KPMG

STATE OF ALASKA
GROUP HEALTH AND LIFE FUND

(An Internal Service Fund of the State of Alaska)

Financial Statements

June 30, 2013 and 2012

(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
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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 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, 2013 and 2012, and the related statement of revenues, expenses, and changes in net assets, 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 opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit 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 control 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 opinions.

Opinions

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, 2013 and 2012, and the changes in net assets 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

November 7, 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, 2013 and 2012. 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, 2013 and 2012. Information for fiscal year 2011 is presented for comparative purposes.

Financial Highlights

The Plan financial highlights as of June 30, 2013 were as follows:

- The Plan's unrestricted net assets decreased by $5.6 million during fiscal year 2013.
- The Plan's health insurance premiums increased by $8.9 million during fiscal year 2013.
- The Plan's investment earnings during fiscal year 2013 were $154,141.
- The Plan's benefit expense totaled $120.5 million during fiscal year 2013.

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, 2013 and 2012.

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, 2013 and 2012 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, 2013 and 2012, and the sources and uses of those funds during fiscal years 2013 and 2012.

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.

Condensed Financial Information

Net Assets

Description	2013	2012	Increase (decrease) Amount	Increase (decrease) Percentage	2011
Assets:					
Cash and cash equivalents	$ 44,854,672	47,588,399	(2,733,727)	(5.7)%	$ 40,155,448
Receivables	32,475	30,054	2,421	8.1	94,508
Other receivable	741	—	741	100.0	—
Other assets	1,014,055	1,013,712	343	—	840,649
Total assets	45,901,943	48,632,165	(2,730,222)	(5.6)	41,090,605
Liabilities:					
Claims payable	19,575,000	16,242,000	3,333,000	20.5	14,096,000
Due to State of Alaska General Fund	1,001,788	1,435,319	(433,531)	(30.2)	1,151,148
Accrued expenses	285,277	268,739	16,538	6.2	229,253
Total liabilities	20,862,065	17,946,058	2,916,007	16.2	15,476,401
Net assets	$ 25,039,878	30,686,107	(5,646,229)	(18.4)%	$ 25,614,204

Changes in Net Assets

Description	2013	2012	Increase (decrease) Amount	Increase (decrease) Percentage	2011
Net assets, beginning of year	$ 30,686,107	25,614,204	5,071,903	19.8%	$ 19,921,430
Operating revenues:					
Health insurance premiums	117,897,163	108,978,716	8,918,447	8.2	97,600,974
Other revenues	1,176,545	1,647,318	(470,773)	(28.6)	1,915,110
Total operating revenues	119,073,708	110,626,034	8,447,674	7.6	99,516,084
Operating expenses:					
Healthcare benefits	120,525,784	102,168,590	18,357,194	18.0	90,752,756
Administrative	4,348,294	3,991,440	356,854	8.9	3,701,488
Total operating expenses	124,874,078	106,160,030	18,714,048	17.6	94,454,244
Operating income (loss)	(5,800,370)	4,466,004	(10,266,374)	(229.9)	5,061,840
Nonoperating revenues:					
Net investment income	154,141	605,899	(451,758)	(74.6)	630,934
Change in net assets	(5,646,229)	5,071,903	(10,718,132)	(211.3)	5,692,774
Net assets, end of year	$ 25,039,878	30,686,107	(5,646,229)	(18.4)%	$ 25,614,204

(Continued)

Financial Analysis of the Plan

The statement of net assets as of June 30, 2013 and 2012 showed total assets exceeding total liabilities by $25,039,878 and $30,686,107, 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 a decrease in net assets of $5,646,229 or 18.4%, an increase of $5,071,903 or 19.8% over fiscal year 2012 and 2011, respectively. Over the long term, healthcare insurance 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.

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 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 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				
			Increase (decrease)		
	2013	2012	Amount	Percentage	2011
Health insurance premiums	$ 117,897,163	108,978,716	8,918,447	8.2%	$ 97,600,974
Other revenue	1,176,545	1,647,318	(470,773)	(28.6)	1,915,110
Net investment income	154,141	605,899	(451,758)	(74.6)	630,934
Total	$ 119,227,849	111,231,933	7,995,916	7.2%	$ 100,147,018

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

Healthcare insurance premiums benefit credit paid by the State of Alaska (the State) increased from $1,250 per month per person in fiscal year 2012 to $1,330 per month per person in fiscal year 2013. Insurance premiums were $1,088 in fiscal year 2011. 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 2013, there was also an increase of 164 members over fiscal year 2012.

