue bonds and reserve funds.

The ASLC remits these principal and interest payments to the trustee, who holds the funds for bond payments and reserves. If the trustee develops a surplus with respect to the required bond payments and reserve funds, the surpluses are returned, upon request, to the Master Student Loan Fund where the ASLC uses the money to make new student loans.

Under the provisions of the May 1, 1988, trust indenture and subsequent supplemental trust indentures, the corporation is responsible for investing the bond proceeds until those proceeds are needed to make loans and for investing the various reserve and operations funds required by the applicable trust indenture. The trustee acts as custodian for those investments.

The May 1, 1988, custodian/depository agreement gives the Department of Revenue the responsibility for handling and investing, for brief periods of time, (1) funds that are

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being disbursed to borrowers (either funds derived from the sale of bonds and loaned through the Series Student Loan Fund or recycled payments loaned through the Master Student Loan Fund); and (2) the loan repayments for loans made on the Series and Master Student Loan Funds. The custodian/depository agreement seems to contemplate one fund for disbursing bond proceeds and Master Student Loan surplus repayment proceeds to borrowers and a second fund for handling monthly collections from Series and Master Student Loans.

Rather than establishing one fund for loan disbursements and a second fund for holding loan repayments pending distribution to the trustee, Treasury established one custodial account for both disbursements and collections for Series Student Loan Fund loans (AY16) and a second custodial account for both disbursements and collections for Master Student Loan Fund loans (AY15). Section 9 of the custodian/depository agreement sets forth the investment restrictions imposed on these funds.

As students repay their loans, the money passes through the GeFONSI (AY01) before deposit to AY15 or AY16 at the custodian bank (this transaction flow is dictated by the accounting system as described in Section XII). Treasury reflects the activity for both bank accounts in Treasury Fund 90655/Liability Account 22368. The chart in [Appendix FG](#) summarizes these transaction flows.

These various fund classifications and designations are unimportant to the student borrower. The borrower is aware that he or she is borrowing money under one of three student loan programs: Alaska Student Loan Program (AS 14.43.090-160), Teacher Scholarship Loan Program (AS 14.43.600-700), or Family Education Loan Program (AS 14.43.710-790). The loan could be a Series Student Loan, a Master Student Loan or a Revolving Student Loan.

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The Revolving Student Loan Fund is not indentured to ASLC bonds. From this fund, ASLC can make regular Alaska Student Loans and Teacher Scholarship loans. In addition, this is the only fund used by ASLC to make loans under the Family Education Loan Program. In this program, the borrower is not the student but rather the student's family member.

Unloaned money in the Revolving Student Loan Fund, GASB Fund 82000, is invested in GeFONSI.

5. Investment Policy

a. Pledged Loan Payment Trust Fund

Treasury invests the Alaska Student Loan Corporation Trust Fund and the Pledged Loan Payment Trust Fund with the following in mind:

Risk Tolerance	Low. Money is held in trust for bondholders pending disbursement of loans or repayment to Trustee.
Investment Objectives	Low exposure of principal to loss. Emphasis on liquidity and safety of principal. Income is secondary objective. Minimal inflation protection needed. High liquidity requirement.
Time Horizon	Short.

Until March 1999, Treasury's investment policy for these funds was to invest them solely in repurchase agreements collateralized to 102% of the principal value by U.S. Treasury Securities. These repurchase agreements mature the next business day. The state's custodian bank takes actual possession of the repurchase agreement collateral and

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deposits it into the two accounts (AY 15 and AY 16) maintained separately for the benefit of the trustee.

In March of 1999, the ASLC and Treasury mutually agreed to modify the investment policy to increase earnings on these funds. The ASLC will, using their cash flow information, specify amounts of money within the funds that Treasury can invest for longer than one day. ASLC will inform Treasury of the amounts and exact dates to which Treasury can invest this money. The Treasury investment policy for these funds is, where practical, to match investment maturities and amount to the schedule provided by ASLC. Treasury will use United States Treasury securities and certain U.S. Agency securities that are specifically authorized under the May 1, 1988 trust indenture, as supplemented. (See Appendices [FE](#) and [FF](#).) Treasury will invest the remainder of the money in overnight repurchase agreements. These overnight repurchase agreements are identical to the agreements described above with one exception. Treasury will require 104% collateralization of the principal value of these agreements. This higher level of collateralization complies with the standards of AMBAC, the bond insurance company used by the ASLC.

Treasury has no performance benchmark for these funds.

b. Investment Policy - Revolving Student Loan Fund (Treasury Fund 82000)

See Section XII(A), the investment policy statement for the GeFONSI.

6. Reporting Requirements

The Student Loan Fund (Fund 82000) within GeFONSI, is included in the annual audit of GeFONSI. The two funds held separately at the custodial bank, the Alaska Student Loan

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Corporation Trust Fund and the Pledged Loan Payment Trust Fund, are included in the annual audit of the Alaska Student Loan Corporation. Treasury has directed the custodian bank to send monthly custodial reports directly to the ASLC for its files. Treasury records the necessary accounting entries monthly in the Statewide Accounting System to reflect the period's investment activity.

The ASLC accesses the balance of Fund 82000 directly through the Statewide Accounting System and contacts Treasury if it has questions.

7. Treasury Funding

Treasury includes the Alaska Student Loan Corporation Trust Fund and the Pledged Loan Payment Trust Fund as funding sources in its annual budget. Treasury allocates a share of its personnel costs and custodial costs to these funds.

Version Control

Revision Date	Effective Date	Summary of Changes	Find it in Version
11/24/00		Update to Facts & Figures Section	1.6

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K. Alaska Heritage Endowment Fund - Investment Policy Statement

1. Overview

The Alaska Heritage Endowment Fund is a trust fund the income of which is dedicated to funding the acquisition of significant historical and cultural items for the Alaska State Museum and the Sheldon Jackson Museum.

The Alaska Heritage Endowment Fund may be funded by legislative appropriations or by contributions from individuals and organizations. Private contributions may be made to the principal of the Fund (in which case only the income derived from those contributions can be used to purchase objects for the museums) or to the net income account of the Fund (in which case the entire contribution can be used to purchase objects for the museums).

2. History

- 1992. The Legislature establishes the Alaska Heritage Endowment Fund. § 5 Ch. 82 SLA 1992. Sponsor of the legislation that established the Fund proposes a tax credit to encourage contributions to the Fund. The Department of Revenue vigorously opposes the tax credit and consequently, that part of the proposed legislation did not pass.
- March 1997. The Alaska Heritage Endowment Fund accumulates slightly more than \$2,300 (\$2,235 in principal and \$125 in income). State records reflect that contributions to the Fund were solicited for the principal account of the Fund by the Friends of the Alaska State Museum.

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3. Facts and Figures

<u>Alaska Heritage Endowment Fund</u>		
Fiscal Year	June 30 Balance	Investment Earnings
1994	226.12	2.00
1995	757.55	34.11
1996	912.46	45.47
1997	2,383.12	77.05
1998	2,642.10	163.23
1999	2,919.50	141.04
2000	7,061.93	227.19

4. Management

The statutes pertinent to the Alaska Heritage Endowment Fund and a sample of the Friends of the Alaska State Museum's solicitation of contributions may be found in [Appendix AO](#).

While the governing statutes clearly contemplate private contributions to the Fund's net income account (see AS 37.14.510), it appears that all expenditures from the Fund's net income account must be authorized by specific appropriations. AS 37.14.520 and AS 37.14.530(b) and (c).

The applicable statutes require Treasury to account for the Fund in a manner that distinguishes "principal" from "income." Treasury intends to follow the practice it has established for the endowment funds (such as Public School Trust Fund and the Alaska Children's Trust), once there is a sufficient balance in the Fund. (See section 5 for discussion of sufficient balance.) Treasury will establish a "principal account" and an "income account" for the Fund. Income may be spent; principal must be preserved.

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AS 37.14.530(a) provides that "any capital gains or losses realized on the principal shall be retained perpetually in the fund for investment;" consequently, income includes only interest and dividends.³¹ AS 37.14.530(c) requires Treasury to reinvest the realized net income not yet appropriated and expended.

5. Investment Policy

a. Investment Policy - General

AS 37.14.170 establishes the investment objectives for the Fund:

Section 37.14.170. Investments. The commissioner of revenue is the fiduciary of the trust fund and shall invest the fund to provide increasing net income over long-term periods to the fund's income beneficiaries. The commissioner may invest the money in the fund on the basis of probable total rate of return to promote the long-term generation of income. In managing the trust fund, the commissioner shall:

- (1) consider the status of the fund's capital and the income generated on both a current and a probable future basis;*
- (2) determine the appropriate investment objectives;*
- (3) establish investment policies to achieve the objectives; and*
- (4) act only in regard to the financial interests of the fund's beneficiaries.*

The investment objective is to provide "increasing net income over long-term periods to the Fund's income beneficiaries." Treasury believes this provision requires an investment policy that is most likely to yield increasing real, or inflation adjusted, income over long-term periods.

³¹ The statute does not address unrealized gains or losses. Treasury will retain such gains and losses with the principal.

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To offset the additional costs incurred from investing the fund in equities or more aggressive assets separately from the GeFONSI, the Fund would need assets in excess of \$3 million. Separate investment of the fund would require Treasury to establish two separate accounts with the state's custodian bank. Treasury would establish the two separate accounts to facilitate management control and separation of principal and income assets. Currently, all of the funds in the Fund are invested in one "account" and that "account" is invested in the GeFONSI.³² If Treasury separately invested the fund, Treasury would allocate costs to the fund in the same manner as it does the Children's Trust and the Public School Trust Fund. Currently, Treasury does not allocate any costs to this fund.

Once separate principal and income accounts were established, monthly, Treasury would transfer income (only dividends and interest and not net appreciation) produced by the principal assets of the Fund to a separate income account within the Fund where it would be held pending expenditure. Net appreciation must be retained in the principal assets account (AS 37.14.530(a)).³³

Consequently, the Fund would require separate investment policies for the principal assets of the Fund and the income assets of the Fund. Once earned, the Legislature could appropriate the income assets for museum acquisitions.

³² If Treasury establishes an Enhanced GeFONSI (See Section XII(A) GeFONSI), the principal of the Alaska Heritage Endowment should clearly be invested in the Enhanced GeFONSI.

³³ Under GASB Statement Number 31, "income" is defined as interest and dividends while "net appreciation" is defined as realized and unrealized capital gains and losses.

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6. Control and Reporting Requirements

AS 37.14.520(7) requires the Commissioner to engage an independent certified public accountant to perform an annual audit. To fulfill this requirement, the State Comptroller contracts with an independent certified public accountant to perform the annual audit.

AS 37.14.520(6) requires the Commissioner of Revenue to maintain accounting records that distinguish between the principal and income of the Fund. The accounting records are maintained by the State Comptroller. It is the policy of the Department for the State Comptroller to inform the Alaska Museum Collections Advisory Committee of the current status of the Fund and to work closely with the staff of the State Museum and the Friends of the State Museum to provide information and assistance with respect to this fund. The State Comptroller sends a letter to the Museum Collections Advisory Committee within 30 days following the end of each fiscal year to describe the financial condition and activity of the fund in accordance with AS 34.14.520(9).

