KPMG

STATE OF ALASKA
RETIREE HEALTH FUND
(A Pension Trust Fund of the State of Alaska)

Financial Statements

June 30, 2011 and 2010

(With Independent Auditors' Report Thereon)

STATE OF ALASKA
RETIREE HEALTH FUND
(A Pension Trust Fund of the State of Alaska)

Table of Contents

KPMG

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

Independent Auditors' Report

Division of Retirement and Benefits and
Members of the Alaska Retirement Management Board
State of Alaska Retiree Health Fund:

We have audited the accompanying statements of fiduciary net assets of the State of Alaska Retiree Health Fund (the Plan),(a pension trust fund of the State of Alaska), as of June 30, 2011 and 2010, and the related statements of changes in fiduciary net assets 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 audit 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 fiduciary net assets of the State of Alaska Retiree Health Fund as of June 30, 2011 and 2010, and the changes in its fiduciary net assets 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 20, 2011

STATE OF ALASKA
RETIREE HEALTH FUND
(A Pension Trust Fund of the State of Alaska)

Management's Discussion and Analysis

June 30, 2011 and 2010

This section presents management's discussion and analysis (MD&A) of the Retiree Health Fund's (Plan) financial condition and performance for the years ended June 30, 2011 and 2010. This section is presented as a narrative overview and analysis. Please read the MD&A in conjunction with the financial statements and notes to the financial statements to better understand the financial condition and performance of the Plan during the fiscal years ended June 30, 2011 and 2010. Information for fiscal year 2009 is presented for comparative purposes.

Financial Highlights

The Plan financial highlights as of June 30, 2011 were as follows:

- The Plan's net assets held in trust for postemployment healthcare benefits increased by $56.0 million during fiscal year 2011.
- The Plan's health premiums increased by $4.2 million during fiscal year 2011.
- The Plan's net investment income increased $22.4 million to $42.4 million during fiscal year 2011.
- The Plan's benefit expenses totaled $37.1 million during fiscal year 2011.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Plan's financial statements. The Plan's financial statements are comprised of three components: (1) statement of fiduciary net assets, (2) statement of changes in fiduciary net assets, and (3) notes to financial statements.

Statement of Fiduciary Net Assets – This statement presents information regarding the Plan's assets, liabilities, and resulting net assets held in trust for postemployment healthcare benefits. This statement reflects the Plan's investments at fair market value, along with cash and short-term investments, receivables, and other assets less liabilities at June 30, 2011 and 2010.

Statement of Changes in Fiduciary Net Assets – This statement presents how the Plan's net assets held in trust for postemployment healthcare benefits changed during the fiscal years ended June 30, 2011 and 2010. This statement presents health premiums earned and net investment income (loss) during the period. Deductions for postemployment healthcare benefits and operating deductions are also presented.

The above statements represent resources available for investment and payment of benefits as of the fiscal year-end and the sources and uses of those funds during fiscal year 2011 and 2010.

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

Fiduciary Net Assets

Description	2011	2010	Increase (decrease) Amount	Increase (decrease) Percentage	2009
Assets:					
Cash and receivables	$ 59,527,980	36,325,225	23,202,755	63.9%	$ 37,957,666
Investments, at fair value	214,860,984	186,494,644	28,366,340	15.2	154,418,451
Other	351,455	351,455	—	—	351,455
Total assets	274,740,419	223,171,324	51,569,095	23.1	192,727,572
Liabilities:					
Claims payable	22,687,000	20,434,000	2,253,000	11.0	19,700,286
Accrued expenses	118,967	151,363	(32,396)	(21.4)	141,883
Due to other funds	349,238	7,020,941	(6,671,703)	(95.0)	7,313,300
Total liabilities	23,155,205	27,606,304	(4,451,099)	(16.1)	27,155,469
Total net assets	$ 251,585,214	195,565,020	56,020,194	28.6%	$ 165,572,103

