



STATE OF ALASKA
GROUP HEALTH AND LIFE FUND
(An Internal Service Fund of the State of Alaska)

Financial Statements

June 30, 2012 and 2011

(With Independent Auditors' Report Thereon)

STATE OF ALASKA
GROUP HEALTH AND LIFE FUND
(An Internal Service Fund of the State of Alaska)

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KPMG LLP
Suite 600
701 West Eighth Avenue
Anchorage, AK 99501

Independent Auditors' Report

The Division of Retirement and Benefits and
Members of the Alaska Retirement Management Board
State of Alaska Group Health and Life Fund:

We have audited the accompanying statements of net assets of the State of Alaska Group Health and Life Fund (the Plan), an Internal Service Fund of the State of Alaska, as of June 30, 2012 and 2011, and the related statements of revenues, expenses, and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets of the State of Alaska Group Health and Life Fund as of June 30, 2012 and 2011, and the changes in net assets and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Management's discussion and analysis is not a required part of the financial statements, but is supplementary information required by the Governmental Accounting Standards Board (GASB). We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit this information and express no opinion on it.

KPMG LLP

October 22, 2012

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Management's Discussion and Analysis

June 30, 2012 and 2011

This section presents management's discussion and analysis (MD&A) of the Group Health and Life Fund's (the Plan) financial condition and performance for the years ended June 30, 2012 and 2011. This section is presented as a narrative overview and analysis. Please read the MD&A in conjunction with the financial statements and notes to financial statements to better understand the financial condition and performance of the Plan during the fiscal years ended June 30, 2012 and 2011. Information for fiscal year 2010 is presented for comparative purposes.

Financial Highlights

The Plan financial highlights as of June 30, 2012 were as follows:

- The Plan's unrestricted net assets increased by \$5.1 million during fiscal year 2012.
- The Plan's health premiums increased by \$11.4 million during fiscal year 2012.
- The Plan's investment earnings during fiscal year 2012 were \$605,899.
- The Plan's benefit expense totaled \$102.2 million during fiscal year 2012.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Plan's basic financial statements. The Plan's financial statements comprise four components: (1) statement of net assets, (2) statement of revenues, expenses, and changes in net assets, (3) statement of cash flows, and (4) notes to financial statements.

Statement of Net Assets – This statement presents information regarding the Plan's assets, liabilities, and resulting unrestricted net assets. This statement reflects the Plan's cash and short-term investments, receivables, and other assets less liabilities at June 30, 2012 and 2011.

Statement of Revenues, Expenses, and Changes in Net Assets – This statement presents how the Plan's net assets changed during the fiscal years ended June 30, 2012 and 2011 as a result of health premiums, investment income, and operating expenses.

Statement of Cash Flows – This statement presents cash flows from operations and investing activities. The Plan presents its cash flows statement using the direct method for reporting cash received and disbursed during the fiscal year.

The above statements represent resources available for investment and payment of benefits as of June 30, 2012 and 2011, and the sources and uses of those funds during fiscal years 2012 and 2011.

Notes to Financial Statements – The notes to financial statements are an integral part of the financial statements and provide additional detailed information and schedules that are essential to a full understanding of the Plan's financial statements.

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Condensed Financial Information

Description	Net Assets				
	2012	2011	Increase (decrease)		2010
			Amount	Percentage	
Assets:					
Cash and cash equivalents	\$ 47,588,399	40,155,448	7,432,951	18.5%	\$ 35,299,978
Receivables	30,054	94,508	(64,454)	(68.2)	36,447
Other assets	1,013,712	840,649	173,063	20.6	840,649
Total assets	48,632,165	41,090,605	7,541,560	18.4	36,177,074
Liabilities:					
Claims payable	16,242,000	14,096,000	2,146,000	15.2	15,266,619
Due to State of Alaska General Fund	1,435,319	1,151,148	284,171	24.7	786,149
Accrued expenses	268,739	229,253	39,486	17.2	202,876
Total liabilities	17,946,058	15,476,401	2,469,657	16.0	16,255,644
Net assets	\$ 30,686,107	25,614,204	5,071,903	19.8%	\$ 19,921,430