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7. Treasury Funding

While the Alaska Heritage Endowment Fund is invested in the GeFONSI, it is not used as a funding source for the Division's annual budget. The Fund is not charged for the actual costs of investment management fees nor for performance measurement costs. Treasury allocates no portion of the Division's personnel costs and custodial costs to the Fund.

Version Control

Revision Date	Effective Date	Summary of Changes	Find it in Version
4/10/00	N/A	Added 1999 figures to fund balance and earnings table.	1.3
4/10/00	5/15/99	Removed Investment Policy Section that would be implemented should Treasury invest the fund separately.	1.3

Effective: 5/15/99

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L. Statutory Budget Reserve Fund - Investment Policy Statement

1. Overview

This fund was created in 1986 and is governed by AS 37.05.540. It was originally intended as a fund where certain "excess" revenues would be placed. These "excess" funds were then to be available when there was a General Fund revenue shortfall. (A copy of AS 37.05.540, the statute governing the operation of this fund, may be found in [Appendix AQ.](#))

2. History

- 1990. Alaska State Legislature appropriates the balance in the General Fund available for appropriation at the end of FY 91 to the Statutory Budget Reserve Fund. § 20(b) Ch. 209 SLA 1990. As a consequence, \$696.3 million is appropriated into this fund effective June 30, 1991.
- FY 1992 - 1993. The Legislature appropriates all of the assets of this fund back out of the Fund.
- FY 1994. The Fund has a zero balance since the beginning of the fiscal year.

3. Investment Policy

Since this fund has no assets and since we do not anticipate that it will have any assets in the foreseeable future, the Department has adopted no investment policy for this fund.

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M. General Fund Real Estate Investments - Investment Policy Statement

1. Overview

The state General Fund portfolio contains separately held real estate investments in the form of direct mortgage-related assets.

2. History

- 1953. The General Fund enters the Alaska mortgage business through the Territory of Alaska's veterans' loan program. (See Section V of this publication.)
- 1970 - 1980. State law governing the investment of surplus funds in the General Fund requires preference for investments in Alaska home mortgages, Alaska business loans and Alaska communities. Further, the law provides that the General Fund can be invested in these loans "at a rate conducive to develop and benefit Alaska and Alaska residents and such rate may be less than the market rate." § 1 Ch. 206 SLA 1970. By 1980, \$750 million of the General Fund had been invested in line with that preference.
- 1980. The Legislature decides to eliminate almost all of the authority for investing the General Fund in residential mortgages and small business loans and to require that all investments be made "at competitive national market rates." § 6 Ch. 122 SLA 1980.³⁴ As a consequence of this change in policy, the General Fund ceases making new investments in Alaska residential, small business and community loans. Most residential loans in the General Fund's portfolio are either appropriated to or sold to the Alaska Housing Finance Corporation (AHFC). (See Section XVIII(B) of this publication.) Most small business loans in the General Fund's portfolio are either appropriated to or sold to the Alaska Industrial Development and Export Authority (AIDEA). (See Section XVIII(C) of this publication.)

³⁴ The Public Employees' Retirement System Fund (PERS) and the Teachers' Retirement System Fund (TRS) were also invested heavily in Alaska residential mortgages and business loans and experienced a similar change in investment policy during the 1980's. (See Section XIV of this publication.)

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The Alaska Municipal Bond Bank Authority (AMBBA) is established to assist Alaskan municipalities borrow money to meet their capital investment needs. (See Section XVIII(D) of this publication.)

- March 1999. The remainder of the General Fund's long-standing investment in Alaska mortgages consists of two performing mobile home loans.

3. Facts and Figures

[Appendix BL](#) reflects General Fund mortgage-related investments at the end of fiscal years 1979-1984.

4. Investment Policy

Treasury does not currently invest the General Fund directly in mortgages and is endeavoring to liquidate the remainder of this portfolio.

Version Control

Revision Date	Effective Date	Summary of Changes	Find it in Version

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N. Mental Health Funds - Investment Policy Statement

[Appendix AV](#) presents a general overview – current as of the summer of 1997 – of the Mental Health Trust and an explanation of the several funds relating to the trust that are reflected in the state's accounting system.

Version Control

Revision Date	Effective Date	Summary of Changes	Find it in Version
4/7/00		Relocated historical overview from this section to Appendix AP .	1.3
1/9/01		Relocated entire policy statement from this section to Appendix AV .	1.7

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O. Oil Spill Funds - Investment Policy Statement

[Appendix AT](#) presents a brief summary – current as of August 1997 – of the oil spill related funds with assets invested in the General Fund and Other Non-segregated Investments. The Legislature established most of these funds in response to the 1989 Exxon Valdez oil spill.

Version Control

Revision Date	Effective Date	Summary of Changes	Find it in Version
4/7/00		Relocated overview, history, and facts & figures sections to Appendix AT	1.3

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P. National Petroleum Reserve Alaska Special Revenue Fund - Investment Policy Statement

1. Overview

Similar to the history of the Alaska Mental Health Lands Trust, the National Petroleum Reserve Alaska (NPRA) Special Revenue Fund started with a federal mandate governing state revenues that later was violated by the Legislature, then decided in a court battle and finally settled with more legislation.

The issue started in 1980 when Congress enacted legislation requiring the federal government to give to the state half of lease payments, bonuses and royalties from federal oil and gas leases in NPRA.

2. History

- 1923. President Warren G. Harding signs an executive order creating the Naval Petroleum Reserve No. 4, a 23-million-acre reserve on Alaska's North Slope, west of Prudhoe Bay. It was one of four petroleum reserves around the country set aside for possible use by the Navy, though no oil had ever been pumped from the Alaska reserve.
- 1976. The reserve is renamed the National Petroleum Reserve Alaska, and jurisdiction is transferred to the U.S. Department of Interior.
- 1980. Congress authorizes the Secretary of the Interior to offer competitive leases in NPRA, clearing the way for private development of the resources. As part of that legislation, Congress enacts P.L. 96-514, which requires that the federal government turn over to the state 50 percent of the revenues from NPRA. The codified statute is 42 U.S.C. § 6508. Federal law specifies that the state use the money for planning, construction, maintenance and operation of essential public facilities and other necessary provisions of public service. "Provided further, that in the allocation of such funds the state shall give priority to use by subdivisions of the state most directly or severely impacted by development of oil and gas leased under this act."

Effective: 1/10/00

XII: P-1

Section XII: National Petroleum Reserve Alaska Special Revenue Fund

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- 1982. The Legislature passes CS SB 835 (Finance) amended House, which would have established an NPRA Special Revenue Fund. All of the state's federal proceeds of NPRA revenues would have gone into the fund, with half going out to communities affected by the leasing and the other half available for state spending. Governor Jay Hammond vetoes the bill.

- 1983. The federal government awards competitive leases for a total of 7.2 million acres of land in NPRA, paying half of the lease payment and bonus income to the state.

Without a specific state law on the books to govern receipt and expenditure of the \$48.6 million in NPRA lease income received by the state during the early 1980s, none of the money is guaranteed for affected communities. Instead, it is disbursed as follows:

- Half of the state's share is automatically deposited into the Alaska Permanent Fund (about \$24.3 million).
 - One-half of one percent of some of the payments is deposited into the Public School Fund (about \$182,000).
 - The remainder is deposited into the General Fund (about \$24.1 million).
-
- 1984. Until 1984, NPRA money in the General Fund is appropriated by the Legislature in the same manner as all other General Fund money (about \$18 million of the \$24.1 million). The General Fund holds about \$6.1 million of NPRA lease money when the Legislature adopts a new law (Chapter 94, SLA 1984) establishing the National Petroleum Reserve Alaska Special Revenue Fund. The law, AS 37.05.530, let stand the 1980-1984 deposits into the Permanent Fund and Public School Fund and the appropriations out of the General Fund. The law designates that the remaining balance (\$6.1 million) and any future income shall be disbursed as grants to communities affected by leasing in NPRA. The law specifically exempts municipalities from using the funds to retire debt. The law directs the Department of Community and Regional Affairs to set up a grant program that would "give priority in the allocation of grants to municipalities that are experiencing or will experience the most direct or severe impact from oil and gas development under 42 U.S.C. § 6508 within the National Petroleum Reserve Alaska." The state distributes NPRA receipts that are not appropriated under AS 37.05.530 as municipal grants by the end of each fiscal year according to the following allocation:

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- Half to the principal of the Permanent Fund.
- One-half of one percent to the Public School Fund.
- The remainder to the General Fund.

The commissioner of Revenue is charged with managing the NPRA Special Revenue Fund, under AS 37.05.530(b).

- 1985. Though the 1984 legislation set up a grant program through the Department of Community and Regional Affairs, the Legislature sidestepped that process and by 1985 had appropriated about 60 percent of the balance of the fund, or \$3.7 million, for directs grants and projects in the North Slope Borough not necessarily related to impacts from leasing in NPRA. In late 1985, the North Slope Borough and the cities of Barrow, Nuiqsit and Wainwright sue the state, alleging that its handling of NPRA revenue violates the federal requirement of priority for communities affected by oil and gas leasing in the reserve. The plaintiffs wanted:
 - A "rational process" for communities to apply for the grants.
 - A declaration that the automatic deposit of whatever is left each year into the Permanent Fund, Public School Fund and General Fund violates federal law.
 - An order directing the state to reconstitute the fund equal to the total amount of federal money received over the years.

Alaska Superior Court Judge Walter Carpeneti rules (see [Appendix ZN](#)):

- The state must establish a process for municipalities to apply for grants.
 - That any automatic deposit of the money to funds other than impact grants to communities violates federal law, though it might be permissible if it covers only those funds remaining each year after grants have been made.
 - The state must reconstitute the fund but does not have to include any money already spent by General Fund appropriation. Subtracting that \$18 million from the original federal payments of \$48.6 million left about \$30.6 million to be returned to the new NPRA Special Revenue Fund.
- 1986. To comply with the court ruling, the Legislature (Chapter 53, SLA 1986) authorizes the Department of Community and Regional Affairs to adopt regulations for a grant program under the 1984 law. The department adopts the regulations (19 AAC 50.010-.090) in July 1986, setting eligibility criteria for the grants. However,

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instead of appropriating the full 30.6 million to comply with the court ruling, the Legislature appropriated just \$24.5 million to the fund. Instead of including in the appropriation the approximately \$2.4 million that remained in the fund (the \$6 million 1984 balance minus the \$3.7 million in direct grants in 1984-1985), the Legislature appropriates \$2.155 million of that money for a residential care alcohol and drug treatment center in Barrow. The plaintiffs in the case, however, agree to stipulate that the treatment center appropriation would be considered as a grant under the Special Revenue Fund program and allowed it as a credit to the overall appropriation that year.