Changes in Fiduciary Net Assets

Description	2011	2010	Increase (decrease) Amount	Increase (decrease) Percentage	2009
Net assets, beginning of year	$ 195,565,020	165,572,103	29,992,917	18.1%	$ 177,625,297
Additions (reductions):					
Healthcare premiums	54,148,964	49,981,997	4,166,967	8.3	47,108,376
Medicare retiree drug subsidy	97,449	58,586	38,863	66.3	2,720,681
Other income	1,172	27,790	(26,618)	(95.8)	1,599,489
Net investment income (loss)	42,360,329	19,925,906	22,434,423	(112.6)	(23,283,038)
Total additions	96,607,914	69,994,279	26,613,635	38.0	28,145,508
Deductions:					
Benefits	39,307,350	38,686,919	620,431	1.6	38,473,565
Administrative	1,280,370	1,314,443	(34,073)	(2.6)	1,725,137
Total deductions	40,587,720	40,001,362	586,358	1.5	40,198,702
Increase (decrease) in net assets	56,020,194	29,992,917	26,027,277	86.8	(12,053,194)
Net assets, end of year	$ 251,585,214	195,565,020	56,020,194	28.6%	$ 165,572,103

(Continued)

Financial Analysis of the Plan

The statements of fiduciary net assets as of June 30, 2011 and 2010 show net assets held in trust for postemployment healthcare benefits of $251,585,214 and $195,565,020, respectively. The entire amount is available to cover the Plan's obligations to pay postemployment healthcare benefits for its members and their beneficiaries.

These amounts also represent an increase in total net assets held in trust for postemployment healthcare benefits of $56,020,194 or 28.6% and an increase of $29,992,917 or 18.1% over fiscal years 2010 and 2009, respectively. Beginning on July 1, 2007, the Alaska Retiree Healthcare Trust (ARHCT) replaced the major medical fund of the Plan for retired members and beneficiaries covered under Public Employees' Retirement System (PERS), Teachers' Retirement System (TRS), and Judicial Retirement System (JRS). Previously, these Systems had paid a monthly health insurance premium to the Plan. With the creation of the ARHCT, participating PERS, TRS, and JRS employer contributions were deposited directly to the ARHCT replacing the monthly health insurance premiums. Healthcare coverage is still accounted for some retired members, dependents, and beneficiaries in the major medical fund via monthly health insurance premiums. Over the long term, healthcare premiums collected for the Dental, Visual, and Audio (DVA) and Long-Term Care (LTC) funds are expected to cover all claims costs. With continued increases in healthcare costs, the Plan must continue to accumulate assets to meet current and future claims costs.

The investment of Plan assets is a long-term undertaking. On an annual basis, the Commissioner of Revenue reviews the asset allocation policies related to Plan assets and adopts an asset allocation strategy to ensure the asset mix will remain at an optimal risk/return level given the Plan's constraints and objectives.

During fiscal years 2011 and 2010, the asset allocation for the major medical fund was 100% Short-term Fixed Income Fund and the asset allocation for the DVA fund was 100% General Fund and Other Non-segregated Investments (GeFONSI). The asset allocation for the Long-Term Care fund was as follows:

	2011	
	Long-Term Care	
	Allocation	Range
Short-term fixed income pool	11%	8% – 14%
Broad market fixed income pool	35	30% – 40%
Intermediate fixed income pool	27	22% – 32%
International equity	9	4% – 14%
Nonretirement domestic equity pool	18	8% – 28%
Total	100%	

(Continued)

	2010	
	Long-Term Care	
	Allocation	Range
Short-term fixed income pool	1%	0% – 2%
Conservative broad market fixed income pool	23	16% – 30%
Conservative bond market pool	3	1% – 5%
International equity	23	19% – 27%
Nonretirement domestic equity pool	50	40% – 60%
Total	100%	

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' (Division) benefit consultant with the governing body's concurrence and the Administrator's approval. Premiums are based on a calendar year. The benefit consultant reviews the historical claims experience and administrative costs and uses that data to estimate trends to develop recommended premiums for the next calendar year.

Healthcare Premiums and Investment Income

The additions required to fund postemployment healthcare benefits are accumulated through a combination of health premiums, prescription drug rebates, and net investment income.

	Additions (reductions)				
			Increase (decrease)		
	2011	2010	Amount	Percentage	2009
Employer health insurance premiums	$ 1,479,396	1,410,804	68,592	4.9%	$ 1,287,169
Member health insurance premiums	52,669,568	48,571,193	4,098,375	8.4	45,821,207
Medicare retiree drug subsidy	97,449	58,586	38,863	66.3	2,720,681
Other	1,172	27,790	(26,618)	(95.8)	1,599,489
Net investment income (loss)	42,360,329	19,925,906	22,434,423	112.6	(23,283,038)
Total	$ 96,607,914	69,994,279	26,613,635	38.0%	$ 28,145,508

System paid medical premiums were $1,075 per month per eligible retiree for calendar year 2011 and were $1,068 per month per eligible retiree for calendar year 2010 and $937 per month per eligible retiree for calendar year 2009.