(Continued)

Net investment income decreased by $451,758 or 74.6% from amounts recorded in fiscal year 2012 and decreased by $25,035 or 4.0% from amounts recorded in fiscal year 2011. In both fiscal years 2012 and 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 2013 and 2012, the GeFONSI investments generated 0.31% and 1.52% rates of return, respectively. The GeFONSI annualized rate of return was 1.18% over the last three years and 2.23% over the last five years. The invested balance decreased by $2,733,727 in fiscal year 2013, and increased by $7,432,951 and increased by $4,855,470 in fiscal years 2012 and 2011, 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 $18,357,194 or 18.0% from fiscal year 2012 and increased by $11,415,834 or 12.6% during fiscal year 2011. Fiscal year 2013 and 2012 saw an increase in covered members, and healthcare costs.

	Expenses				
			Increase (decrease)		
	2013	2012	Amount	Percentage	2011
Healthcare benefits	$ 120,525,784	102,168,590	18,357,194	18.0%	$ 90,752,756
Administrative	4,348,294	3,991,440	356,854	8.9	3,701,488
Total	$ 124,874,078	106,160,030	18,714,048	17.6%	$ 94,454,244

Administrative expenses increased by $356,854 or 8.9% from fiscal year 2012 and increased by $289,952 or 7.8% from fiscal year 2011.

Economic Conditions, Market Environment, and Results

Net investment rate of return remains below the five-year average ending the year at 13.9% 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 2014.

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, Finance Section
P.O. Box 110203
Juneau, Alaska 99811-0203

STATE OF ALASKA
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Statements of Net Assets

June 30, 2013 and 2012

		2013	2012
Assets:			
Cash and cash equivalents (notes 3 and 4):			
Investment in State of Alaska General Fund and Other Nonsegregated Investments Pool	$	44,854,672	47,588,399
Premiums receivable		32,475	30,054
Other receivable		741	—
Other assets		1,014,055	1,013,712
Total assets		45,901,943	48,632,165
Liabilities:			
Claims payable (note 5)		19,575,000	16,242,000
Due to State of Alaska General Fund (note 5)		1,001,788	1,435,319
Accrued expenses		285,277	268,739
Total liabilities		20,862,065	17,946,058
Unrestricted net assets	$	25,039,878	30,686,107

See accompanying notes to financial statements.

STATE OF ALASKA
GROUP HEALTH AND LIFE FUND
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Statements of Revenues, Expenses, and Changes in Net Assets

Years ended June 30, 2013 and 2012

	2013	2012
Operating revenues:		
Employer health insurance premiums	$ 101,677,005	93,838,322
Member health insurance premiums	16,220,158	15,140,394
Other revenue	1,176,545	1,647,318
Total operating revenues	119,073,708	110,626,034
Operating expenses:		
Benefits (note 5)	120,525,784	102,168,590
Administrative	4,348,294	3,991,440
Total operating expenses	124,874,078	106,160,030
Operating income	(5,800,370)	4,466,004
Nonoperating revenues:		
Net investment income	154,141	605,899
Change in unrestricted net assets	(5,646,229)	5,071,903
Total unrestricted net assets, beginning of year	30,686,107	25,614,204
Total unrestricted net assets, end of year	$ 25,039,878	30,686,107

See accompanying notes to financial statements.

STATE OF ALASKA
GROUP HEALTH AND LIFE FUND
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Statements of Cash Flows

Years ended June 30, 2013 and 2012

	2013	2012
Cash flows from operating activities:		
Cash received for premiums from the State of Alaska	$ 117,897,163	108,978,716
Cash received from others for premiums	(2,421)	1,960
Cash received from third-party administrator	1,175,804	1,709,811
Cash payments to third-party administrator for benefits	(117,626,315)	(99,738,419)
Cash payments to employees	(234,808)	(226,890)
Cash payments to suppliers	(4,097,291)	(3,898,126)
Net cash (used in) provided by operating activities	(2,887,868)	6,827,052
Cash flows from investing activity:		
Net investment income received	154,141	605,899
Net (decrease) increase in cash and cash equivalents	(2,733,727)	7,432,951
Cash and cash equivalents, beginning of year	47,588,399	40,155,448
Cash and cash equivalents, end of year	$ 44,854,672	47,588,399

	2013	2012
Reconciliation of operating income to net cash used for operating activities:		
Operating income	$ (5,800,370)	4,466,004
Adjustments to reconcile operating income to net cash (used in) provided by operating activities:		
(Increase) decrease in assets:		
Premiums receivable	(2,421)	1,960
Other receivables	(741)	—
Other assets	(343)	62,492
Deposit with third party administrator	—	(173,061)
Increase (decrease) in liabilities:		—
Claims payable	3,333,000	2,146,000
Due to State of Alaska General Fund	(433,530)	284,171
Accrued expenses	16,537	39,486
Net cash (used in) provided by operating activities	$ (2,887,868)	6,827,052

See accompanying notes to financial statements.