Description	Changes in Net Assets				
	2012	2011	Increase (decrease)		2010
			Amount	Percentage	
Net assets, beginning of year	\$ 25,614,204	19,921,430	5,692,774	28.6%	\$ 30,991,715
Operating revenues:					
Health premiums	108,978,716	97,600,974	11,377,742	11.7	81,098,549
Other revenues	1,647,318	1,915,110	(267,792)	(14.0)	1,720,541
Total operating revenues	110,626,034	99,516,084	11,109,950	11.2	82,819,090
Operating expenses:					
Benefits	102,168,590	90,752,756	11,415,834	12.6	91,429,449
Administrative	3,991,440	3,701,488	289,952	7.8	3,924,530
Total operating expenses	106,160,030	94,454,244	11,705,786	12.4	95,353,979
Operating income (loss)	4,466,004	5,061,840	(595,836)	(11.8)	(12,534,889)
Nonoperating revenues:					
Net investment income	605,899	630,934	(25,035)	(4.0)	1,464,604
Change in net assets	5,071,903	5,692,774	(620,871)	(10.9)	(11,070,285)
Net assets, end of year	\$ 30,686,107	25,614,204	5,071,903	19.8%	\$ 19,921,430

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Financial Analysis of the Plan

The statement of net assets as of June 30, 2012 and 2011 showed total assets exceeding total liabilities by \$30,686,107 and \$25,614,204, respectively. These amounts represent the total plan net assets held in trust for healthcare benefits on each of those dates. The entire amount is available to cover the Plan's obligation to pay healthcare benefits for its members and their beneficiaries.

These amounts also represent an increase in net assets of \$5,071,903 or 19.8%, an increase of \$5,692,774 or 28.6% over fiscal year 2011 and 2010, respectively. Over the long term, healthcare premiums collected and investment income earned are expected to cover all claim costs. With continued increases in healthcare costs, the Plan must continue to accumulate assets to meet current and future claim costs.

Premium Calculations

The overall objective of the Plan is to have sufficient funds to meet claim costs. The premiums are recommended each year by the Division of Retirement and Benefits' (the Division) benefit consultant with the governing body's concurrence and the administrator's approval. Premiums are based on the Plan's fiscal year. The benefit consultant reviews the historical claims experience and administrative costs and uses that data to estimate trends to recommend premiums for the next fiscal year.

Healthcare Premiums and Investment Income

The revenues required to fund healthcare benefits are accumulated through a combination of employer health premiums, member health premiums, other income, and net investment income.

	Revenues				
	2012	2011	Increase (decrease)		2010
			Amount	Percentage	
Health insurance premiums	\$ 108,978,716	97,600,974	11,377,742	11.7%	\$ 81,098,549
Other income	1,647,318	1,915,110	(267,792)	(14.0)	1,720,541
Net investment income	605,899	630,934	(25,035)	(4.0)	1,464,604
Total	<u>\$ 111,231,933</u>	<u>100,147,018</u>	<u>11,084,915</u>	<u>11.1%</u>	<u>\$ 84,283,694</u>

Over the long term, health premiums earned and net investment income are expected to cover all costs of the Plan.

Healthcare premiums benefit credit paid by the State of Alaska (the State) increased from \$1,088 per month per person in fiscal year 2011 to \$1,250 per month per person in fiscal year 2012. Premiums were \$910 in fiscal year 2010. Increases to health premiums are the result of rising healthcare costs related to covered benefits. Premiums are based on historical and anticipated experience. During fiscal year 2012, there was also an increase of approximately 140 members over fiscal year 2011.

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Net investment income decreased by \$25,035 or 4.0% from amounts recorded in fiscal year 2011 and decreased by \$833,670 or 56.9% from amounts recorded in fiscal year 2010. In both fiscal years 2011 and 2012, the decrease was due to lower returns on investments as well as a lower invested balance from higher healthcare costs. The Group Health and Life Fund is invested in the General Fund and Other Non-segregated Investments (GeFONSI). The GeFONSI is an investment pool managed by the State of Alaska Treasury Division in the Department of Revenue. For fiscal years 2012 and 2011, the GeFONSI investments generated 1.52% and 1.72% rates of return, respectively. The GeFONSI annualized rate of return was 2.21% over the last three years and 3.33% over the last five years. The invested balance increased by \$7,432,951 in fiscal year 2012, and increased by \$4,855,470 and decreased by \$9,441,195 in fiscal years 2011 and 2010, respectively.