(Continued)

Other income primarily comprises reimbursements for retiree prescription medication. The Plan was approved for participation in the Medicare Part D retiree drug subsidy (RDS) program starting in calendar year 2006. One of the provisions of Medicare Part D provides sponsors of pension healthcare plans the opportunity to receive a payment, the retiree drug subsidy (RDS), if the sponsor's plan provides a prescription drug benefit that is actuarially equivalent to the Medicare Part D benefit. The RDS is equal to 28% of the amount of eligible prescription drug benefit costs of retirees who are eligible for, but not enrolled in, Medicare Part D, by virtue of continuing to be covered by the sponsor's plan.

The System's net investment income in FY 2011 increased by $22,434,423 or 112.6% from amounts recorded in fiscal year 2010 and net investment income in FY 2010 increased by $43,208,944 or 185.6% from amounts recorded in fiscal year 2009. During FY 2011 and FY 2010, the System experienced positive return on investments.

For fiscal years 2011 and 2010, the Retiree Health Fund Medical Plan investments generated 0.48% and 1.17%, respectively, rate of return. The Retiree Health Fund Medical Plan annualized rate of return was 0.95% over the last three years and 2.83% over the last five years. For fiscal years 2011 and 2010, the Retiree Health Fund LTC Plan investments generated 21.77% and 12.48%, respectively, rate of return. The Retiree Health Fund LTC Plan annualized rate of return was 5.27% over the last three years and 4.91% over the last five years. The Retiree Health Fund DVA Plan is invested in the GeFONSI. The GeFONSI is an investment pool managed by the State of Alaska Treasury Division in the Department of Revenue. For fiscal years 2011 and 2010, the GeFONSI investments generated 1.72% and 3.38%, respectively, rate of return. The GeFONSI annualized rate or return was 3.11% over the last three years and 4.15% over the last five years.

Benefits and Deductions

The primary deduction of the Plan is the payment of postemployment healthcare benefits. These benefit costs and the cost of administering the Plan comprise the costs of operation.

	Deductions		Increase (decrease)		
	2011	2010	Amount	Percentage	2009
Healthcare benefits	$ 39,307,350	38,686,919	620,431	1.6%	$ 38,473,565
Administrative	1,280,370	1,314,443	(34,073)	(2.6)	1,725,137
Total	$ 40,587,720	40,001,362	586,358	1.5%	$ 40,198,702

Benefit expense increased by $620,431 and $213,354 or 1.6% and 0.6% from fiscal years 2010 and 2009, respectively. The increase in fiscal year 2011 was due to increasing healthcare costs and an increase in covered members. The Plan's benefit consultants identify and develop premiums necessary to cover the increased claims costs.

(Continued)

Funding

Postemployment healthcare benefits are funded by premiums received from the remaining participating retirement systems and plan members as well as from income earned on Plan investments. Healthcare premiums are recommended each year by the Division's consultant with the governing body's concurrence and the Administrator's approval.

Economic Conditions, Market Environment, and Results

The overall objective of the Plan is to have sufficient funds to meet current and future claim costs. The premiums for the major medical and DVA plans are calculated each year based on the anticipated claims and administrative costs for the following year. The benefit consultant reviews the historical claims experience and administrative costs and uses that data to estimate trends to develop premiums. The amount of reserves is considered when setting the premiums. The premiums for the LTC plan have been developed to provide future benefits for the retirees, much like an annuity. The LTC plan will accumulate large reserves to pay future benefits.

