



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

Financial Statements

June 30, 2014 and 2013

(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 fiduciary net position 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, 2014 and 2013, and the related statement of revenues, expenses, and changes in fiduciary net position, and cash flows for the years then ended, and the related notes to the financial statements, which collectively comprise the Plan's basic financial statements as listed in the table of contents.

### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditors' Responsibility*

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### *Opinion*

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net position of the State of Alaska Group Health and Life Fund as of June 30, 2014 and 2013, and its changes in fiduciary net position and cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.



***Other Matters***

***Required Supplementary Information***

U.S. generally accepted accounting principles require that the Management’s Discussion and Analysis, on pages 3–7 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management’s responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

**KPMG LLP**

December 5, 2014

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Management's Discussion and Analysis

June 30, 2014 and 2013

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, 2014 and 2013. 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, 2014 and 2013. Information for fiscal year 2012 is presented for comparative purposes.

**Financial Highlights**

The Plan financial highlights as of June 30, 2014 were as follows:

- The Plan's net position decreased by \$8.4 million during fiscal year 2014.
- The Plan's health insurance premiums increased by \$6.8 million during fiscal year 2014.
- The Plan's investment earnings during fiscal year 2014 were \$253,092.
- The Plan's benefit expense during fiscal year 2014 totaled \$129.9 million.

**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 position, (2) statement of revenues, expenses, and changes in net position, (3) statement of cash flows, and (4) notes to financial statements.

*Statement of Fiduciary Net Position* – This statement presents information regarding the Plan's assets, liabilities, and resulting net position. This statement reflects the Plan's cash and short-term investments, receivables, and other assets less liabilities at June 30, 2014 and 2013.

*Statement of Revenues, Expenses, and Changes in Fiduciary Net Position* – This statement presents how the Plan's net position changed during the fiscal years ended June 30, 2014 and 2013, as a result of health insurance 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, 2014 and 2013, and the sources and uses of those funds during fiscal years 2014 and 2013.

*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**

<b>Fiduciary Net Position</b>					
<b>Description</b>	<b>2014</b>	<b>2013</b>	<b>Position increase (decrease)</b>		<b>2012</b>
			<b>Amount</b>	<b>Percentage</b>	
<b>Assets:</b>					
Cash and cash equivalents	\$ 34,337,324	44,854,672	(10,517,348)	(23.4)%	\$ 47,588,399
Receivables	—	32,475	(32,475)	(100.0)	30,054
Other receivable	263	741	(478)	(64.5)	—
Other assets	1,606,871	1,014,055	592,816	58.5	1,013,712
Total assets	<u>35,944,458</u>	<u>45,901,943</u>	<u>(9,957,485)</u>	<u>(21.7)</u>	<u>48,632,165</u>
<b>Liabilities:</b>					
Claims payable	18,023,000	19,575,000	(1,552,000)	(7.9)	16,242,000
Due to State of Alaska General Fund	859,331	1,001,788	(142,457)	(14.2)	1,435,319
Accrued expenses	430,314	285,277	145,037	50.8	268,739
Total liabilities	<u>19,312,645</u>	<u>20,862,065</u>	<u>(1,549,420)</u>	<u>(7.4)</u>	<u>17,946,058</u>
Net position	<u>\$ 16,631,813</u>	<u>25,039,878</u>	<u>(8,408,065)</u>	<u>(33.6)%</u>	<u>\$ 30,686,107</u>

<b>Revenues, Expenses and Changes in Net Position</b>					
<b>Description</b>	<b>2014</b>	<b>2013</b>	<b>Position increase (decrease)</b>		<b>2012</b>
			<b>Amount</b>	<b>Percentage</b>	
Net position, beginning of year	\$ 25,039,878	30,686,107	(5,646,229)	(18.4)%	\$ 25,614,204
<b>Operating revenues:</b>					
Health insurance premiums	124,675,001	117,897,163	6,777,838	5.7	108,978,716
Other revenues	593,724	1,176,545	(582,821)	(49.5)	1,647,318
Total operating revenues	<u>125,268,725</u>	<u>119,073,708</u>	<u>6,195,017</u>	<u>5.2</u>	<u>110,626,034</u>
<b>Operating expenses:</b>					
Healthcare benefits	129,947,203	120,525,784	9,421,419	7.8	102,168,590
Administrative	3,982,679	4,348,294	(365,615)	(8.4)	3,991,440
Total operating expenses	<u>133,929,882</u>	<u>124,874,078</u>	<u>9,055,804</u>	<u>7.3</u>	<u>106,160,030</u>
Operating (loss) income	(8,661,157)	(5,800,370)	(2,860,787)	49.3	4,466,004
<b>Nonoperating revenues:</b>					
Net investment income	253,092	154,141	98,951	64.2	605,899
Change in net position	<u>(8,408,065)</u>	<u>(5,646,229)</u>	<u>(2,761,836)</u>	<u>48.9</u>	<u>5,071,903</u>
Net position, end of year	<u>\$ 16,631,813</u>	<u>25,039,878</u>	<u>(8,408,065)</u>	<u>(33.6)%</u>	<u>\$ 30,686,107</u>