- 1987. After several million dollars were disbursed as municipal grants, there remained about \$17.2 million in the Special Revenue Fund before the end of fiscal year 1987. The state distributes that money to the Permanent Fund and Public School Fund according to the allocation plan set out in AS 37.05.530(g) - though it was short by almost \$2 million of what should have been distributed because of the Legislature's short-funding the 1986 appropriation to settle the court case. In addition to the \$48.6 million received through Fiscal 1986, the state receives an additional \$1.5 million in fiscal year 1987, which is disbursed according to the allocation table set out in AS 37.05.530(g).
- 1994 – 1999. The state receives no NPRA payments from the federal treasury. There is no money in the fund and there are no operating leases in NPRA.
- 1998. Following an environmental review process, Interior Secretary Babbitt decides in October 1998 to proceed with leasing in the 4.6-million acre northeastern corner of the refuge.
- 1999. Following the October 1998 environmental review, the Department of the Interior completes the May 1999 sale, the largest on-land federal oil lease sale ever, drawing bids on 135 tracts from six companies. Treasury anticipates payment from the sale will arrive about one quarter later.
- January 10, 2000. The state receives \$40,222,795.50 from the federal Bureau of Land Management as its share of revenue from the May 1999 sale of oil and gas leases in the National Petroleum Reserve – Alaska.

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3. Investment Policy

Money in the fund that the legislature does not appropriate will be transferred at the end of each fiscal year - either as deposits to the Permanent Fund, Public School Fund or the state's General Fund. The investment policy is therefore based on low risk and significant liquidity. The NPRA Fund is currently a participant in the General Fund and Other Non-segregated Investments pool (the GeFONSI is described earlier in this section). However, NPRA is a type 3 participant (does not get investment earnings). This essentially makes risk irrelevant since Treasury does not allocate investment earnings (losses) to this account. Treasury invests NPRA assets in the GeFONSI with the following in mind:

- Risk Tolerance Low. The money could be spent or transferred at any time.
- Investment Objectives Low exposure of principal to loss.
Emphasis on liquidity and safety of principal. Income is secondary objective.
Minimal inflation protection needed.
High liquidity requirement.
- Time Horizon Short. Treasury expects much of the money in the pool to be spent or transferred in less than one year.

Version Control

Revision Date	Effective Date	Summary of Changes	Find it in Version
1/25/00	1/10/00	In January 2000, \$40.2 million arrives from the May 1999 sale of NPRA leases. Treasury revises IPS history and determines the money should be invested in the GeFONSI.	1.3

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Q. Energy Funds - Investment Policy Statement

[Appendix AU](#) presents a brief overview of the energy-related funds with assets invested in GeFONSI.

These funds exist because of past state investment in and financial support for energy-generating and distribution projects across Alaska.

Version Control

Revision Date	Effective Date	Summary of Changes	Find it in Version
4/7/00	4/25/00	Moved overview, history, and facts & figures sections to Appendix AU	1.4

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R. Retiree Health Insurance Fund - Investment Policy Statement

1. Overview

The Department of Administration established the Group Health and Life Insurance Fund (GHLIF) to account for the state's self-funded health insurance program for active employees and the Retiree Health Insurance Fund (RHIF) for the state's self-funded health insurance program for retired employees.

AS 39.30.091 and AS 39.30.095 expressly authorize the Commissioner of Administration to provide certain group health and life insurance benefits for active employees by means of self-insurance. The Commissioner of Administration has determined that AS 39.30.090, AS 39.30.091 and AS 39.30.095, by implication, confer that same authority with respect to retired employees. The Division of Retirement and Benefits manages these two programs. Treasury manages the funds' excess cash.

Three insurance plans comprise the RHIF: (1) major medical, (2) long-term care (LTC), and (3) dental, visual and audio (DVA).

2. History

- July 1, 1997. The Department of Administration establishes the GHLIF and RHIF to account for the state's self-funded health insurance program for active employees and inactive employees, respectively. Treasury manages GHLIF and RHIF assets as participants in the GeFONSI.
- May 28, 1998. Treasury reaches an agreement with the Department of Administration to manage excess RHIF assets. The Division of Retirement and Benefits determines that there is no surplus in the GHLIF; it remains invested in the GeFONSI.

Effective: 7/1/99

XII: R-1

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- July 1, 1998. Treasury transfers excess assets in the RHIF to a separate bank account at the custodian bank. Initial funding is \$36,967,803. Treasury establishes an asset allocation policy for these invested assets.

- April – June 1999. The Division of Retirement and Benefits determines that the three plans comprising the RHIF should be invested separately (see memorandum dated May 17, 1999 shown in [Appendix ZD](#)). On April 13, 1999, the Division of Retirement and Benefits moved the LTC portion into a new fund within the statewide accounting system (AKSAS). Given its long-term investment time horizon, asset allocation for the LTC portion will include equities. Treasury decides to fund the equity allocation in equal installments on a quarterly basis. In the interim, Treasury decides to manage these LTC assets (the portion to be invested in equities) in the Short-term Fixed Income Investment Pool. Given its short investment horizon and high liquidity requirements, Treasury decides to invest the DVA portion in the GeFONSI.³⁵ Finally, Treasury modifies asset allocation policy for the major medical portion.

3. Facts and Figures

- a. RHIF – Major Medical: Balance of Invested Assets (at fair value) with Investment Earnings by Fiscal Year

Fiscal Year	Beginning NAV	Total Earnings	Ending NAV
1999*	0	1,583,061	33,001,306
2000	33,001,306	1,514,794	44,050,959

* Prior to FY 1999, Treasury managed the RHIF assets in the GeFONSI.

³⁵ Before April 13, 1999, the Division of Retirement and Benefits held assets for all three plans in one fund (FU 11156) to separately account for plan assets. The Division of Retirement and Benefits created additional funds as follows:

FU 11159 Retiree Health Funds
11156 Major Medical Retiree
11158 LTC Retiree
11157 DVA Retiree Health

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- b. RHIF – LTC Insurance: Balance of Invested Assets (at fair value) with Investment Earnings by Fiscal Year

Fiscal Year	Beginning NAV	Total Earnings	Ending NAV
1999*	0	156,313	35,207,877
2000	35,207,877	2,240,733	43,351,919

* Prior to FY 1999, Treasury managed the RHIF assets in the GeFONSI.

4. Management

- a. Statutory Authorization

Under AS 39.30.095, the Department of Administration is explicitly authorized to create a reserve for active state employees. If the commissioner of administration determines that there is more money in the fund than the amount needed to pay premiums, benefits, and administrative costs for the current fiscal year, the surplus, or so much of it as the commissioner of administration considers advisable, may be invested by the commissioner of revenue in the same manner as retirement funds are invested under AS 14.25.180.

In this section of the statutes, "fund" means the Group Health and Life Benefits Fund, also known as the Group Health and Life Insurance Fund (GHLIF). AS 39.30.095 (e). Department of Administration officials acted on implied parallel authorization to set up RHIF reserve and self-insurance for retirees.

- b. Cash Flow Projections

Under a self-insurance program, the employer collects and holds premiums for future claims. The Division of Retirement and Benefits provides annually updated cash flow projections as reflected in an agreement with Treasury dated May 28, 1998. The agreement, including the FY 1998 cash flow analysis, is shown in [Appendix ZJ](#).

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c. General Management

The Statewide Accounting System (AKSAS) is designed to sweep excess assets (those in excess of immediate daily needs) nightly into a specified Treasury Pool.³⁶ Treasury manages the fund's invested assets under a Reimbursable Services Agreement with the Division of Retirement and Benefits. The RSA is renewed each fiscal year. A copy of the current RSA is on file in Treasury's Accounting Section.

d. Investment Policy – RHIF Major Medical Insurance

Treasury began to manage the RHIF assets as a separate account in July 1998 (AY03). Over the year, daily net cash flows within a given month were as much as 25% of the total portfolio. The RHIF receives one significant contribution during the month and cash outflows occur throughout the month. Therefore, a 30% allocation in short-term instruments is necessary to meet immediate working capital requirements. Treasury will continue to monitor cash flow needs and adjust asset allocation accordingly.

The following table reflects the asset allocation policy applicable to the RHIF Major Medical effective July 1, 1999. The investment policy has a plus or minus band for each investment pool in the allocation to avoid the expense of continually rebalancing the investments.

Short-term Fixed Income Investment Pool	30%	+10%/-30%
Intermediate-term Fixed Income Investment Pool	30%	± 15%
Broad Market Fixed Income Investment Pool	40%	± 15%

Effective July 1, 1999, Treasury's performance benchmark for RHIF Major Medical is:

30%	Three-month U.S. Treasury Bill
30%	Merrill Lynch 1-5 year Government Index
40%	Lehman Brothers Aggregate Index

³⁶ Excess RHIF Major Medical assets are swept into Treasury Pool 98000. Excess RHIF LTC Insurance assets are swept into Treasury Pool 98500.

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e. Investment Policy – RHIF LTC Insurance

The following reflects the interim and target asset allocation policies applicable to the RHIF LTC portion effective July 1, 1999. The target asset allocation will include equities, which Treasury will fund in equal installments on a quarterly basis. In the interim, Treasury will manage these LTC assets (the portion to be invested in equities) in the Short-term Fixed Income Investment Pool. The target investment policy has a plus or minus band for each investment pool in the allocation to avoid the expense of continually rebalancing the investments.

Effective July 1, 1999, the interim target asset allocation policy for the RHIF LTC portion is:

63%	± 20%	Three-month U.S. Treasury Bill
37%	± 20%	Lehman Brothers Aggregate Index

Effective July 1, 1999, the related interim performance benchmark for RHIF LTC portion is:

63%	Short-term Fixed Income Investment Pool
37%	Broad Market Fixed Income Investment Pool

Effective July 1, 1999, the long-term target asset allocation policy for the RHIF LTC portion is (will be fully implemented by July 2000):

36%	± 10%	Broad Market Fixed Income Investment Pool
45%	± 10%	Domestic Equity Collective Funds
19%	± 4%	SOA International Equity Investment Pool

Effective July 1, 1999, the related long-term target performance benchmark for RHIF LTC portion is:

36%	Lehman Brothers Aggregate Index
45%	Russell 3000 Index
19%	MSCI EAFE Index

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5. Control and Reporting Requirements Pertinent to the RHIF

AS 37.10.071(a)(8) requires the fiduciary (i.e., the commissioner of revenue) to maintain accounting records for the RHIF in accordance with generally accepted accounting principles. The commissioner has delegated this responsibility to the state comptroller.

AS 37.10.071(a)(9) requires the commissioner of revenue to engage an independent certified public accountant to perform an annual audit of the financial condition of RHIF and the pertinent investment transactions. To fulfill this requirement, the state comptroller contracts with an independent certified public accountant to perform an annual audit.

Additional accounting and reporting requirements are included in the May 28, 1998 agreement (see [Appendix ZJ](#)).