Benefits and Expenses

The primary expense of the Plan is the payment of healthcare benefits. These benefit costs and the cost of administering the Plan comprise the cost of operations.

Benefit expenses increased by \$11,415,834 or 12.6% from fiscal year 2011 and decreased by \$676,693 or 0.7% during fiscal year 2010. Fiscal year 2012 saw an increase in covered members, and healthcare costs increased over fiscal year 2011.

	Expenses				
	2012	2011	Increase (decrease)		2010
			Amount	Percentage	
Healthcare benefits	\$ 102,168,590	90,752,756	11,415,834	12.6%	\$ 91,429,449
Administrative	3,991,440	3,701,488	289,952	7.8	3,924,530
Total	\$ 106,160,030	94,454,244	11,705,786	12.4%	\$ 95,353,979

Administrative expenses increased by \$289,952 or 7.8% from fiscal year 2011 and decreased by \$223,042 or 5.7% from fiscal year 2010.

Economic Conditions, Market Environment, and Results

Net investment rate of return remains far below the five-year average, having decreased an additional 11.6% during fiscal year 2012, and ending the year at 45.7% of the five-year rate of return. Short-term fixed-income rates of return are expected to stay low and to continue falling during fiscal year 2013.

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Requests for Information

This financial report is designed to provide a general overview of the Plan's financial condition for those with interest in the Plan's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to:

State of Alaska Group Health and Life Fund
Division of Retirement and Benefits, Accounting Section
P.O. Box 110203
Juneau, Alaska 99811-0203

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Statement of Net Assets

June 30, 2012 and 2011

	2012	2011
Assets:		
Cash and cash equivalents (notes 3 and 4):		
Investment in State of Alaska General Fund and Other		
Nonsegregated Investments Pool	\$ 47,588,399	40,155,448
Premiums receivable	30,054	32,015
Other receivable	—	62,493
Other assets	1,013,712	840,649
Total assets	48,632,165	41,090,605
Liabilities:		
Claims payable (note 5)	16,242,000	14,096,000
Due to State of Alaska General Fund (note 5)	1,435,319	1,151,148
Accrued expenses	268,739	229,253
Total liabilities	17,946,058	15,476,401
Unrestricted net assets	\$ 30,686,107	25,614,204

See accompanying notes to financial statements.

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Statement of Revenues, Expenses, and Changes in Net Assets
Years ended June 30, 2012 and 2011

	2012	2011
Operating revenues:		
Employer health premiums	\$ 93,838,322	80,575,203
Member health premiums	15,140,394	17,025,771
Cobra subsidy	—	62,838
Other	1,647,318	1,852,272
Total operating revenues	110,626,034	99,516,084
Operating expenses:		
Benefits (note 5)	102,168,590	90,752,756
Administrative	3,991,440	3,701,488
Total operating expenses	106,160,030	94,454,244
Operating income	4,466,004	5,061,840
Nonoperating revenues:		
Net investment income	605,899	630,934
Change in unrestricted net assets	5,071,903	5,692,774
Total unrestricted net assets, beginning of year	25,614,204	19,921,430
Total unrestricted net assets, end of year	\$ 30,686,107	25,614,204

See accompanying notes to financial statements.

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Statement of Cash Flows

Years ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Cash flows from operating activities:		
Cash received for premiums from the State of Alaska	\$ 108,978,716	97,600,974
Cash received from others for premiums	1,960	67,270
Cash received from third-party administrator	1,709,811	1,789,780
Cash payments to third-party administrator for benefits	(99,738,419)	(91,558,376)
Cash payments to employees	(226,890)	(196,648)
Cash payments to suppliers	(3,898,126)	(3,478,464)
Net cash provided by operating activities	<u>6,827,052</u>	<u>4,224,536</u>
Cash flows from investing activity:		
Net investment income received	<u>605,899</u>	<u>630,934</u>
Net increase in cash and cash equivalents	7,432,951	4,855,470
Cash and cash equivalents, beginning of year	<u>40,155,448</u>	<u>35,299,978</u>
Cash and cash equivalents, end of year	<u>\$ 47,588,399</u>	<u>40,155,448</u>
Reconciliation of operating income to net cash used for operating activities:		
Operating income	\$ 4,466,004	5,061,840
Adjustments to reconcile operating income to net cash provided by operating activities:		
(Increase) decrease in assets:		
Premiums receivable	1,960	4,431
Other assets	62,492	(62,492)
Deposit with third party administrator	(173,061)	—
Increase (decrease) in liabilities:		
Claims payable	2,146,000	(1,129,000)
Due to State of Alaska General Fund	284,171	364,999
Accrued expenses	39,486	(15,242)
Net cash provided by operating activities	<u>\$ 6,827,052</u>	<u>4,224,536</u>