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**Financial Analysis of the Plan**

The statement of net position as of June 30, 2014 and 2013, showed total assets exceeding total liabilities by \$16,631,813 and \$25,039,878, respectively. These amounts represent the total plan net position 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 a decrease in net position of \$8,408,065 or 33.6%, and an increase of \$5,646,229 or 18.4% over fiscal year 2013 and 2012, respectively. Over the long term, healthcare insurance premiums collected and investment income earned are expected to cover all costs of the plan. With continued increases in healthcare costs, the Plan must continue to accumulate assets to meet current and future claim costs.

**Insurance Premium Calculations**

The overall objective of the Plan is to have sufficient funds to meet claim costs. The insurance 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. Insurance premiums are based on the Plan's benefit 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 benefit year.

**Healthcare Insurance Premiums and Investment Income**

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

	Revenues				
	2014	2013	Increase (decrease)		2012
			Amount	Percentage	
Health insurance premiums	\$ 124,675,001	117,897,163	6,777,838	5.7%	\$ 108,978,716
Other revenue	593,724	1,176,545	(582,821)	(49.5)	1,647,318
Net investment income	253,092	154,141	98,951	64.2	605,899
Total	\$ 125,521,817	119,227,849	6,293,968	5.3%	\$ 111,231,933

Healthcare insurance premiums benefit credit paid by the State of Alaska (the State) increased from \$1,330 per month per person in fiscal year 2013 to \$1,371 per month per person in fiscal year 2014. Insurance premiums were \$1,250 in fiscal year 2012. Increases to health insurance premiums are the result of rising healthcare costs related to covered benefits. Premiums are based on historical and anticipated experience. During fiscal year 2014, there was also an increase of 160 members over fiscal year 2013.

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Net investment income increased by \$98,951 or 64.2% from amounts recorded in fiscal year 2013 and decreased by \$451,758 or 74.6% from amounts recorded in fiscal year 2012. In fiscal years 2013, 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 2014 and 2013, the GeFONSI investments generated 0.57% and 0.31% rates of return, respectively. The GeFONSI annualized rate of return was 0.80% over the last three years and 1.50% over the last five years. The invested balance decreased by \$10,517,348 and \$2,733,727 in fiscal years 2014 and 2013, respectively, and increased by \$7,432,951 in fiscal year 2012.

**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.

	<b>Expenses</b>				<b>2012</b>
	<b>2014</b>	<b>2013</b>	<b>Increase (decrease)</b>		
			<b>Amount</b>	<b>Percentage</b>	
Healthcare benefits	\$ 129,947,203	120,525,784	9,421,419	7.8%	\$ 102,168,590
Administrative	3,982,679	4,348,294	(365,615)	(8.4)	3,991,440
Total	<u>\$ 133,929,882</u>	<u>124,874,078</u>	<u>9,055,804</u>	<u>7.3%</u>	<u>\$ 106,160,030</u>

Benefit expenses increased by \$9,421,419 or 7.8% from fiscal year 2013 and increased by \$18,357,194 or 18.0% during fiscal year 2012. Fiscal year 2014 and 2013 saw an increase in covered members and healthcare costs.

Administrative expenses decreased by \$365,615 or 8.4% from fiscal year 2013 and increased by \$356,845 or 8.9% from fiscal year 2012.

**Economic Conditions, Market Environment, and Results**

Net investment rate of return remains below the five-year average ending the year at 38.0% of the five-year rate of return. Short-term fixed income rates of returns are expected to remain low during fiscal year 2015.



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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 the following:

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

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Statements of Net Position

June 30, 2014 and 2013

	<b>2014</b>	<b>2013</b>
<b>Assets:</b>		
Cash and cash equivalents (notes 3 and 4):		
Investment in State of Alaska General Fund and Other		
Nonsegregated Investments Pool	\$ 34,337,324	44,854,672
Premiums receivable	—	32,475
Other receivable	263	741
Other assets	1,606,871	1,014,055
Total assets	35,944,458	45,901,943
<b>Liabilities:</b>		
Claims payable (note 5)	18,023,000	19,575,000
Due to State of Alaska General Fund (note 5)	859,331	1,001,788
Accrued expenses	430,314	285,277
Total liabilities	19,312,645	20,862,065
Unrestricted net position	\$ 16,631,813	25,039,878

See accompanying notes to financial statements.