Version Control

Revision Date	Effective Date	Summary of Changes	Find it in Version
12/31/98	7/1/98	Original draft IPS written.	DRAFT
12/31/98	10/1/98	Treasury revises asset allocation policy to accommodate large swings in working capital. Greater portion of assets now managed in more liquid assets.	DRAFT
7/9/99	7/1/99	The Division of Retirement and Benefits breaks the RHIF into three separate funds. Treasury revises the RHIF asset allocation policy accordingly. RHIF asset allocation was: Short-term Fixed Income Investment Pool - Residual Intermediate-term Fixed Income Investment Pool 49% ±8% Broad Market Fixed Income Investment Pool 43% ±8%	1.2

Effective: 7/1/99

XII: R-6

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S. Oil and Gas Lease Bonus Funds - Investment Policy Statement

The fund's investment policy statement and related material may be found in [Appendix ZI](#). They are preserved there for the purpose of maintaining institutional memory.

Version Control

Revision Date	Effective Date	Summary of Changes	Find it in Version
1/25/00	8/15/90	Added investment policy statement to appendices.	1.3

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T. Margaret Nick Cooke Memorial Trust - Investment Policy Statement

1. Overview

This trust was established in memory of Margaret Nick Cooke of Bethel, Alaska. Margaret Cooke was a leader in cultivating, protecting and advancing Alaska Native arts and language. At the time of her death in 1996, she was a member of the Alaska State Council on the Arts.

2. History

- 1996. Ms. Cooke's family makes arrangements to establish this trust.
- 1997. Private contributions are solicited for this trust and the trust has a balance of approximately \$9,500.

3. Facts and Figures

Fund Balance and Earnings		
<u>Fiscal Year</u>	<u>Balance at June 30</u>	<u>Earnings</u>
1996	1,860	4*
1997	9,773	384
1998	10,532	649
1999	11,361	552
2000	12,034	620

* Earnings for June through December 1996 were distributed in December 1996 (FY 97).

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4. Management

The Trust sponsors an annual award, the Margaret Nick Cooke Award, through the Alaska State Council on the Arts. This award is presented each year to honor a person or persons for furthering Alaska Native arts and language.

The Arts council has the authority to receive gifts, contributions and bequests from private individuals and firms for the purpose of furthering the educational objectives of the Council's programs. AS 44.27.052(a)(4). It is not clear whether this trust was intended as an expendable or a non-expendable trust. Nor is it clear if a legislative appropriation is required to authorize expenditure of the income or principal assets of the Trust.

This trust is currently invested with the GeFONSI. See Section XII(A) for the GeFONSI Investment Policy Statement. The Margaret Cooke Memorial Trust would be a good candidate to be invested in an Enhanced Return GeFONSI if Treasury establishes such a fund. (See Section X(D)).

5. Control and Reporting Requirements

Treasury works with staff of the Alaska State Council on the Arts to assist them in making the best use of Treasury's investment services in relation to this fund.

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Version Control

Revision Date	Effective Date	Summary of Changes	Find it in Version
4/1/00	5/15/99	Added Margaret Cooke Memorial Trust IPS to this manual.	1.3
11/24/00		Inserted fund balances and earnings figures in Facts & Figures section	1.6

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U. Exxon Valdez Oil Spill (EVOS) Investment Fund – Investment Policy Statement

1. Overview

Following a lawsuit and the filing of criminal charges, Exxon Corporation agreed to pay the state and federal governments restitution for damages caused when the Exxon Valdez oil tanker hit Bligh Reef on March 24, 1989. The settlement provided for payment to the state and federal governments as follows:

- Criminal plea agreement for \$150 million with a portion suspended for Exxon’s spill clean up expenses.³⁷
- Criminal restitution of \$100 million. This money was evenly divided between the federal and state governments. The state’s share is deposited in the Oil Restoration Fund.
- Civil settlement of \$900 million,³⁸ paid in annual installments through September 2001. Payments through September 1999 went into a fund that was managed by Court Registry Investment System (CRIS) until the Exxon Valdez Trustee Council approved projects and requested transfers to the applicable state or federal agency. Current balance in this federally managed fund is approximately \$100 million (as of June 15, 2000). The council adopted a long-term reserve policy for this balance and is working to put in place a longer-term investment program for the reserve.

³⁷ The court forgave \$125 million in recognition of Exxon’s spill clean up efforts. Of the remaining \$25 million, \$12 million went to the North American Wetlands Conservation Fund and \$13 million went to the national Victims of Crime Fund.

³⁸ United States of America v. Exxon Corporation, Civil Action No. A91-082CIV and State of Alaska v. Exxon Corporation, Civil Action No. A91-083CIV. The civil settlement has a “re-opener” clause that would allow the governments to make a claim for up to an additional \$100 million to restore resources that suffered a substantial loss, the nature of which could not have been anticipated from the data available at the time of the settlement.

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The Treasury Division will become responsible for implementing the council's investment policy for the reserve upon court approval of the council's investment program. The fund will be called the EVOS Investment Fund.

2. History

- March 24, 1989. Exxon Valdez oil tanker hits Bligh Reef spilling millions of gallons of Alaskan crude oil into Prince William Sound. The state and federal governments subsequently file criminal charges and civil claims for damages.
- October 9, 1991. U.S. District Court approves settlement among the State of Alaska, the United States Government and Exxon Corporation. The civil portion of the settlement creates the Exxon Valdez Trustee Council to oversee expenditure of the settlement money. The settlement mandates use of Court Registry Investment System for investment management.
- 1992. Treasury starts managing council funds that have been approved for expenditure for state projects.
- November 1994. Reserve established to provide a secure source of funding for restoration into the future beyond the last annual payment from Exxon Corporation.
- 1994. Treasury starts advising the council on possible investment approaches for the reserve.
- Council worked with the Alaska Congressional Delegation, the Federal Court, and Exxon to gain the authority to consider investment options beyond what CRIS could provide. (Public Law No. 106-113.)
- July 2000. The Exxon Valdez Trustee Council enters into an agreement with Treasury Division to manage the reserve until designated to projects by the council. Treasury sets up the EVOS Investment Fund to hold this money. Initial funding takes place October 5, 2000.

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3. Facts and Figures

Cash Flows

Exxon makes payments on the civil settlement in annual installments (see the schedule in [Appendix AT](#), page AT-10). As of June 2000, the undesignated portion of the civil settlement held in trust is approximately \$100 million, all of which the CRIS will transfer to Treasury in August 2000.³⁹ In addition, the two final payments are scheduled to arrive at the state treasury on September 1, 2000 and 2001. The dollar amount of expected transfers and payments into the EVOS Investment Fund is as follows:

<u>State Fiscal Year</u>	<u>Expected Contributions</u>	<u>Total Earnings</u>	<u>Ending NAV at Fair Value</u>
2001	170,000,000 ⁴⁰	TBA	TBA
2002	70,000,000	TBA	TBA

The council has adopted a payout schedule, which, after a transitional period, provides for an annual payout of 4.5% of the Fund’s five-year average ending net asset value. (See [Appendix ZY](#)). The council adopted an investment policy with an expected real or inflation adjusted return of 5%. This combination of payout plan and investment policy is expected to inflation-proof the reserve. The council does not intend to spend the “principal” of the reserve.

³⁹ Prior to August 2000, the CRIS managed the undesignated EVOS settlement money until needed to pay for specific expenditures authorized by the Trustee Council. CRIS held the settlement money in two separate accounts at the Federal Reserve Bank in Texas: the liquidity account and the reserve account. The liquidity account is invested in 100-day securities. The reserve account is invested in laddered strip securities.

⁴⁰ \$100 million initial balance plus \$70 million additional from Exxon.

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Flow of Funds

The Trustee Council approves any disbursements from the EVOS Investment Fund. The flow of funds and responsible parties are shown below.

Inflows:

- For incoming money, Treasury's Cash Management Section records deposits to the EVOS Investment Fund (wired by Exxon Corporation to the state's custodian bank) using a collocation code (which points to the associated GASB fund) and a liability account provided by the Alaska Department of Fish and Game (see Management Section for an explanation of their role).
- For earnings, each month Treasury's Accounting Section credits investment earnings to the EVOS Investment Fund.

Outflows:

- For outgoing money, the Trustee Council approves expenditures for restoration projects and administrative costs. A court order is entered by the United States District Court for the District of Alaska to disburse funds.
- For state expenditures, the Legislature appropriates any money the Trustee Council has designated for state agencies. Once appropriated, the Alaska Department of Administration, Division of Finance transfers money from the EVOS Investment Fund to the existing EVOS Expendable Trust (FU33070).⁴¹ Finally, state agencies expend from FU33070 as authorized by the Alaska Legislature.
- If the Trustee Council directs money to Federal agencies (e.g., U.S.F.S), Treasury wires the money directly to federal agency at the request of the Alaska Department of Fish and Game who records the associated GASB fund transaction.

⁴¹ Each time the Trustee Council requests a payment from the EVOS Investment Fund for expenditure by a state agency, the money flows into a state fund called the Exxon Valdez Settlement Fund (GASB Fund 33070) to receive and expend money requested by the Exxon Valdez Trust Council. Assets of this latter fund are held in the GeFONSI, a state investment pool with many other participants, which is described earlier in this document.

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4. Management

The Trustee Council is responsible for deciding how to spend the civil settlement money and is the fiduciary for the portion held in trust pending their decision to spend. The council has adopted an investment policy ([Appendix ZT](#)) and an asset allocation ([Appendix ZU](#)). The council's investment policy calls for the council to review its asset allocation annually. Following a period of due diligence, the Trustee Council selected the Treasury Division to manage these assets in a fund to be called the EVOS Investment Fund.⁴² In July 2000, the Trustee Council, through the Alaska Department of Fish and Game, entered into an agreement⁴³ with the Department of Revenue to provide investment management services for invested assets of the EVOS Investment Fund.⁴⁴ Under the agreement, the Commissioner of Revenue acts as custodian for the EVOS Investment Fund.⁴⁵ (See [Appendix ZV](#).)

Treasury separately manages the EVOS Investment Fund as a participant in State of Alaska investment pools or other mutual fund-like investment options such as the World Common Trust Funds managed by State Street Global Advisors; the Fund does not hold individual securities. The amount invested in the respective investment vehicles is at the direction of the Fund's fiduciary, the Trustee Council. The council's investment procedures for the EVOS Investment Fund are set forth in [Appendix ZT](#). In part, those

⁴² Public Law No. 106-113 allows the settlement money to be deposited "in a federal account ... or in other accounts outside the U.S. Treasury."

⁴³ Subsequent annual renewals of the RSA and are kept on file in Treasury's Asset Accounting Section.

⁴⁴ The Exxon Valdez Trustee Council takes action through a member agency such as the Alaska Department of Fish and Game to fulfill its administrative support functions.

⁴⁵ As a part of the due diligence effort, the council obtained an Attorney General Opinion that advised that it is appropriate for the money to be held in a "state fund". See [Appendix ZW](#), page 7.