See accompanying notes to financial statements.

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(1) Description

The following brief description of the State of Alaska Group Health and Life Fund (the Plan), an Internal Service Fund of the State of Alaska (the State), is provided for general information purposes only. Participants should refer to the Select Benefits Information Booklet for more complete information.

General

The Plan was established on July 1, 1997 to provide self-insured healthcare benefits to eligible employees of the State. The Plan is an internal service fund of the State financial reporting entity and is included as such in the State's comprehensive annual financial report. As of June 30, 2012 and 2011, there were approximately 6,340 and 6,200 employees, excluding dependents, covered by the Plan, respectively.

Prior to July 1, 1997, healthcare benefits for state employees were fully insured through the payment of premiums to an insurance company.

Benefits

The Plan offers medical, dental, vision, and audio benefits to eligible state employees and their dependents.

Eligibility

The Plan does not provide benefits to members of the following collective bargaining units, who chose to receive health coverage through a union trust:

- Labor, Trades and Crafts Unit
- Public Safety Airport Security Unit
- Public Safety Troopers Unit
- Masters, Mates and Pilots
- General Government Unit

All other permanent and long-term nonpermanent employees of the State are covered by the Plan, including permanent and long-term nonpermanent seasonal and part-time employees who elect coverage.

The Plan also provides coverage for state legislators and elected officials.

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(1) Description (cont.)

Flexible Benefits

Employees who are not covered through a union trust are eligible for flexible healthcare benefits. Under this program, employees are provided benefit credits by the State. Employees can use the benefit credits to purchase the benefits they want. Benefit credits equal the amount that the State contributes towards health benefits for all employees. The amount of benefit credits each employee receives is decided by the legislature and/or the appropriate collective bargaining agreement and can be adjusted each year. Each of the available options offers different benefits or pays benefits at different rates. If the cost of the benefit option selected by an employee exceeds the amount of their benefit credits, the difference is funded by the employee through pretax payroll deductions. If the cost of the benefit options selected by an employee is less than the amount of their benefit credits, the remaining benefit credits are contributed to a healthcare reimbursement account for that employee.

(2) Summary of Significant Accounting Policies

Basis of Accounting

The Plan's financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting. Premiums are recognized in the period in which they are due. Benefits are recognized when due and payable.

Financial Statement Presentation

The Plan distinguishes operating revenues and expenses from nonoperating revenues and expenses. Operating revenues and expenses generally result from providing services in connection with the Plan's principal ongoing operations. The principal operating revenues of the Plan are employer and member contributions. Operating expenses for the Plan include benefits and administrative expenses. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of additions and deductions during the reporting period. Actual results could differ from those estimates.

Investments

Investments are recorded at fair value. Fair value is "the amount that a plan can reasonably expect to receive for an investment in a current sale between a willing buyer and a willing seller – that is, other than in a forced or liquidation sale." Security transactions are accounted for on a trade-date (ownership) basis at the current fair value.

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(2) Summary of Significant Accounting Policies (cont.)

The Plan participates in the State General Fund and Other Non-segregated Investments (GeFONSI) pool. GeFONSI invests in fixed income securities that are valued each business day using an independent pricing service. Money market funds are valued at amortized cost, which approximates fair value.

GeFONSI investment income is distributed to pool participants if prescribed by statute or if appropriated by state legislature.

Statements of Cash Flows

For purposes of reporting cash flows, cash and cash equivalents include the Plan's investment in the GeFONSI, which includes appreciation (depreciation) at June 30, 2012 and 2011. This investment pool has the general characteristics of a demand deposit account.