Requests for Information

This financial report is designed to provide a general overview of the Plan's financial condition for all 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 Retiree Health Fund
Division of Retirement and Benefits, Accounting Section
P.O. Box 110203
Juneau, Alaska 99811-0203

STATE OF ALASKA
RETIREE HEALTH FUND
(A Pension Trust Fund of the State of Alaska)

Statements of Fiduciary Net Assets

June 30, 2011 and 2010

	2011				2010			
	Major medical	**Dental, visual and audio**	**Long-term care**	**Total**	**Major medical**	**Dental, visual and audio**	**Long-term care**	**Total**
Assets:								
Cash and cash equivalents (notes 2 and 3):								
Investment in State of Alaska General Fund and other nonsegregated investments pool	$ —	15,894,741	—	15,894,741	—	15,800,372	—	15,800,372
Short-term fixed income pool	11,617,849	—	31,747,070	43,364,919	17,612,701	—	2,676,813	20,289,514
Total cash and cash equivalents	11,617,849	15,894,741	31,747,070	59,259,660	17,612,701	15,800,372	2,676,813	36,089,886
Investments (notes 2, 3, and 4):								
Broad market fixed income pool	—	—	86,000,717	86,000,717	—	—	48,885,994	48,885,994
Intermediate-term fixed income pool	—	—	64,728,105	64,728,105	—	—	—	—
Domestic equity pool	—	—	41,687,248	41,687,248	—	—	90,603,544	90,603,544
International equity pool	—	—	22,444,914	22,444,914	—	—	41,936,840	41,936,840
U.S. Treasury fixed income pool	—	—	—	—	—	—	5,068,266	5,068,266
Total investments	—	—	214,860,984	214,860,984	—	—	186,494,644	186,494,644
Other:								
Premiums receivable	168,804	35,094	60,832	264,730	93,524	26,420	54,344	174,288
Interest and dividends receivable	1,211	—	2,379	3,590	15,561	—	1,808	17,369
Other receivables	—	—	—	—	43,682	—	—	43,682
Other assets	32,346	281,717	37,392	351,455	32,346	281,717	37,392	351,455
Total other	202,361	316,811	100,603	619,775	185,113	308,137	93,544	586,794
Total assets	11,820,210	16,211,552	246,708,657	274,740,419	17,797,814	16,108,509	189,265,001	223,171,324
Liabilities:								
Claims payable (note 5)	151,000	3,543,000	18,993,000	22,687,000	163,000	2,987,000	17,284,000	20,434,000
Accrued expenses	13,585	79,454	25,928	118,967	18,022	84,933	48,408	151,363
Due to State of Alaska General Fund (note 2)	2,034	339,591	7,613	349,238	1,931,857	284,772	105,144	2,321,773
Due to PERS Alaska Retiree Health Care Trust	—	—	—	—	1,189,512	—	—	1,189,512
Due to TRS Alaska Retiree Health Care Trust	—	—	—	—	3,496,609	—	—	3,496,609
Due to JRS Alaska Retiree Health Care Trust	—	—	—	—	13,047	—	—	13,047
Total liabilities	166,619	3,962,045	19,026,541	23,155,205	6,812,047	3,356,705	17,437,552	27,606,304
Total net assets held in trust for postemployment healthcare benefits	$ 11,653,591	12,249,507	227,682,116	251,585,214	10,985,767	12,751,804	171,827,449	195,565,020

See accompanying notes to financial statements.

STATE OF ALASKA
RETIREE HEALTH FUND
(A Pension Trust Fund of the State of Alaska)