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Statements of Revenues, Expenses, and Changes in Net Position  
Years ended June 30, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Operating revenues:		
Employer health insurance premiums	\$ 109,198,073	101,677,005
Member health insurance premiums	15,476,928	16,220,158
Other revenue	593,724	1,176,545
Total operating revenues	<u>125,268,725</u>	<u>119,073,708</u>
Operating expenses:		
Benefits (note 5)	129,947,203	120,525,784
Administrative	3,982,679	4,348,294
Total operating expenses	<u>133,929,882</u>	<u>124,874,078</u>
Operating loss	(8,661,157)	(5,800,370)
Nonoperating revenues:		
Net investment income	253,092	154,141
Change in unrestricted net position	(8,408,065)	(5,646,229)
Total unrestricted net position, beginning of year	<u>25,039,878</u>	<u>30,686,107</u>
Total unrestricted net position, end of year	<u>\$ 16,631,813</u>	<u>25,039,878</u>

See accompanying notes to financial statements.

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Statements of Cash Flows

Years ended June 30, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Cash flows from operating activities:		
Cash received for premiums from the State of Alaska	\$ 124,675,001	117,897,163
Cash received for premiums from others	32,475	(2,421)
Cash received from third-party administrator	594,202	1,175,804
Cash payments for benefits to third-party administrator	(131,641,660)	(117,626,315)
Cash payments to employees	(66,706)	(234,808)
Cash payments to suppliers	(4,363,752)	(4,097,291)
Net cash used in operating activities	<u>(10,770,440)</u>	<u>(2,887,868)</u>
Cash flows from investing activity:		
Net investment income received	<u>253,092</u>	<u>154,141</u>
Net decrease in cash and cash equivalents	(10,517,348)	(2,733,727)
Cash and cash equivalents, beginning of year	<u>44,854,672</u>	<u>47,588,399</u>
Cash and cash equivalents, end of year	<u>\$ 34,337,324</u>	<u>44,854,672</u>
Reconciliation of operating income to net cash used for operating activities:		
Operating loss	\$ (8,661,157)	(5,800,370)
Adjustments to reconcile operating income to net cash (used in) provided by operating activities:		
(Increase) decrease in assets:		
Premiums receivable	32,475	(2,421)
Other receivables	478	(741)
Other assets	(593,159)	(343)
Deposit with third-party administrator	343	—
Increase (decrease) in liabilities:		
Claims payable	(1,552,000)	3,333,000
Due to State of Alaska General Fund	(142,457)	(433,530)
Accrued expenses	145,037	16,537
Net cash used in operating activities	<u>\$ (10,770,440)</u>	<u>(2,887,868)</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, 2014 and 2013, there were 6,664 and 6,504 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. Insurance 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, 2014 and 2013. 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), Aetna, Moda Health, and PayFlex, 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 insurance premiums from employees, if applicable, and the State. Insurance 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).

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**(3) Investments**

The Department of Revenue, Treasury Division (Treasury) has created a pooled environment by which it manages the investments the Commissioner has fiduciary responsibility for. Actual investing is performed by investment officers in Treasury or by contracted external investment managers. The fund invests in the State's internally managed General Fund and Other Non-Segregated Investments Pool (GeFONSI). The GeFONSI consists of investments in the State's internally managed Short-term Fixed Income Pool, Short-term Liquidity Fixed Income Pool, and the Intermediate-term Fixed Income Pool. The complete financial activity of the funds is shown in the Comprehensive Annual Financial Report available from the Division of Finance in the Department of Administration.

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.

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, 2014, 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>	
Corporate bonds	\$ 1,122,510	—	709,106	\$ 1,831,616
Mortgage backed	77,134	—	326,772	403,906
Other asset backed	5,417,278	—	354,098	5,771,376
Overnight sweep accounts (Imcs)	1,759,121	—	—	1,759,121
Repurchase agreement	1,099,195	—	—	1,099,195
U.S. government agency	—	—	15,803	15,803
Treasury bills	9,482,453	4,718,697	687,905	14,889,055
Treasury notes	2,133,154	158,000	9,332,214	11,623,368
Treasury strip	—	—	25,256	25,256
Yankees:				
Corporate	254,587	—	163,320	417,907
Government	—	—	53,822	53,822
Total invested assets	21,345,432	4,876,697	11,668,296	37,890,425
Pool-related net assets (liabilities)	(4,490,132)	1,964	935,067	(3,553,101)
Net invested assets	\$ 16,855,300	4,878,661	12,603,363	\$ 34,337,324