Administration

The Plan is administered by the State's Division of Retirement and Benefits (the Division). The Division utilizes the services of a claims administrator, HealthSmart Benefit Solutions (HealthSmart), to process all medical, dental, and prescription drug claims. Some of the managed-care vision benefits provided by the Plan are administered by Vision Service Plan (VSP).

Funding

The Plan is self-insured for all benefits. The Plan's funding policy provides for the collection of premiums from employees, if applicable, and the State. Premium amounts are actuarially determined on an annual basis and adjusted as necessary. The State retains the risk of loss of allowable claims.

Due from (to) State of Alaska General Fund

Amounts due from (to) the State of Alaska General Fund represent the net difference between amounts paid by the Plan on behalf of others and amounts paid by others on behalf of the Plan.

Federal Income Tax Status

The Plan is a qualified plan under section 401(a) of the Internal Revenue Code and is exempt from federal income taxes under Section 501(a).

(3) Investments

The Plan invests in the State's internally managed GeFONSI pool. GeFONSI consists of investments in the State's internally managed Short-Term Fixed Income Pool, the Short-Term Liquidity Fixed Income Pool and the Intermediate-Term Fixed Income Pool. Actual investing is performed by investment officers in the State's Department of Revenue, Treasury Division (Treasury). The complete financial activity of the fund is shown in the Comprehensive Annual Financial Report available from the Division of Finance in the Department of Administration.

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(3) Investments (cont.)

Assets in the pools are reported at fair value. Investment purchases and sales are recorded on a trade-date basis. Securities are valued each business day using prices obtained from a pricing service when such prices are available; otherwise, such securities are valued at the mid-point between the bid and asked price or at prices for securities of comparable maturity, quality and type.

The accrual basis of accounting is used for investment income and GeFONSI investment income is distributed to pool participants monthly if prescribed by statute or if appropriated by the state legislature. Income in the Short-Term, Short-Term Liquidity and Intermediate-Term Fixed Income Pools is allocated to pool participants daily on a pro rata basis.

At June 30, 2012, the Plan's share of pool investments was as follows:

<u>Investment type</u>	<u>Fair value</u>			<u>Total</u>
	<u>Short-term fixed income pool</u>	<u>Short-term liquidity fixed income pool</u>	<u>Intermediate- term fixed income pool</u>	
Commercial paper	\$ 784,714	—	12,355	797,069
Corporate bonds	2,099,135	—	3,156,799	5,255,934
Deposit	92,146	—	—	92,146
Mortgage backed	195,610	—	772,734	968,344
Other asset backed	8,126,405	—	84,905	8,211,310
U.S. government agency	276,314	—	1,010,526	1,286,840
U.S. Treasury bills	12,185,779	3,232,125	1,683,335	17,101,239
U.S. Treasury notes	—	—	13,934,239	13,934,239
U.S. Treasury strip	—	—	12,421	12,421
Yankees:				
Corporate	482,968	—	—	482,968
Government	—	—	127,006	127,006
Total invested assets	<u>24,243,071</u>	<u>3,232,125</u>	<u>20,794,320</u>	<u>48,269,516</u>
Pool-related net assets (liabilities)	<u>(662,577)</u>	<u>528</u>	<u>(19,068)</u>	<u>(681,117)</u>
Net invested assets	<u>\$ 23,580,494</u>	<u>3,232,653</u>	<u>20,775,252</u>	<u>47,588,399</u>

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(3) Investments (cont.)

At June 30, 2011, the Plan share of pool investments was as follows:

<u>Investment type</u>	<u>Fair value</u>			
	<u>Short-term fixed income pool</u>	<u>Intermediate- term fixed income pool</u>	<u>Other</u>	<u>Total</u>
Commercial paper	\$ 1,663,479	61,826	—	1,725,305
Corporate bonds	7,358,249	3,158,569	—	10,516,818
Mortgage backed	341,618	624,702	—	966,320
Other asset backed	7,382,578	293,557	—	7,676,135
Overnight sweep account (LMCS)	198,490	—	—	198,490
U.S. government agency	410,534	824,583	—	1,235,117
U.S. government agency discount notes	608,342	—	—	608,342
U.S. Treasury bills	3,477,990	—	—	3,477,990
U.S. Treasury notes	—	12,335,775	—	12,335,775
U.S. Treasury strip	—	11,293	—	11,293
Yankees:				
Corporate	145,263	523,072	—	668,335
Government	—	139,762	—	139,762
Total invested assets	<u>21,586,543</u>	<u>17,973,139</u>	<u>—</u>	<u>39,559,682</u>
Pool-related net assets	<u>14,856</u>	<u>311,509</u>	<u>—</u>	<u>326,365</u>
Net invested assets	21,601,399	18,284,648	—	39,886,047
Participant unallocated cash	<u>—</u>	<u>—</u>	<u>269,401</u>	<u>269,401</u>
Net cash and cash equivalents	<u>\$ 21,601,399</u>	<u>18,284,648</u>	<u>269,401</u>	<u>40,155,448</u>

(4) Deposit and Investment Risk

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

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(4) Deposit and Investment Risk (cont.)

Short-Term Fixed Income Pool

As a means of limiting its exposure to fair value losses arising from increasing interest rates, Treasury's investment policy limits individual fixed rate securities to fourteen months to maturity or fourteen months expected average life upon purchase. Floating rate securities are limited to three years to maturity or three years expected average life upon purchase. Treasury utilizes the actual maturity date for commercial paper and twelve-month prepay speeds for other securities. At June 30, 2012, the expected average life of individual fixed rate securities range from one day to one year and the expected average life of floating rate securities ranged from eight days to fourteen years.

Short-Term Liquidity Fixed Income Pool

Treasury's investment policy limits individual fixed rate securities to six months to maturity. These constraints apply to trade date, except for securities bought at new issue, for which settlement date applies. At June 30, 2012, the expected average life of fixed rate securities ranged from 163 to 170 days.

Intermediate-Term Fixed Income Pool

Duration is a measure of interest rate risk. It measures a security's sensitivity to a 100-basis point change in interest rates. The duration of a pool is the average fair value weighted duration of each security in the pool taking into account all related cash flows.

Treasury uses industry-standard analytical software developed by The Yield Book Inc. to calculate effective duration. The software takes into account various possible future interest rates, historical and estimated prepayment rates, call options, and other variable cash flows for purposes of the effective duration calculation.

Through its investment policy, Treasury manages its exposure to fair value losses arising from increasing interest rates by limiting effective duration of the Intermediate-Term Fixed Income Pool to the following:

Intermediate-Term Fixed Income Pool – $\pm 20\%$ of the Merrill Lynch 1-5 year Government Bond Index. The effective duration for the Merrill Lynch 1-5 year Government Bond Index at June 30, 2012, was 2.66 years.

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(4) Deposit and Investment Risk (cont.)

At June 30, 2012, the effective duration by investment type was as follows (in years):

	Intermediate-term fixed income pool
Cash equivalent	0.26
Corporate	1.62
Mortgage-backed	1.28
Other asset-backed	2.43
U.S. government agency	1.24
U.S. Treasury bill	0.30
U.S. Treasury notes	2.78
U.S. Treasury strip	5.26
Yankees:	
Corporate	2.63
Government	1.72
Portfolio effective duration	2.23

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations.

Treasury's investment policy has the following limitations with regard to credit risk:

Short-Term Fixed Income Pool investments are limited to instruments with a long-term credit rating of at least A3 or equivalent and instruments with a short-term credit rating of at least P-1 or equivalent. Commercial paper must be rated at least P-1 by Moody's and A-1 by Standard and Poor's. Asset-backed and non-agency mortgage securities must be rated A3 or equivalent. The A3 rating is defined as the median rating of the following three rating agencies: Standard & Poor's Corporation, Moody's and Fitch. Asset-backed and non-agency mortgage securities may be purchased if only rated by one of these agencies if they are rated AAA.

Short-Term Liquidity Pool investments are limited to U.S. Treasury obligations or other U.S. Government securities issued in full faith or guaranteed by agencies and instrumentalities of the U.S. Government, obligations of foreign governments, sovereign states, supranational entities, and their instrumentalities denominated in U.S. dollars, and the State's internally-managed Short-Term Fixed Income Pool.