Statements of Changes in Fiduciary Net Assets

Years ended June 30, 2011 and 2010

	2011				2010			
	Major medical	Dental, visual and audio	Long-term care	Total	Major medical	Dental, visual and audio	Long-term care	Total
Additions:								
Contributions:								
Employer health insurance premiums	$ 1,479,396	—	—	1,479,396	1,410,804	—	—	1,410,804
Member health insurance premiums	1,206,295	30,672,814	20,790,459	52,669,568	1,088,256	28,044,890	19,438,047	48,571,193
Total contributions	2,685,691	30,672,814	20,790,459	54,148,964	2,499,060	28,044,890	19,438,047	49,981,997
Medicare retiree drug subsidy (note 6)	97,449	—	—	97,449	58,586	—	—	58,586
Investment income:								
Net appreciation in fair value	—	—	37,150,407	37,150,407	—	—	15,222,695	15,222,695
Interest	78,570	249,010	2,614,668	2,942,248	237,131	542,910	1,050,439	1,830,480
Dividends	—	—	2,344,163	2,344,163	—	—	2,930,345	2,930,345
Total investment income	78,570	249,010	42,109,238	42,436,818	237,131	542,910	19,203,479	19,983,520
Less investment expense	4,936	—	71,553	76,489	1,789	—	55,825	57,614
Net investment income	73,634	249,010	42,037,685	42,360,329	235,342	542,910	19,147,654	19,925,906
Other income	43	960	169	1,172	27,050	653	87	27,790
Total additions	2,856,817	30,922,784	62,828,313	96,607,914	2,820,038	28,588,453	38,585,788	69,994,279
Deductions:								
Benefits	2,042,481	30,498,683	6,766,186	39,307,350	4,916,384	26,740,565	7,029,970	38,686,919
Administrative	146,512	926,398	207,460	1,280,370	170,502	908,997	234,944	1,314,443
Total deductions	2,188,993	31,425,081	6,973,646	40,587,720	5,086,886	27,649,562	7,264,914	40,001,362
Net change in fiduciary net assets	667,824	(502,297)	55,854,667	56,020,194	(2,266,848)	938,891	31,320,874	29,992,917
Net assets held in trust for postemployment healthcare benefits:								
Net assets, beginning of year	10,985,767	12,751,804	171,827,449	195,565,020	13,252,615	11,812,913	140,506,575	165,572,103
Net assets, end of year	$ 11,653,591	12,249,507	227,682,116	251,585,214	10,985,767	12,751,804	171,827,449	195,565,020

See accompanying notes to financial statements.

(1) Description

The following brief description of the State of Alaska Retiree Health Fund (the Plan), a pension trust fund of the State of Alaska (the State), is provided for general information purposes only. Participants should refer to the Retiree Group Insurance Information Booklet for more complete information.

General

The Plan was established to provide self-insured healthcare benefits to retirees of the Public Employees' Retirement System, Teachers' Retirement System, Judicial Retirement System, and Elected Public Officers Retirement System (collectively referred to as the Retirement Systems) beginning July 1, 1997. The Plan is a pension trust fund of the State financial reporting entity and is included as such in the State's comprehensive annual financial report. As of June 30, 2011 and 2010, there were approximately 35,300 and 34,000 retirees, respectively, excluding dependents, covered by the Plan.

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

Benefits

The Plan offers major medical, voluntary dental, visual, and audio (DVA) and voluntary long-term care (LTC) benefits to eligible benefit recipients of the Retirement Systems and their dependents.

Medical

The Plan provides medical benefits to qualified benefit recipients of the Retirement Systems. The State pays the medical premiums for benefit recipients of the Elected Public Officers Retirement System, for benefit recipients of the Marine Engineers Beneficial Association who retired from the State after July 1, 1986 and for benefit recipients of the NorthWest Marine Trust who retired from the State before July 1, 1984. The following benefit recipients must elect coverage and pay a premium:

- Benefit recipients of the Public Employees' Retirement System (PERS) first hired under the PERS on or after July 1, 1986, who are under age 60, are not receiving a disability benefit, and had less than 25 years of peace officer/firefighter service or less than 30 years of other service.
- Benefit recipients of the Teachers' Retirement System (TRS) first hired under the TRS on or after July 1, 1990, who are under age 60, are not receiving a disability benefit, and had less than 25 years of service.
- Benefit recipients of the PERS first hired under the PERS on or after July 1, 1996, who are age 60 or older and do not have at least 10 years of credited service.
- Alternate payees under a Qualified Domestic Relations Order (QDRO).

(1) Description (cont.)

Beginning July 1, 2007, the Alaska Retiree Healthcare Trust (ARHCT), a healthcare trust fund of the State, was established. The ARHCT is self-funded and provides major medical coverage to retirees of the Plan. The Plan retains the risk of loss of allowable claims for eligible members. The ARHCT began paying member healthcare claims on March 1, 2008. Prior to that, healthcare claims were paid for by the Plan.

Voluntary DVA and LTC

Individuals receiving benefits from one of the Retirement Systems, excluding alternate payees under a QDRO, may elect coverage for themselves and their eligible dependents. If coverage is elected, the premiums are paid by deductions from retirement checks.

(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.