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procedures require that “all principal and interest shall be accounted for separately by the custodian.” EVOS staff clarified that earnings on principal do not need to be separately held by the custodian; rather, income must be distinguishable from the principal in the accounting records.

5. Investment Policy

The Trustee Council determines asset allocation policy for the EVOS Investment Fund. At its April 24, 2000 meeting, the council adopted the following asset allocation policy ([Appendix ZU](#)) (Note that Treasury’s management of these assets is currently pending):

42%	± 7%	Broad Market Fixed Income Investment Pool
41%	± 7%	Domestic Equity Investment Pool
17%	± 5%	State of Alaska International Equity Investment Pool

Effective July 2000, the Trustee Council’s performance benchmark for EVOS Investment Fund assets is:

42%	Lehman Brothers Aggregate Index
41%	Russell 3000 Index
17%	Morgan Stanley Capital International Europe, Australia and Far East (EAFE) Index

Each year after capital market assumptions are available, Treasury will work with the council to review the asset allocation for the EVOS Investment Fund. Any change to the asset allocation must be made by unanimous agreement of the council. As authorized by the Trustee Council, the EVOS executive director has discretion to move assets among investment managers and asset categories provided that such actions are consistent with the bands of the council’s adopted strategic asset allocation policy. Treasury will provide guidance relating to investment allocation within the policy to the executive director when the director requests it. (See [Appendix ZT](#), page 12, “Rebalancing Guidelines.”)

Effective: 5/24/00

XII: U-6

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6. Control and Reporting Requirements

Money in the EVOS Investment Fund is held in trust and has not been designated or appropriated by the EVOS Trustee Council. Therefore, invested assets in the EVOS Investment Fund under Treasury management are not included in Treasury's annual consolidated financial statements but are included in the State of Alaska Comprehensive Annual Financial Report with similar agency trust funds. The Trustee Council contracts with an independent CPA firm to audit the invested assets of the EVOS Investment Fund (previously held by CRIS).⁴⁶

The State Comptroller will transmit monthly reports to the Trustee Council's Executive Director for the EVOS Investment Fund. Such reports are set out in the most current Reimbursable Services Agreement covering Treasury investment services.

Version Control

Revision Date	Effective Date	Summary of Changes	Find it in Version
8/11/00	8/14/00	Treasury enters into an agreement to manage the undesignated portion of the Exxon Valdez Oil Spill civil settlement. Added IPS. Money first arrived in the Treasury on October 5, 2000.	1.6

⁴⁶ As of July 2000, the most recent audited financial statement for the EVOS Settlement Account is for the fiscal year end September 30, 1999 (on file in Treasury Division).

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**V. Power Cost Equalization Endowment (PCE) Fund – Investment Policy
Statement**

1. Overview

The Alaska Legislature created the Power Cost Equalization (PCE) Endowment Fund through Chapter 60, SLA 2000 Sec. 6 and 7, codified under AS 42.45.070 (c) effective July 1, 2000.⁴⁷ The PCE Endowment Fund is established as a separate fund of the Alaska Energy Authority, a component unit of the State of Alaska.

The purpose of the PCE Endowment Fund is to provide for a long-term, stable financing source for power cost equalization which provides affordable levels of electric utility costs in otherwise high-cost service areas of the state.

Initial capitalization of the PCE Endowment Fund comes from a \$100 million transfer (authorized by HB 447, Chapter 60, SLA 2000) from the Constitutional Budget Reserve, a fund established through a 1990 electoral vote amending the State Constitution Article IX, Section 17. Additional funding will come from the sale of the four dam hydroelectric project to joint purchasing utilities plus payments received after June 30, 2001 for the sale of power made to the state, future legislative appropriations, and accumulated earnings of the fund.

⁴⁷ Other portions of the Act have effective dates conditioned upon formation of joint purchasing utilities under a memorandum of understanding with the Alaska Energy Authority dated April 11, 2000 and the sale of the four dam pool hydroelectric project. The joint purchasing agencies are the Copper Valley Electric Association, Inc., City of Ketchikan, Kodiak Electric Association, Inc., City of Petersburg and City of Wrangell.

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2. History

- 1993. The Alaska Legislature created the Power Cost Equalization & Rural Electric Capitalization Fund through Chapter 18 SLA 1993 which is codified under AS 42.45.100, effective August 11, 1993. The former Department of Community and Regional Affairs is named as the administering agency (now the Department of Community and Economic Development). Treasury manages the fund's assets in the GeFONSI (which is described earlier in this document).
- 1999. At the start of fiscal year 1999, the Power Cost Equalization & Rural Electric Capitalization Fund held a balance of more than \$21 million. Despite a cash infusion of \$5.5 million into the Fund in late September 1999, the balance is nearly depleted by mid-April 2000.
- 2000. The 21st Legislature, in its second session, took action to reorganize the Power Cost Equalization & Rural Electric Capitalization Fund by authorizing the sale of the four dam pool hydroelectric project to a newly established joint action agency comprised of local public utilities. The proceeds of the sale will be used to establish an endowment fund for the PCE program. Chapter 60, SLA 2000 Sec. 6 and 7, codified under AS 42.45.070 (c).

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3. Facts and Figures

The Power Cost Equalization & Rural Electric Capitalization Fund consists of money transferred to it under AS 42.45.050. The monthly transfers (subject to appropriation) are comprised of 40% of the balance in the Four Dam Pool Fund.⁴⁸ The Power Cost Equalization & Rural Electric Capitalization Fund⁴⁹ is used to make grants to eligible utilities under AS 42.45.180 to improve the performance of the utility, and to help offset the high cost of electric power generation costs relative to other areas of the state.⁵⁰ The chart shown in [Appendix CC](#) depicts the steady decrease in the amount of cash available in the Power Cost Equalization & Rural Electric Capitalization Fund (Fund 11150 in the statewide accounting system, AKSAS).

⁴⁸ The **Four Dam Pool Transfer Fund** established by Chapter 18 SLA 1993, codified under AS 42.45.050, became effective August 11, 1993. The [former] Department of Community and Regional Affairs was the custodian. The fund consists of repayments of principal and income that would have been deposited in the former power development revolving loan fund under AS 44.83.500. Subject to appropriation, the balance of the fund was transferred each month as follows: 40% to the Power Cost Equalization and Rural Electric Capitalization Fund; 40% to the Southeast Energy Fund, and 20% to the Power Project Fund.

The **Southeast Energy Fund** established by Chapter 18 SLA 1993, codified under AS 42.45.040, became effective August 11, 1993. The [former] Department of Community and Regional Affairs was the custodian. The fund consists of money transferred to it under AS 42.45.050 through monthly transfers (subject to appropriation) of 40% of the balance in the Four Dam Pool fund. The fund was used to make grants to utilities participating in the power transmission intertie between the Swan Lake and Tye Lake hydroelectric projects for power projects.

The **Power Project Fund** was established under AS 42.45.010 to make loans to electric utilities, regional electric authorities, municipalities, regional and village corporations, village councils, independent power producers, and non profit marketing cooperatives to pay the cost of reconnaissance studies, feasibility studies, license and permit applications, preconstruction engineering, and design of power projects; constructing, equipping, modifying, improving, and expanding small-scale power production facilities; reconnaissance studies, preconstruction engineering, design, construction, equipping, modification, and expansion of potable water supply including surface storage and groundwater sources and transmission of water from surface storage to existing distribution systems.

⁴⁹ The Power Cost Equalization & Rural Electric Capitalization Fund is a Type 1 GeFONSI participant as described in a Memorandum of Understanding between the Departments of Administration and

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Revenue (on file in Treasury Division). Accordingly, Treasury calculates and credits investment earnings to the PCE Fund.

- ⁵⁰ Alaska has more than 118 independent utilities serving a total population of about 600,000 and covering an enormous range of geographic and economic diversity. The Alaska Energy Authority (AEA), which places emphasis on lowering the costs and increasing the safety and reliability of rural power systems, is responsible for administering the Power Cost Equalization Program. The goal of the program is to provide economic assistance to customers in rural areas of Alaska where, in many instances, the kilowatt-hour charge for electricity can be three to five times higher than the charge in more urban areas of the state.

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4. Management

a. Fiduciary Responsibilities

The Alaska Energy Authority is responsible for administering the PCE Endowment Fund.⁵¹ The Department of Revenue is the fiduciary for invested assets of the new endowment fund as follows (Sec. 42.45.080. Powers and duties of the commissioner of revenue):⁵²

- (a) The commissioner of revenue is the fiduciary of the [Power Cost Equalization Endowment F]und. In managing the fund, the commissioner shall:
 - (1) have the same powers and duties as are provided in AS 37.10.071;
 - (2) invest the fund in a manner likely to achieve at least a seven percent nominal return over time.

- (b) In managing the fund, the commissioner shall:
 - (1) consider the status of the fund's capital and the income generated on both current and probable future bases;
 - (2) determine the appropriate investment objectives;
 - (3) establish investment policies to achieve the objectives; and
 - (4) act only in regard to the best financial interests of the fund.

⁵¹ The Alaska Legislature created the Alaska Energy Authority (AEA) in 1976. AEA's original mission was to construct, acquire, finance, and operate power projects and facilities that utilize Alaska's natural resources to produce electricity and heat. In 1993, under comprehensive energy legislation, oversight of AEA's existing state hydroelectric projects and the Alaska Intertie (Railbelt) was transferred to the Alaska Industrial Development and Export Authority (AIDEA). Programs addressing the energy needs of rural communities were transferred to a newly-created Division of Energy within the (former) Department of Community and Regional Affairs (now merged with the Department of Community and Economic Development). In 1999, rural energy programs were integrated into AEA, with AIDEA oversight and management. Both AEA and AIDEA share a 5-member board of directors.

⁵² The Division of Finance established the new endowment fund in the statewide accounting system as the "Power Cost Equalization Endowment" (AKSAS Fund 33065).

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(c) On July 1 of each year, the commissioner shall determine the monthly average market value of the fund for the previous three fiscal years [following a transition period as noted in Chapter 60, SLA 2000 Sec. 14].⁵³

b. Authorized Uses

Sec. 42.45.085. Use of the power cost equalization endowment fund.

(a) Seven percent of the amount determined by the commissioner of revenue on July 1 of each year under AS 42.45.080(c) may be appropriated for the fiscal year beginning the following July 1 for the following purposes:

- (1) funding the power cost equalization and rural electric capitalization fund (AS 42.45.100);
- (2) reimbursement to the Department of Revenue for the costs of establishing and managing the fund; and
- (3) reimbursement of other costs of administration of the fund.

(b) Nothing in this section creates a dedicated fund.

Sec. 42.45.099. Definition. In AS 42.45.070 - 42.45.099, "fund" means the power cost equalization endowment fund established in AS 42.45.070.

5. Investment Policy

There are two primary factors driving the asset allocation policy of the PCE Endowment Fund: (a) the legislative mandate to invest the fund in a manner likely to achieve at least a seven percent nominal return over time, and (b) seven percent of the amount determined by the commissioner of revenue on July 1 of each year under AS 42.45.080(c) may be

⁵³ See "Control and Reporting Requirements" Section of this policy statement regarding interim funding formulas. Annual transmittal memoranda are on file in Treasury Division's Asset Accounting Section.