Intermediate-Term Fixed Income Pool investments are limited to securities with a long-term credit rating of at least Baa3 or equivalent and securities with a short-term credit rating of at least P-1 or equivalent. Asset-backed and non-agency mortgage securities must be rated investment grade. The investment grade rating is defined as the median rating of the following three rating agencies: Standard & Poor's Corporation, Moody's and Fitch. Asset-backed and non-agency mortgage securities may be purchased if only rated by one of these agencies if they are rated AAA.

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June 30, 2012 and 2011

(4) Deposit and Investment Risk (cont.)

At June 30, 2012, the State's internally managed pools consisted of investments with credit quality ratings issued by nationally recognized statistical rating organizations as follows (using Standard and Poor's Corporation rating scale):

<u>Investment type</u>	<u>Rating</u>	<u>Short-term fixed income pool</u>	<u>Short-term liquidity fixed income pool</u>	<u>Intermediate- term fixed income pool</u>
Commercial paper	Not rated	3.33 %	— %	0.06 %
Corporate bonds	AAA	—	—	0.66
Corporate bonds	AA	4.94	—	7.54
Corporate bonds	A	3.60	—	3.52
Corporate bonds	BBB	—	—	1.21
Corporate bonds	Not rated	0.35	—	0.06
Government agency	AA	1.17	—	4.75
Government agency	A	—	—	0.06
Mortgage backed	AAA	0.46	—	1.73
Mortgage backed	AA	—	—	1.27
Mortgage backed	CCC	—	—	0.02
Mortgage backed	Not rated	0.37	—	0.61
Other asset backed	AAA	26.15	—	0.27
Other asset backed	AA	1.90	—	—
Other asset backed	A	0.08	—	—
Other asset backed	Not rated	6.30	—	0.13
Other pool ownership	Not rated	—	0.11	2.42
U.S. Treasury bills	AA	51.67	99.87	7.91
U.S. Treasury notes	AA	—	—	65.44
U.S. Treasury strip	AA	—	—	0.06
Yankees:				
Corporate	AAA	—	—	0.50
Corporate	AA	1.42	—	0.66
Corporate	A	0.62	—	0.30
Corporate	BBB	—	—	0.32
Government	AA	—	—	0.54
Government	A	—	—	0.01
Government	Not rated	—	—	0.04
No credit exposure	No exposure	(2.36)	0.02	(0.09)
		<u>100.00%</u>	<u>100.00%</u>	<u>100.00%</u>

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Notes to Financial Statements

June 30, 2012 and 2011

(4) Deposit and Investment Risk (cont.)

Concentration of Credit Risk

Treasury's policy with regard to concentration of credit risk is to prohibit the purchase of more than 5% of a pool's holdings in corporate bonds of any one company or affiliated group.

At June 30, 2012, the fund did not have more than 5% of their investments in any one company or affiliated group.

(5) Claims Payable

The liability for claims incurred but not reported represents the estimated amounts necessary to settle all outstanding claims, incurred but not reported (IBNR), as of the balance sheet date. The Plan's reserve estimates are based primarily on historical development patterns adjusted for current trends that would modify past experience. Claims are reevaluated periodically to consider the effects of inflation, claims settlement trends, and other economic factors. The process of establishing loss reserves is subject to uncertainties that are normal, recurring, and inherent in the healthcare business.

Changes in the balances of claims liabilities during the years ended June 30 were as follows:

	<u>2012</u>	<u>2011</u>
Beginning of year:		
Due to State of Alaska General Fund for outstanding warrants	\$ 1,151,148	786,149
Outstanding claims included in accrued expenses	—	41,619
Incurred but not reported	<u>14,096,000</u>	<u>15,225,000</u>
Total, beginning of year	15,247,148	16,052,768
Benefit deduction	102,168,590	90,752,756
Benefits paid	<u>(99,738,419)</u>	<u>(91,558,376)</u>
Total, end of year	<u>\$ 17,677,319</u>	<u>15,247,148</u>
End of year:		
Due to State of Alaska General Fund for outstanding warrants	\$ 1,435,319	1,151,148
Incurred but not reported	<u>16,242,000</u>	<u>14,096,000</u>
Total, end of year	<u>\$ 17,677,319</u>	<u>15,247,148</u>