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

The Department of Revenue, Division of Treasury (Treasury) has created a pooled environment by which it manages investments the Commissioner has fiduciary responsibility for. Actual investing is performed by investment officers in Treasury or by contracted external investment managers. The DVA invests in the State's internally managed General Fund and Other Non-segregated Investments (GeFONSI), Short-Term, and Broad Market Fixed Income Pools. GeFONSI consists of investments in the State's internally managed Short-Term and Intermediate-Term Fixed Income Pools. 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.

Valuation and Income Allocation

Assets 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.

(Continued)

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

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 state legislature. Income in the Short-Term, Intermediate-Term, and Broad Market Fixed Income Pools as well as the International Equity Pool is allocated to pool participants daily on a pro rata basis. Domestic Equity income is credited and allocated in accordance with the participants pro rata share of the fund when received.

Federal Income Tax Status

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

Administration

The Plan is administered by the State's Division of Retirement and Benefits (DRB). DRB utilizes the services of a claims administrator, Wells Fargo Insurance Services, to process all medical, dental, and prescription drug claims.

Funding

The Plan is self-insured for all benefits. The Plan's funding policy provides for the collection of premiums from the retirement systems administered by the Division of Retirement and Benefits as well as from benefit recipients, as applicable. Premium amounts are actuarially determined on an annual basis and adjusted as necessary. The retirement systems retain the risk of loss of allowable claims.

Due to State of Alaska General Fund

Due to the State of Alaska General Fund represents reimbursements to be made by the Plan to other funds for net payments made by other funds on behalf of the Plan.

(Continued)

(3) Deposit and Investment Risk

At June 30, 2011, the Plan had the following investments:

	Fair value				
	Fixed income pools				
Investment type	**Short-term**	**Intermediate-term**	**Broad market**	**Other**	**Total**
Commercial paper	$ 5,337,870	226,210	—	—	5,564,080
Corporate bonds	23,611,587	11,556,564	17,538,902	—	52,707,053
Mortgage-backed	1,096,204	2,285,657	31,207,839	—	34,589,700
Other asset-backed	23,689,655	1,074,065	2,276,777	—	27,040,497
Overnight sweep account (LMCS)	636,927	—	—	—	636,927
U.S. government agency	1,317,347	3,016,980	3,150,085	—	7,484,412
U.S. government agency discount note	1,952,084	—	778,740	—	2,730,824
U.S. Treasury bills	11,160,380	—	—	—	11,160,380
U.S. Treasury bonds	—	—	1,968,525	—	1,968,525
U.S. Treasury notes	—	45,134,096	24,324,432	—	69,458,528
U.S. Treasury strip	—	41,320	—	—	41,320
Yankees:					
Corporate	466,130	1,913,813	4,162,467	—	6,542,410
Government	—	511,360	856,066	—	1,367,426
Domestic equity	—	—	—	41,687,248	41,687,248
International equity	—	—	—	22,444,914	22,444,914
Total invested assets	69,268,184	65,760,065	86,263,833	64,132,162	285,424,244
Pool related net assets (liabilities)	36,224	1,139,748	(12,475,982)	—	(11,300,010)
Other pool ownership	(17,327,381)	5,114,515	12,212,866	—	—
Net invested assets	$ 51,977,027	72,014,328	86,000,717	64,132,162	274,124,234

(3) Deposit and Investment Risk (cont.)

At June 30, 2010, the Plan had the following investments:

	Fair value					
	Fixed income pools					
Investment type	Short-term	Intermediate-term	Broad market	U.S. Treasury	Other	Total
Deposits	$ (69,323)	—	—	—	31,408	(37,915)
Commercial paper	1,839,396	—	—	—	—	1,839,396
Corporate bonds	17,230,221	1,102,803	10,017,566	477,435	—	28,828,025
Mortgage-backed	290,234	459,084	18,151,584	—	—	18,900,902
Municipal bonds	—	—	16,831	—	—	16,831
Other asset-backed	8,085,817	12,487	1,037,224	—	—	9,135,528
Short-term investment fund	—	—	—	—	1,027,755	1,027,755
U.S. government agency discount note	—	176,897	—	—	—	176,897
U.S. government agency	2,445,124	816,823	1,837,050	278,622	—	5,377,619
U.S. Treasury bills	4,476,279	—	—	—	—	4,476,279
U.S. Treasury bonds	—	—	2,621,604	495,466	—	3,117,070
U.S. Treasury notes	—	2,406,264	10,959,002	3,767,238	—	17,132,504
U.S. Treasury when issued	688,665	3,124,824	—	—	—	3,813,489
Yankees:						
Corporate	482,476	283,977	1,746,056	—	—	2,512,509
Government	—	69,509	517,056	28,116	—	614,681
Domestic equity	—	—	—	—	90,603,544	90,603,544
International equity	—	—	—	—	40,692,040	40,692,040
Total invested assets	35,468,889	8,452,668	46,903,973	5,046,877	132,354,747	228,227,154
Pool related net assets (liabilities)	16,318	(194,744)	(4,153,714)	(392,190)	185,637	(4,538,693)
Other pool ownership	(7,635,876)	—	6,135,737	413,579	—	(1,086,560)
Unallocated cash	—	—	(2)	—	—	(2)
Net invested assets	$ 27,849,331	8,257,924	48,885,994	5,068,266	132,540,384	222,601,899