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appropriated annually. Treasury would invest the PCE Endowment Fund with the following in mind:

- | | |
|-----------------------|---|
| Risk Tolerance | High. The Commissioner of Revenue is to invest the fund in a manner likely to achieve at least a seven percent nominal return over time. |
| Investment Objectives | High exposure of principal to loss in return for higher expected longer-term returns.
Limited current income requirement.
Limited inflation protection needed.
Moderate liquidity requirement. |
| Time Horizon | Long. |
| Other Constraints | Seven percent of the amount determined by the commissioner of revenue on July 1 of each year under AS 42.45.080(c) may be appropriated annually. |

Effective July 1, 2000, Treasury's investment policy for the PCE Endowment Fund is:

- | | |
|----------|--|
| 42% ± 7% | Broad Market Fixed Income Investment Pool |
| 41% ± 7% | Domestic Equity Investment Pool |
| 17% ± 5% | State of Alaska International Equity Investment Pool |

Effective July 1, 2000, Treasury's performance benchmark(s) for the PCE Endowment Fund is:

- | | |
|-----|--|
| 42% | Lehman Brothers Aggregate Index |
| 41% | Russell 3000 Index |
| 17% | Morgan Stanley Capital International Europe, Australia, and Far East Stock Index |

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6. Control and Reporting Requirements

On July 1 of each year, the Commissioner [of Revenue (or designee)] shall determine the monthly average market value of the [PCE Endowment] fund for the previous three fiscal years [following a transition period as noted in Chapter 60, SLA 2000 Sec. 14].⁵⁴

Sec. 42.45.080(c).⁵⁵ The Commissioner [or designee] sends the results of the calculation to the Alaska Energy Authority. The Alaska Energy Authority then uses this information to construct their budget request relating to the state's power cost equalization program.

Under AS 37.10.071(a)(9), the invested assets of the PCE Endowment Fund are subject to an annual independent audit. The State Comptroller contracts with an independent certified public accountant to perform an annual audit of the Fund. Within 90 days after

⁵⁴ **Chapter 60, SLA 2000 Sec. 14.** The uncodified law of the State of Alaska is amended by adding a new section to read: INTERIM DETERMINATION OF AMOUNTS AVAILABLE FOR APPROPRIATION.

Notwithstanding AS 42.45.080(c) and 42.45.085(a), enacted by sec. 6 of this Act, the amount that may be appropriated from the power cost equalization endowment fund (AS 42.45.070, enacted by sec. 6 of this Act) shall be determined as follows:

(1) for fiscal year 2002, the amount that may be appropriated from the power cost equalization endowment fund (AS 42.45.070, enacted by sec. 6 of this Act) is seven percent of the market value of the fund on February 1, 2001;

(2) for fiscal year 2003 through the first fiscal year that begins after the closing date of the sale of the four dam pool hydroelectric project under the memorandum of understanding, the amount that may be appropriated annually from the power cost equalization endowment fund (AS 42.45.070, enacted by sec. 6 of this Act) is seven percent of the market value of the fund on February 1 of the prior fiscal year;

(3) for subsequent fiscal years, the commissioner of revenue shall exclude the time period and market value of the power cost equalization endowment fund (AS 42.45.070, enacted by sec. 6 of this Act) before the closing date of the sale of the four dam pool hydroelectric project in making the determination required under AS 42.45.080(c), enacted by sec. 6 of this Act.

The definitions contained in sec. 15(d) of this Act apply to the terms used in this section.

⁵⁵ Sec. 42.45.099. Definition. In AS 42.45.070 - 42.45.099, "fund" means the power cost equalization endowment fund established in AS 42.45.070.

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the completion of the audit, the State Comptroller transmits a copy of the audited report to the Alaska Energy Authority. Alternatively, the audit report may be distributed at the Authority's next scheduled board meeting. Treasury Division shall also provide interim monthly financial statements to the Alaska Energy Authority.

Since the Alaska Energy Authority maintains a separate accounting system, Treasury Division provides a monthly trial balance report for the PCE Fund generated by the Alaska Statewide Accounting System (following posting of prior month investment activity).

To assist the Alaska Energy Authority in preparation of their annual audit (fiscal year ends June 30), Treasury Division provides fiscal year-to-date realized and unrealized capital gains for each investment pool in which the PCE Fund participants. Treasury also facilitates fiscal year end account balance confirmation requests through the custodian bank. The fund's permanent file in Treasury's Asset Accounting Section contains additional information concerning custodian reports required for account balance confirmation.

Payment for the cost of investing assets of the PCE Endowment Fund is set forth in a reimbursable service agreement (RSA) with the Alaska Energy Authority. The State Comptroller updates the RSA annually on or before July 1 (or prior to the first day of service).

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Version Control

Revision Date	Effective Date	Summary of Changes	Find it in Version
5/24/01	5/24/00	Governor signed enabling legislation for the new Power Cost Equalization Endowment Fund effective May 24, 2000; Treasury Division begins to manage invested assets of the new PCE Endowment Fund on July 3, 2000 (actual transfer date).	1.8

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XIII. Securities Lending Program

From early 1991 through mid-1995 Treasury had in place a securities lending program that covered all public securities under management. Treasury staff terminated the program in early 1995 for several reasons.⁵⁶ Following changes in the industry that help reduce risk and improve monitoring capabilities, Treasury staff recommended reestablishment of a securities lending program. See [Appendix CA](#).

On January 4, 2001, Treasury entered into an agreement with State Street Bank & Trust Co. to lend securities for selected investment pools and participants shown in [Appendix ZE](#).⁵⁷ The program is intended to include all assets not precluded from lending by statute or other constraints except for the Non-retirement Domestic Equity Investment Pool. The following funds or investment pools currently do not participate pending fiduciary approval or for other reason(s) as noted:

⁵⁶ See [Appendix CA](#), page 1.

⁵⁷ Contract term is January 4, 2001 ending December 31, 2005. The current contract is on file in the Department of Revenue, Division of Administrative Services. Program costs are paid directly from participating accounts.

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<u>Account</u>	<u>Entity</u>
AY02	Exxon Valdez Oil Spill Investment Fund
AY12	University of Alaska Endowment Trust Fund
AY15	Alaska Student Loan Collateral Receipts*
AY16	Alaska Student Loan Bond Proceeds*
AY27	Alaska Advance College Tuition Savings Fund
N/A	Non-retirement Domestic Equity Investment Pool**

* Bond covenants specify permitted investments and collateral restrictions.

** Includes the S&P 500 Index Common Trust Fund and the Russell 3000 Index Common Trust Fund.⁵⁸

The custodian bank's systems are designed to allocate income based on each participant's pro rata share in the respective pool(s) in which they are invested. Since certain entities do not participate in the securities lending program, the bank's accounting systems are currently unable to automatically allocate the income to participating funds. Therefore, Treasury's Asset Accounting Section allocates securities lending income in accordance with the procedures set forth in [Appendix CB](#).⁵⁹

⁵⁸ These domestic equity investments are made through a collective trust vehicle. The Russell 3000 Index CTF assets can not at this time participate in the program developed for the balance of the State's assets. They could be lent but under a program that does not provide as much protection. These assets are not attractive assets to lend so the revenue loss for not lending them is minor. Therefore, the pool does not engage in securities lending at this time.

⁵⁹ Treasury's securities lending program is modeled after that of the state pension trust funds' program. The Alaska State Pension Investment Board (ASPIB) approved participation in a securities lending program at their December 3, 2000 meeting. See ASPIB Resolution No. 2000-12 (includes only defined benefit plans, not defined contribution or deferred compensation plans). Treasury's Asset Accounting Section staff allocate securities lending income to the participating pension trust funds in accordance with the procedures set forth in [Appendix CB](#).

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XIV. Commission Recapture Program

Program Overview

On April 2, 2001, Treasury Division entered in a directed brokerage program with the Citation Group of Merrill Lynch (the broker) to capture a portion of commission fees stemming from trading for certain funds under management that participate in the SOA International Equity Investment Pool (AY 66). The third party brokerage agreement is shown in [Appendix EA](#).

For domestic equity transactions a ratio of 1.50 will be used to calculate the rebate such that for each \$1.00 the broker pays to the state it will have received \$1.50 in commissions from state-originated transactions. For international equity transactions a ratio of 1.65 will be used to calculate the ratio such that for each \$1.00 the broker pays to the state it will have received \$1.65 in commissions from state-originated transactions

Management and Monitoring Responsibilities

The Portfolio Management Section authorizes certain international equity managers to process brokerage transactions through the broker, monitors participation rates, and provides instructions for the broker to wire rebates to the state's master custodian bank, State Street Bank & Trust Co.

Accounting Treatment

The Asset Accounting Section within Treasury Division separately accounts for rebates from the commission recapture program and ensures fair allocation to funds participating in the SOA International Equity Pool.

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XV. Investment Practices and Investment Restrictions

A. Standard Practices

1. Execution

The Commissioner has delegated authority to invest as follows:

a. Domestic Fixed Income

The Commissioner has delegated the investment authority for this class of investments to the investment officers of the Portfolio Management Section of the Treasury Division, through the Chief Investment Officer, by written delegation included in [Appendix I](#). The investment officers in the Portfolio Management Section select, execute, and manage all fixed income investments in conformance with the investment policies and standards established elsewhere in this document subject to the following exceptions:

- The State Mortgage Insurance Fund.
- Unexpended daily cash surpluses that arise at the master custodian bank. The bank is authorized to invest these balances for an overnight period under the terms of Treasury's custody contract and the Public Securities Association (PSA) Master Repurchase Agreement.
- Unexpected daily cash surpluses that may arise at state banks with which Treasury has collateral agreements. The Cash Manager has authority to invest these balances for an overnight period in repurchase agreements. The Commissioner has delegated this investment authority by written delegation included in [Appendix ZG](#).
- Certificates of deposit held as compensating balances. The Cash Manager has the authority to make arrangements for the purchase of these certificates of deposit. This authority includes purchasing zero-interest certificates of deposit at state banks to offset bank fees as provided in AS 37.10.075 and the pertinent contract. The

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Commissioner has delegated this investment authority by written delegation included in [Appendix ZG](#).

b. Real Estate Mortgages

The Commissioner has delegated the authority to enter into transactions involving real estate mortgages to the Real Estate Investment Officer and the Mortgage Loan Supervisor of the Treasury Division, through the Chief Investment Officer, by written delegation included in [Appendix I](#). Treasury is not making direct mortgage loans or purchasing mortgage loans. The staff is currently responsible for: (1) the administration of existing mortgage loans; (2) dealing with judgments pertinent to mortgage loans; and (3) dealing with and disposing of other real estate owned.

c. Domestic Equities

The Commissioner has delegated the authority to purchase interests in domestic equity securities to State Street Bank Global Advisors (SSGA) under the terms of the World Index Common Trust Fund's Declaration of Agreement (Fourth Amendment and Restatement effective November 1, 1995). Subsequent amendments are on file in Treasury's Accounting Section. SSGA may invest the assets in domestic equities in one or more of the World Common Index Trust Funds under the provisions and limitations of the applicable Declaration of Trust Agreement, as amended.

d. International Equities

The Commissioner has delegated to Lazard Asset Management the authority to actively manage an international equity portfolio under the contractual provisions agreed upon

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with the State of Alaska, Department of Revenue. Subsequent contract amendments and/or extensions are on file in Treasury's Accounting Section.