(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, 2013 and 2012, there were 6,504 and 6,340 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.

(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.

(Continued)

(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, 2013 and 2012. 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 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).

(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.

(Continued)

(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 midpoint 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, 2013, the Plan’s share of pool investments was as follows:

	Fair value			
Investment type	**Short-term fixed income pool**	**Short-term liquidity fixed income pool**	**Intermediate-term fixed income pool**	**Total**
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	—	—	649,317	649,317
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 assets (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

(3) Investments (cont.)

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

	Fair value			
Investment type	Short-term fixed income pool	Short-term liquidity fixed income pool	Intermediate-term fixed income pool	Total
Commercial paper	$ 784,714	—	12,355	797,069
Corporate bonds	2,099,135	—	3,156,799	5,255,934
Deposits	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	24,243,071	3,232,125	20,794,320	48,269,516
Pool-related net assets (liabilities)	(662,577)	528	(19,068)	(681,117)
Net invested assets	$ 23,580,494	3,232,653	20,775,252	47,588,399

(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.

(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, 2013, the expected average life of individual fixed rate securities ranged from 3 days to 34 years and the expected average life of floating rate securities ranged from 14 days to 22 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, 2013, the expected average life of fixed rate securities ranged from 46 to 67 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 – ± 20% of the Barclays 1-3 Year Government Bond Index. The effective duration for Barclays 1-3 Year Government Bond Index at June 30, 2013 was 1.87 years.

(4) Deposit and Investment Risk (cont.)

At June 30, 2013, the effective duration by investment type was as follows (in years):

	Intermediate-term fixed income pool
Corporate	2.42
Mortgage-backed	1.45
Municipal bonds	4.41
Other asset-backed	0.59
U.S. government agency	1.70
U.S. Treasury bill	0.11
U.S. Treasury notes	2.04
U.S. Treasury strip	4.43
Yankees:	
Corporate	1.85
Government	2.06
Portfolio effective duration	**1.77**

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.

(4) Deposit and Investment Risk (cont.)

At June 30, 2013, 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):

Investment type	Rating	Short-term fixed income pool		Short-term liquidity fixed income pool		Intermediate-term fixed income pool	
Deposits	Not rated	2.22	%	—	%	—	%
Commercial paper	Not rated	4.34		—		—	
Corporate bonds	AAA	—		—		0.40	
Corporate bonds	AA	2.41		—		1.73	
Corporate bonds	A	2.91		—		4.80	
Corporate bonds	BBB	—		—		0.83	
Corporate bonds	BB	—		—		0.16	
U.S. government agency	AA	—		—		2.75	
U.S. government agency	Not rated	0.01		—		0.38	
Mortgage-backed	AAA	0.07		—		0.80	
Mortgage-backed	AA	0.08		—		0.76	
Mortgage-backed	A	0.07		—		0.09	
Mortgage-backed	Not rated	—		—		0.43	
Municipal bonds	AA	0.05		—		—	
Municipal bonds	A	—		—		0.02	
Other asset-backed	AAA	39.98		—		1.86	
Other asset-backed	AA	0.72		—		—	
Other asset-backed	Not rated	3.71		—		0.76	
Other pool ownership	Not rated	—		0.07		5.92	
U.S. Treasury bills	AA	43.83		99.93		6.62	
U.S. Treasury notes	AA	—		—		70.18	
U.S. Treasury strip	AA	—		—		0.58	
Yankees:							
Corporate	AAA	—		—		0.18	
Corporate	AA	0.55		—		0.69	
Corporate	A	0.84		—		0.42	
Corporate	BBB	—		—		0.13	
Government	AA	—		—		0.34	
Government	Not rated	—		—		0.04	
No credit risk	No exposure	(1.79)		—		(0.87)	
		100.00%		100.00%		100.00%	

(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, 2013, the commissioner did not have exposure to any one issuer greater than 5% of invested assets.

(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:

		2013	2012
Beginning of year:			
Due to State of Alaska General Fund for outstanding warrants	$	1,435,319	1,151,148
Incurred but not reported		16,242,000	14,096,000
Total, beginning of year		17,677,319	15,247,148
Benefit deduction		120,525,784	102,168,590
Benefits paid		(117,626,315)	(99,738,419)
Total, end of year	$	20,576,788	17,677,319
End 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, end of year	$	20,576,788	17,677,319