Interest Rate Risk

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

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, 2011, the expected average life of individual fixed-rate securities ranged from one day to one year and the expected average life of floating rate securities ranged from eight days to fourteen years.

(3) Deposit and Investment Risk (cont.)

Intermediate, Broad Market, and U.S. Treasury Fixed Income Pools

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 and the Broad Market Fixed Income Pool to the following:

Intermediate-Term Fixed Income Pool – ± 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, 2011 was 2.54 years.

Broad Market Fixed Income Pool – ± 20% of the Barclays Capital U.S. Aggregate Bond Index. The effective duration for the Barclays Capital U.S. Aggregate Bond Index at June 30, 2011 was 5.19 years.

At June 30, 2011, the effective duration by investment type was as follows:

	Effective duration (in years)	
	Intermediate-term fixed income pool	**Broad market fixed income pool**
Commercial paper	0.05	—
Corporate bonds	2.01	5.93
Mortgage-backed	1.52	3.25
Other asset-backed	1.08	0.97
U.S. Treasury bonds	—	14.64
U.S. Treasury notes	3.09	4.74
U.S. Treasury strip	6.37	—
U.S. government agency	2.65	5.74
U.S. government agency discount	—	0.01
Yankees:		
Corporate	2.28	—
Government	1.92	6.38
Portfolio effective duration	2.53	4.46

(3) Deposit and Investment Risk (cont.)

Credit Risk

Credit risk is the risk that an issuer or other counter party 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. 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.

Intermediate-Term and Broad Market 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.

(3) Deposit and Investment Risk (cont.)

At June 30, 2011, 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	Intermediate-term fixed income pool	Broad market fixed income pool
Commercial paper	A-1	6.95%	—%	—%
Commercial paper	Not Rated	0.75	0.31	—
Corporate bonds	AAA	23.65	10.25	1.88
Corporate bonds	AA	1.45	1.07	2.71
Corporate bonds	A	3.20	3.20	9.37
Corporate bonds	BBB	—	1.39	6.38
Corporate bonds	Not Rated	5.78	—	0.04
Mortgage-backed	AAA	1.58	2.79	18.90
Mortgage-backed	AA	—	0.06	0.75
Mortgage-backed	A	—	0.02	0.57
Mortgage-backed	BBB	—	—	0.02
Mortgage-backed	Not Rated	—	0.28	16.01
Other asset-backed	AAA	30.49	1.32	2.36
Other asset-backed	A	0.07	—	—
Other asset-backed	CCC	—	0.02	—
Other asset-backed	Not Rated	3.62	—	0.29
U.S. government agency	AAA	1.90	3.47	3.66
U.S. government agency Discount notes	Not Rated	2.82	0.69	0.91
U.S. Treasury bills	AAA	16.10	—	2.29
U.S. Treasury notes	AAA	—	62.13	28.31
U.S. Treasury strip	AAA	—	0.06	—
Yankees:				
Government	AA	—	0.65	0.50
Government	A	—	0.01	0.15
Government	BBB	—	—	0.34
Government	Not Rated	—	0.05	—
Corporate	AAA	—	0.98	1.09
Corporate	AA	0.49	1.02	0.71
Corporate	A	0.11	0.40	1.73
Corporate	BBB	—	0.23	1.09
Corporate	Not Rated	0.07	—	0.21
No credit exposure		0.97	9.60	(0.27)
		100.00%	100.00%	100.00%

(3) Deposit and Investment Risk (cont.)