2. Pricing

Treasury's objective in buying and selling "priced" securities is the lowest price when purchasing and the highest price when selling. When Treasury buys or sells "non-priced" securities, Treasury aims to achieve "prevailing rates." To achieve these objectives, the following policies apply:

- All U.S. Treasury and federal agency transactions must be executed with U.S. Treasury primary dealers with at least \$200 million in capital using competitive procedures or directly with one U.S. Treasury primary dealer when such execution is reasonably expected to be equal to or better than the competitive execution.
- All mortgage backed securities must be executed with U.S. Treasury primary dealers with at least \$200 million in capital using competitive procedures or directly with one U.S. Treasury primary dealer when such execution is reasonably expected to be equal to or better than the competitive execution.
- All corporate debt securities must be executed with U.S. Treasury primary dealers with at least \$200 million in capital using competitive procedures or directly with one U.S. Treasury primary dealer when such execution is reasonably expected to be equal to or better than the competitive execution.
- All common stock transactions must be executed in national stock exchange markets or over-the-counter markets by the contracted manager. The manager is obligated to obtain prompt execution of orders at the most favorable prices reasonably obtainable. The manager may execute trades of equity securities in the block trade market based on one or more of the following: (1) the size of the transaction; (2) greater speed of execution; (3) better prices; or (4) lower commission costs.
- All other investments including repurchase agreements, commercial paper, marketable bank paper, asset-backed securities and options, futures and forwards must be executed at prevailing national rates.
- Miscellaneous

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- To prevent the risk of releasing investments or cash without receiving the offsetting cash or investments, all investment transactions must be made on the basis of delivery versus payment (DVP). Without exception, no payments may be made nor investments delivered against "due bills." (A "due bill" is a written promise to deliver an investment, or to make payment for the delivery of an investment, at a future time or date.)
- Contracted managers are authorized and must vote any or all of the securities held by them for the accounts of the funds managed for Treasury. In voting, the manager shall act prudently in the interest and for the benefit of the applicable fund's beneficiaries.

3. Prohibited Transactions

The following transactions are prohibited with respect to the funds for which Treasury is responsible unless those transactions have the prior written consent of the Commissioner:

- Short sale of securities (the sale and settlement of a security not currently owned by the Treasury Division and a formal agreement to borrow the security to facilitate the settlement of the short sale);
- Purchases of futures, forwards or options for the purpose of speculating (currency futures, forwards and options are permitted only for hedging or to facilitate otherwise permissible transactions);
- Borrowing to leverage the return on investments with the exception of borrowing from the Short-term Fixed Income Investment Pool. Borrowing from the Short-term Fixed Income Investment Pool may occur for short periods of time in the normal course of state operations. In addition, extended settlement of securities purchases executed to facilitate or improve the efficiency of a transaction will not be considered borrowing, provided that sufficient cash equivalent securities or receivables are available to facilitate the extended settlement;

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- Purchases of "private placement" or unrated corporate bonds;
- Purchases of more than 10% of a corporate bond issue; and
- Purchases of more than 5% of the outstanding stock of a company.

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**XVI. Investment Policies Pertaining to Funds Under the Policy Control of the
Alaska State Pension Investment Board**

A. The Alaska State Pension Investment Board / Treasury Relationship

Pursuant to AS 37.10.260 and AS 44.25.020(6), the Department, acting through the Treasury Division (Treasury), provides the staff to the Alaska State Pension Investment Board (ASPIB).

The statutes pertinent to the ASPIB's fiduciary responsibility for various funds are set forth in [Appendix BA](#). Those funds are:

- Public Employees' Retirement Trust Fund;
- Teachers' Retirement Trust Fund;
- Judicial Retirement Trust Fund;
- National Guard and Naval Militia Retirement Trust Fund;
- State Deferred Compensation Plan; and
- State Supplemental Benefits System.⁶⁰

As described more fully in Section V of this publication, the Commissioner of Revenue was the fiduciary of the first four retirement trust funds listed above before the creation of the ASPIB in 1992. Following the enactment of the legislation creating the ASPIB and the appointment of the members of that Board, there was a transition period before the ASPIB formally assumed the responsibility for the retirement trust funds listed above. The ASPIB assumed that responsibility on June 30, 1993. The pertinent ASPIB resolution may be found in [Appendix BB](#) of this publication.

⁶⁰ Does not include in-transit contributions and withdrawals held in trust under the Revenue Commissioner's fiduciary responsibility.

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There is an annually updated Reimbursable Services Agreement (RSA) delineating Treasury's responsibilities to the ASPIB. An example of the RSA between the ASPIB and Treasury is included in [Appendix BC](#). The current year RSA is on file in the State Comptroller's Office.

B. Delegations of Authority from ASPIB to Treasury

In addition to the delegations of authority derived from the RSA set forth in [Appendix BC](#), ASPIB, by resolution, has made other important specific delegations to Treasury. The Delegation of Investment Authority is shown in [Appendix ZQ](#).

C. ASPIB Objectives and Policies and Asset Allocations for the Four Retirement Systems

See [Appendix BE](#).

D. ASPIB Domestic Fixed Income Policy and Guidelines

See [Appendix BF](#).

E. ASPIB Equity (Stock) Policy and Guidelines

See [Appendix BG](#).

F. ASPIB International Fixed Income Policy and Guidelines

See [Appendix BH](#).

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G. ASPIB Real Estate Policies and Procedures; Real Estate Investment Guidelines; and Real Estate Investment Plan

See [Appendix BI](#).

H. ASPIB Policy Relating to Direct Mortgages and Other Direct Loans

The Public Employees' (PERS) and Teachers' (TRS) Retirement Trust Funds were once heavily invested in direct mortgage loans and other direct loans. In Fiscal Year 1985, when the combined total of direct loans reached approximately \$500 million, policy makers reversed the policy of investing these funds in direct loans. Through 1980, the direct loan investments were solely in Alaska loans. From 1981 to 1985, the Funds held mortgages nation-wide.

[Appendix BK](#) reflects the history of these direct loan investments for fiscal year 1975 through 1993. Note that the proportion of the two funds invested in direct mortgages reached its apex in 1978. ASPIB has continued the policy of liquidating the direct loan portfolios. That policy is reflected in [Appendix BJ](#). As of May 1, 1997, the remaining balances in the two portfolios combined are:

Principal Balance	\$ 5,330,272.17
Less Loan Loss Reserve	\$ <u>(1,937,792.60)</u>
Book Balance	\$ <u>3,392,479.57</u>

I. ASPIB Private Equity Policy and Guidelines

See [Appendix ZR](#).

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XVII. Policies Pertinent to the State Comptroller

A. Preserving Institutional Memory and Basic Governing Documents

The State Comptroller is responsible for ensuring that Treasury is properly accountable for the funds it manages and that all of Treasury's investment activities are subject to appropriate controls. One of the major purposes of maintaining this publication is to properly document Treasury's authority and activity with respect to the funds it manages. With respect to the Treasury-managed funds, maintaining this publication coupled with supplemental permanent files for each fund should sufficiently ensure the necessary basic documentation for each fund. The current account list of Treasury-managed funds is shown in [Appendix ZE](#).

The "AY Accounts" shown in [Appendix ZE](#) are the separate accounts Treasury has established at the custodian bank. Treasury's custodian bank establishes these accounts, upon request from the state per terms of the custody contract. The State Comptroller is responsible for ensuring any additions are properly authorized in writing and made part of the contract files.

[Appendix ZE](#) also reflects the "AY Accounts" and "QD Accounts" at State Street Bank and Trust Company pertinent to the State's Supplemental Benefits System and the State's Deferred Compensation Plan.⁶¹ Like the "AY Accounts," "QD Accounts" are also separate accounts Treasury has established at the custodian bank.

Finally, the State Comptroller maintains a comprehensive description of all the funds that may have assets invested in the GeFONSI. See [Appendix Q](#).

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B. Monthly Reports

The State Comptroller is responsible for the monthly preparation of the Statement of Invested Assets and Statement of Investment Income and Changes in Invested Assets for the following funds:

- Public Employees' Trust Fund
- Teachers' Retirement Trust Fund
- Judicial Retirement Trust Fund
- National Guard and Naval Militia Retirement Trust Fund
- Supplemental Benefits System Plan
- Deferred Compensation Plan
- General Fund and Other Non-segregated Investments
- Alaska Student Loan Corporation
- Constitutional Budget Reserve Fund
- Public School Trust Fund
- Alaska Children's Trust
- Investment Loss Trust Fund
- Alaska College Tuition Savings Fund
- International Airports Funds
- Supplemental Benefits System Trust Fund
- Retiree Health Insurance Fund
- Exxon Valdez Oil Spill Investment Fund
- Power Cost Equalization Endowment Fund

In addition, the monthly Retirement Trust Funds' reports include analyses of the retirement funds at the manager and participant level, as well as budget updates.

Treasury does not include Alaska Student Loan Corporation assets in the annual audit. Treasury prepares and records the appropriate month-end investment adjusting journal entries for the Corporation. The Corporation includes the investment balances in their own reports and audited financial statements.

⁶¹ As reflected elsewhere in this publication, the ASPIB is the fiduciary for the trust funds pertinent to the

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C. Annual Audits

The State Comptroller is responsible for preparing the annual financial statements and contracting with an independent certified public accounting firm to perform audits of the following funds at June 30:

- Public Employees' Trust Fund
- Teachers' Retirement Trust Fund
- Judicial Retirement Trust Fund
- National Guard and Naval Militia Retirement Trust Fund
- General Fund and Other Non-segregated Investments (GeFONSI)
- Constitutional Budget Reserve Fund
- Public School Trust Fund
- Children's Trust
- Alaska Advance College Tuition Savings Fund
- International Airports Funds
- Investment Loss Trust Fund
- Supplemental Benefits System Trust Fund
- Retiree Health Insurance Fund
- Power Cost Equalization Endowment Fund

D. Special Reports to Boards and Commissions

The State Comptroller is responsible for providing:

- The latest monthly financial reports of the Retirement Trust Funds to the Alaska State Pension Investment Board's Liaison Officer for inclusion in the regular meetings;
- The annual audit of the Retirement System Trust Funds to the Board's Liaison Officer for inclusion in their annual report;
- Quarterly financial reports to the boards of the Public School Trust Fund; the Alaska Children's Trust; and

state's Supplemental Benefits System and Deferred Compensation Plan.

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- The annual proposed budget of the Alaska State Pension Investment Board for their adoption.