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**(3) Investments (cont.)**

At June 30, 2013, 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>	
Deposits	\$ 468,227	—	—	468,227
Commercial paper	913,742	—	—	913,742
Corporate bonds	1,120,068	—	1,641,601	2,761,669
Mortgage backed	46,998	—	432,402	479,400
Municipal bonds	10,964	—	4,431	15,395
Other asset backed	9,349,923	—	543,679	9,893,602
U.S. government agency Discount notes	1,559	—	—	1,559
U.S. government agency Treasury bills	9,228,562	4,409,705	1,370,269	15,008,536
Treasury notes	—	—	14,523,507	14,523,507
Treasury strip	—	—	119,453	119,453
Yankees:				
Corporate	293,458	—	292,844	586,302
Government	—	—	78,385	78,385
Total invested assets	21,433,501	4,409,705	19,655,888	45,499,094
Pool-related net liabilities	(440,068)	(1)	(181,544)	(621,613)
Unalloted cash	(22,809)	—	—	(22,809)
Net invested assets	\$ 20,970,624	4,409,704	19,474,344	44,854,672

**(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 14 months to maturity or 14 months expected average life upon purchase. Floating rate securities are limited to 3 years to maturity or 3 years expected average life upon purchase. These constraints apply to trade date, except for securities bought at new issue, for which settlement date applies. At June 30, 2014, the expected average life of individual fixed rate securities ranged from one day to 2.2 years and the expected average life of floating rate securities ranged from 8 days to 3.2 years.

***Short-Term Liquidity Fixed Income Pool***

Treasury's investment policy limits individual fixed rate securities to 6 months to maturity. These constraints apply to trade date, except for securities bought at new issue, for which settlement date applies. At June 30, 2014, the expected average life of fixed rate securities ranged from 31 to 179 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 its other fixed income pool portfolios to the following:

Intermediate-Term Fixed Income Pool –  $\pm$  20% of the Barclays 1-3 Year Government Bond Index. The effective duration for Barclays 1-3 Year Government Bond Index at June 30, 2014 was 1.94 years.

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**(4) Deposit and Investment Risk (cont.)**

At June 30, 2014, the effective duration by investment type was as follows (in years):

	<b>Intermediate-term fixed income pool</b>
Corporate	1.40
Mortgage-backed	0.99
Other asset-backed	0.70
U.S. government agency	1.71
U.S. Treasury bill	0.42
U.S. Treasury notes	2.14
U.S. Treasury strip	3.27
Yankees:	
Corporate	0.62
Government	0.78
<b>Portfolio effective duration</b>	<b>1.72</b>

***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 nonagency 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 nonagency 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 nonagency 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 nonagency mortgage securities may be purchased if only rated by one of these agencies if they are rated AAA.

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**(4) Deposit and Investment Risk (cont.)**

At June 30, 2014, 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>
Corporate bonds	AAA	0.06%	—%	0.10%
Corporate bonds	AA	2.90	—	1.33
Corporate bonds	A	3.71	—	2.98
Corporate bonds	BBB	—	—	0.73
U.S. government agency	AA	—	—	0.11
Overnight sweep accounts (Imcs)	Not rated	10.44	—	—
Mortgage backed	AAA	0.23	—	1.19
Mortgage backed	AA	0.04	—	0.69
Mortgage backed	A	0.06	—	0.15
Mortgage backed	BBB	—	—	0.01
Mortgage backed	Not rated	0.12	—	0.32
Other asset backed	AAA	22.93	—	1.71
Other asset backed	AA	0.21	—	0.34
Other asset backed	A	0.79	—	—
Other asset backed	Not rated	8.20	—	0.51
Other pool ownership	Not rated	—	0.01	8.81
Repurchase agreement	AA	6.52	—	—
U.S. Treasury bills	AA	56.25	96.71	4.98
U.S. Treasury notes	AA	12.65	3.24	67.52
U.S. Treasury strip	AA	—	—	0.18
Yankees:				
Corporate	AA	0.77	—	0.63
Corporate	A	0.74	—	0.38
Corporate	BBB	—	—	0.06
Corporate	Not rated	—	—	0.11
Government	AA	—	—	0.35
Government	Not rated	—	—	0.04
No credit risk	No exposure	(26.62)	0.04	6.77
		<u>100.00%</u>	<u>100.00%</u>	<u>100.00%</u>

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**(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, 2014, the Plan did not have more than 5% of 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:

	<b>2014</b>	<b>2013</b>
Beginning of year:		
Due to State of Alaska General Fund for outstanding warrants	\$ 1,001,788	1,435,319
Incurred but not reported	19,575,000	16,242,000
Total, beginning of year	20,576,788	17,677,319
Benefit deduction	129,947,203	120,525,784
Benefits paid	(131,641,660)	(117,626,315)
Total, end of year	\$ 18,882,331	20,576,788
End of year:		
Due to State of Alaska General Fund for outstanding warrants	\$ 859,331	1,001,788
Incurred but not reported	18,023,000	19,575,000
Total, end of year	\$ 18,882,331	20,576,788