Foreign Currency Risk

The Commissioner of Revenue formally adopts asset allocation policies for the Plan at the beginning of each fiscal year, which places policy limitations on the amount of international securities the Plan is allowed to hold. The following policy was in place during fiscal year 2011 and invested assets included the following holdings at June 30, 2011, for the Plan's investment in the International Equity Pool:

	Policy	**Actual**
Retiree Health Insurance Fund, Long Term Care	9% ± 5%	9.10%

At June 30, 2011, the Plan had exposure to foreign currency risk as follows (in thousands):

Currency		**Fair value**
Deposits:		
Danish Krone	$	854
Euro Currency		2,956
Japanese Yen		23,298
		27,108
Investments – International equity:		
Australian Dollar		552,290
Canadian Dollar		277,727
Euro Currency		4,023,906
Hong Kong Dollar		172,958
Japanese Yen		2,929,591
New Zealand Dollar		194,842
Norwegian Krone		120,288
Pound Sterling		4,135,344
Swedish Krona		320,294
Swiss Franc		857,827
		13,585,067
Total	$	13,612,175

(3) 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. Federal National Mortgage Association securities are not corporate bonds.

At June 30, 2011, the fund had more than 5% of their investments in Federal National Mortgage Association as follows:

		Fair value	Percentage of total pool investments
Federal National Mortgage Association	$	24,330,215	8.88%

(4) Foreign Exchange, Foreign Exchange Contracts, Off-Balance-Sheet Risk, and Derivative Exposure

The Commissioner is exposed to credit risk on investment derivative instruments that are in asset positions. The Commissioner has no policy of requiring collateral or other security to support derivative instruments subject to credit risk. Additionally, the Commissioner has no policy regarding entering into netting arrangements when it enters into derivative instrument transactions with a counterparty, nor does the Commissioner have a policy for contingencies. The International Equity Pool investment includes the following income from derivative investments at June 30, 2011:

	Changes in fair value			Fair value at June 30, 2011			
	Classification		Amount	Classification		Amount	Notional
FX Forwards	Investment Revenue	$	(5,903)	Long-Term Instruments	$	—	—
Rights	Investment Revenue		3,550	Common Stock		—	—

Additionally, the International Equity Pool had the following income from foreign currency transactions:

Net realized gain on foreign currency	$	392,683

The International Equity Pool includes foreign currency forward contracts to buy and sell specified amounts of foreign currencies at specified rates on specified future dates for the purpose of hedging existing security positions. The counterparties to the foreign currency forward contracts consist of a diversified group of financial institutions. Credit risk exposure exists to the extent of nonperformance by these counterparties; however, the risk of default is considered to be remote. The market risk is limited to the difference between contractual rates and forward rates at the balance sheet date. At June 30, 2011, the International Equity Pool had no outstanding contracts.

(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, 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 follow:

		2011	2010
Beginning of year:			
Due to State of Alaska General Fund for outstanding warrants	$	2,321,773	2,810,257
Outstanding claims received but not paid		—	532,286
Incurred but not reported		20,434,000	19,168,000
Total, beginning of year		22,755,773	22,510,543
Benefit deductions		39,307,350	38,686,919
Benefits paid		(39,026,885)	(38,441,689)
Total, end of year	$	23,036,238	22,755,773
End of year:			
Due to State of Alaska General Fund for outstanding warrants	$	349,238	2,321,773
Incurred but not reported		22,687,000	20,434,000
Total, end of year	$	23,036,238	22,755,773

(6) Medicare Part D Retiree Drug Subsidy

One of the provisions of Medicare Part D provides sponsors of pension healthcare plans the opportunity to receive a retiree drug subsidy (RDS) payment if the sponsor's plan provides a prescription drug benefit that is actuarially equivalent to the Medicare Part D benefit. The RDS is equal to 28% of the amount of eligible prescription drug benefit costs of retirees who are eligible for, but not enrolled in, Medicare Part D, by virtue of continuing to be covered by the sponsor's plan. The Plan was approved for participation in the Medicare Part D program beginning calendar year 2006. The RDS for the six-month period ended June 30, 2011 cannot be reasonably estimated and, therefore, is not recorded in the financial statements for the period ended June 30, 2011.