E. Special Meetings with Boards and Commissions

The State Comptroller is responsible for contacting the Department of Education to arrange for a meeting of the Public School Advisory Board for the purpose of reviewing the prior year's performance and audited financial statements.

The State Comptroller also provides pertinent investment and contribution information to the Alaska Children's Trust Board when requested.

F. Special Reports to the Legislature

1. Alaska Marine Highway Funds

The State Comptroller is responsible for calculating the monthly earnings on Alaska Marine Highway System Vessel Replacement Fund and the Alaska Marine Highway System Fund. AS 37.05.550 and AS 19.65.070, respectively. The State Comptroller, per statute, is to prepare a report by the 10th legislative day of each regular session that reflects the prior year's earnings and the current and next fiscal years' projected earnings. The State Comptroller shall notify the Legislature that the report is available. It should be noted that Treasury does not distribute the earnings unless they are specifically appropriated by the Legislature.

2. Constitutional Budget Reserve Fund

The State Comptroller is responsible for preparing a report setting out the balance in the CBRF on January 1 and December 31 of the previous calendar year. The report must include the nominal, real and realized return on the CBRF compared to those of the

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Permanent Fund and the General Fund during the previous calendar year. AS 37.10.430.

The report is due to the legislature by March 15 each year.

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XVIII. Policies Pertinent to the Cash Manager

A. Establish and Maintain Control Systems to Capture, Record and Report Bank Activity

The Cash Manager is responsible for collecting and recording state revenues. To meet this requirement, a network of banks is established for receiving and consolidating State deposits. Cash Management polls each of these banks daily and obtains a report of all receipts and disbursements. The results of this polling are processed through a Treasury subsystem that prepares the information for a batch interface into the State accounting system. Programming and other technical support required for the Treasury subsystem will be completed internally by Cash Management personnel, with support, as needed by Treasury Data Processing staff.

B. Project the State's Cash Flow Needs

The Cash Manager is responsible for projecting the State's cash flow needs on both a daily and an annual basis. Daily cash projections consist of determining cash available for investment. Monthly projections will evaluate cash required on an annual basis and estimated borrowing from the Constitutional Budget Reserve Fund (CBRF).

To determine the amount of cash available for investment in excess of amounts necessary for operations, Cash Management uses a cash availability projection model that accounts for the consolidation of deposits made at the Alaskan Banks together with the projected cash inflows and outflows at the State's custody bank. From the total cash available, the amount of warrants to be presented that day are deducted, and this amount is from the State's custody account to the warrant clearing account. The remaining balance of represents cash available for investment. The projected cash availability (positive or

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negative) is given to Portfolio Management for inclusion with the net investment position for the day. As part of this analysis, Cash Management also extracts data from the State's accounting system that reflects the daily balances due to or due from the general fund and 19 other funds managed by the Portfolio Management section. Of the 19 funds, 5 require the transfer of cash to or from the General Fund. Cash Management must maintain sufficient balances in these funds, and in the General Fund to meet the daily transfer requirements.

Monthly cash flow analysis will compare cash available plus anticipated revenues to expenditures projected for each month of the current Fiscal Year. This analysis is used to determine whether the State will have adequate cash balances to meet its spending needs during the current Fiscal Year. If the State's General Fund does not have adequate cash balances to meet its needs, this analysis will report total borrowing from the CBRF required for the year. This report shall be prepared for general distribution at the end of each quarter.

C. Monitor Cash Balances

Cash Manager must ensure that adequate cash balances exist to fund State operations. To determine cash available for operations, Cash Management takes the amount of Cash with Treasury Pool less Warrants Outstanding on the State's accounting system. If the daily balance of cash available for State operations drops below \$150 million, the State is in a cash deficiency situation. When a deficiency occurs, the appropriate steps, as stated in the Cash Deficiency Operating Plan, will be followed (See [Appendix DA](#)).

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D. Establish and Manage Banking Contracts And Relationships

The Cash Manager is responsible for providing the majority of the financial services required by the State for the receipt and disbursement of funds. The Cash Management Section issues and manages the depository concentration, lockbox, warrant clearing and processing, check collection, credit card acceptance, and debit ACH payment contracts in accordance with the State's procurement policies. All Requests for Proposals and contract awards made by Cash Management are drafted not only to obtain the required services at the most competitive price, but also provide a high level of detail for the handling of the respective service. The contracts managed in the section are up for renewal every three to five years. To minimize the impact that changes in banking relationships may have on State agencies, the State has its own ABA number. This allows the bulk of the State's critical banking information to remain the same even when the State changes banks.

Listed below are highlights of the services provided by the section's contracts.

1. Depository Concentration

Depository and concentration contracts allow agencies located around the State to deposit funds in bank branch offices that are conveniently located near each agency. These funds are then transferred daily to the warrant clearing account to provide funding for State warrants clearing the next day.

2. Lockbox Services

Lockbox services are used by the State to facilitate the collection and processing of payments to the State. Remitters are instructed to send their payments and, in most cases,

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a payment coupon to a specific Post Office Box. The financial institution retrieves and opens the mail, sorts the transactions as instructed and then deposits the checks and processes the payment coupons. The State is then provided an electronic report, on a daily basis, identifying the remitters together with a summary total of the amount deposited to the State's account. The following divisions are currently involved in lockbox processing of cash receipts:

- Department of Commerce and Economic Development, Division of Investments
- Alaska Commission on Postsecondary Education
- Department of Commerce & Economic Development, Division of Occupational Licensing

3. Warrant Clearing and Processing Contract

The issuance of warrants is the primary method of payment utilized by the State. For the purpose of payment and accounting, State warrants are broken into (2) two categories. Those issued by the Department of Administration and those issued by the Department of Labor.

The warrant-clearing bank is responsible for:

- Obtaining and advising the state of the dollar amount of warrants to be presented each business day
- Providing payment to the presenting financial institutions
- Electronically transmitting individual warrant detail
- Reprocessing or returning warrants as advised
- Providing images of each day's warrant presentments on CD-ROM
- Retaining warrants for 90 days
- Providing original or microfilm copies as requested
- Accepting and processing warrants submitted on collection

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Cash Management's management responsibilities with regard to this contract include monitoring presentments, working warrant exceptions lists, reviewing and recording adjustments, processing warrant and forgery requests, and maintaining custody of CD-ROM images of all paid warrants.

4. Check Collection

This contract is with a collection agency to provide collection of checks that have been rejected by the maker's bank due to insufficient funds (NSF). The depository banks automatically represent NSF checks. If the checks are again rejected, the check amounts are then charged back to the accepting State agency and the checks are forwarded to a collection agency outside the State system.

5. Credit Card Acceptance

The credit card acceptance and processing contract allows State agencies to accept credit cards as payment for services. Agencies process credit card information, including account number and amount charged manually, electronically, using a point of sales device, or via a touch tone phone or the Internet and pass the information to a third-party processor. The processor then passes it on to the card issuer. Payment is remitted two days after the transaction date. State agencies implementing the credit card acceptance program include:

- Department of Administration - Division of Motor Vehicles, Pioneer Homes
- Department of Commerce - Measurement & Standards, Alaska Seafood Marketing Institute, Occupational Licensing
- Department of Transportation - Alaska Marine Highways
- Department of Natural Resources - Public Information Offices, District Recorder
- Department of Fish & Game - Licensing

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Except for the Credit Card Acceptance, Check Collection, and ACH Debit contracts, all bank fees assessed for services provided by the banking contracts are paid using compensating balances as authorized under AS 37.10.075 (d). The earnings rate is roughly based on the 91-day Treasury bill and is reduced by the amount of service fees for the month.

6. Other Contracts

Two other contracts are important to, but not managed directly by, Cash Management. These are the direct deposit and financial electronic data interchange contract and the State funds custody contract. The Department of Administration, Finance Division administers the direct deposit and financial electronic data interchange contract which governs the electronic payroll, Unemployment Insurance, and vendor payments made by the State.

The Asset Accounting section of the Treasury Division administers the custody contract. This contract governs the Cash Management services provided by the State's custodial bank. The custodial bank is the primary concentration bank for all large dollar deposits to the State. The services covered under the custody contract include the receipt and disbursement of domestic and foreign funds transfers, transfers between the general and segregated funds, and the electronic reporting of these transactions. The state uses the custodial bank's electronic funds transfer system for all distributions and settlements made by fedwire or ACH. The contract also accommodates the manual transfer of funds, which are commonly used for the payment of foreign obligations. Due to the sensitivity and finality of electronic payments, the section has established a security process that requires multiple authorizations together with written confirmation of banking instructions for all outgoing transactions originated by the section.

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7. Debit ACH Revenues

The Debit ACH contract arranges for a third party processor to set up a system using a touch-tone phone number or the Internet. Payers to the State can then instruct the system to debit their bank accounts and make payment to the State electronically. This system can be used for the collection of a wide variety of payments to the state, including corporate and other tax, royalty, child support, unemployment insurance, retirement benefits, and insurance revenues.

E. Establish and Maintain the Cash Management Agreement with the Federal Treasury

The Cash Management Improvement Act Agreement with the Federal Treasury outlines the drawdown procedures for federally funded programs. The Cash Manager is responsible for establishing and maintaining the Cash Management Agreement, centralized processing of daily requests for federal monies owed the state, and monitoring State agencies for compliance with the agreement.

F. Collateralize State Deposits

The Cash Manager is responsible for establishing and monitoring the collateralization of the State's deposits. Collateralization is the process of pledging assets as collateral for State deposits to protect those deposits in the event of a bank failure. Acceptable collateral is currently defined as U.S. Treasury Bonds, Notes, Bills and agency guaranteed obligations approved by Portfolio Management. An eligible trustee holds the pledged assets for safekeeping. The State requires its depository banks to collateralize State deposits to the extent that they exceed insurance coverage provided by the Federal Deposit Insurance Corporation (FDIC). The market value of assets pledged for State

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deposits is about \$30 million. The Cash Manager must periodically reevaluate the deposit balances to ensure that collateral levels are not exceeded.

G. Provide consulting services to improve employee productivity and cash processing

The Cash Manager is involved with all processes requiring the receipt or disbursement of cash, and is the primary facilitator between State agencies and the State's depository banks. The Cash Manager is responsible for establishing all bank accounts and night depository agreements, distributing bank supplies, and assisting agencies in recording all bank adjustments, returned items and liquidations of suspense receipts. Additionally, this involvement often results in assisting other State agencies in determining more efficient ways in which to receive or disburse cash. Recently, Cash Management has been involved in assisting agencies with the following special projects:

- Direct deposit
- Department of Administration - payroll and vendor payments
- Department of Labor - unemployment insurance
- Department of Revenue - child support, permanent fund dividends
- Direct Payment
- Department of Administration, Division of Motor Vehicles - dealer payments
- Department of Revenue - corporate taxes, child support
- Electronic benefit transfer cards - Department of Health and Social Services - public assistance programs
- New warrant stock issuance
- Women and Infant Children

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