



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

Financial Statements

June 30, 2012 and 2011

(With Independent Auditors' Report Thereon)

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

Table of Contents

	Page(s)
Independent Auditors' Report	1
Management's Discussion and Analysis	2 – 7
Statements of Fiduciary Net Assets	8
Statements of Changes in Fiduciary Net Assets	9
Notes to Financial Statements	10 – 22



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, 2012 and 2011, 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, 2012 and 2011, 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 22, 2012

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

Management's Discussion and Analysis

June 30, 2012 and 2011

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

Financial Highlights

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

- The Plan's net assets held in trust for postemployment healthcare benefits increased by \$35.0 million during fiscal year 2012.
- The Plan's health premiums increased by \$6.0 million during fiscal year 2012.
- The Plan's net investment income decreased \$32.0 million to \$10.4 million during fiscal year 2012.
- The Plan's benefit expenses totaled \$34.4 million during fiscal year 2012.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Plan's 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.

Statements 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, 2012 and 2011.

Statements 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, 2012 and 2011. 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 2012 and 2011.

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

STATE OF ALASKA
RETIREE HEALTH FUND
(A Pension Trust Fund of the State of Alaska)
Management's Discussion and Analysis
June 30, 2012 and 2011

Condensed Financial Information

Fiduciary Net Assets					
Description	2012	2011	Increase (decrease)		2010
			Amount	Percentage	
Assets:					
Cash and receivables	\$ 91,160,270	59,527,980	31,632,290	53.1%	\$ 36,325,225
Investments, at fair value	212,486,694	214,860,984	(2,374,290)	(1.1)	186,494,644
Other	776,948	351,455	425,493	121.1	351,455
Total assets	<u>304,423,912</u>	<u>274,740,419</u>	<u>29,683,493</u>	<u>10.8</u>	<u>223,171,324</u>
Liabilities:					
Claims payable	17,178,000	22,687,000	(5,509,000)	(24.3)	20,434,000
Accrued expenses	133,574	118,967	14,607	12.3	151,363
Due to other funds	545,692	349,238	196,454	56.3	7,020,941
Total liabilities	<u>17,857,266</u>	<u>23,155,205</u>	<u>(5,297,939)</u>	<u>(22.9)</u>	<u>27,606,304</u>
Total net assets	<u>\$ 286,566,646</u>	<u>251,585,214</u>	<u>34,981,432</u>	<u>13.9%</u>	<u>\$ 195,565,020</u>

Changes in Fiduciary Net Assets					
Description	2012	2011	Increase (decrease)		2010
			Amount	Percentage	
Net assets, beginning of year	\$ 251,585,214	195,565,020	56,020,194	28.6%	\$ 165,572,103
Additions:					
Healthcare premiums	60,142,982	54,148,964	5,994,018	11.1	49,981,997
Medicare retiree drug subsidy	81,361	97,449	(16,088)	(16.5)	58,586
Early retiree reinsurance program	159,646	—	159,646	100.0	—
Other income	4,932	1,172	3,760	320.8	27,790
Net investment income	10,404,104	42,360,329	(31,956,225)	(75.4)	19,925,906
Total additions	<u>70,793,025</u>	<u>96,607,914</u>	<u>(25,814,889)</u>	<u>(26.7)</u>	<u>69,994,279</u>
Deductions:					
Benefits	34,389,584	39,307,350	(4,917,766)	(12.5)	38,686,919
Administrative	1,422,009	1,280,370	141,639	11.1	1,314,443
Total deductions	<u>35,811,593</u>	<u>40,587,720</u>	<u>(4,776,127)</u>	<u>(11.8)</u>	<u>40,001,362</u>
Increase in net assets	<u>34,981,432</u>	<u>56,020,194</u>	<u>(21,038,762)</u>	<u>(37.6)</u>	<u>29,992,917</u>
Net assets, end of year	<u>\$ 286,566,646</u>	<u>251,585,214</u>	<u>34,981,432</u>	<u>13.9%</u>	<u>\$ 195,565,020</u>

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

Management's Discussion and Analysis

June 30, 2012 and 2011

Financial Analysis of the Plan

The statements of fiduciary net assets as of June 30, 2012 and 2011 show net assets held in trust for postemployment healthcare benefits of \$286,566,646 and \$251,585,214, 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 \$34,981,432 or 13.9% and an increase of \$56,020,194 or 28.6% over fiscal years 2011 and 2010, 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 2012 and 2011, 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:

	2012	
	Long-Term Care	
	Allocation	Range
Short-term fixed income pool	22%	21% - 23%
Broad market fixed income pool	52	42% - 62%
International equity	9	5% - 13%
Nonretirement domestic equity pool	17	7% - 27%
Total	<u>100%</u>	

STATE OF ALASKA
RETIREE HEALTH FUND
(A Pension Trust Fund of the State of Alaska)
Management's Discussion and Analysis
June 30, 2012 and 2011

	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%	

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				
	2012	2011	Increase (decrease)		2010
			Amount	Percentage	
Employer health insurance premiums	\$ 1,517,260	1,479,396	37,864	2.6%	\$ 1,410,804
Member health insurance premiums	58,625,722	52,669,568	5,956,154	11.3	48,571,193
Medicare retiree drug subsidy	81,361	97,449	(16,088)	(16.5)	58,586
Early retiree reinsurance program	159,646	—	159,646	100.0	—
Other	4,932	1,172	3,760	320.8	27,790
Net investment income	10,404,104	42,360,329	(31,956,225)	(75.4)	19,925,906
Total	\$ 70,793,025	96,607,914	(25,814,889)	(26.7)%	\$ 69,994,279

System paid medical premiums were \$1,200 per month per eligible retiree for calendar year 2012 and was \$1,075 per month per eligible retiree for calendar year 2011 and was \$1,068 per month per eligible retiree for calendar year 2010.

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

Management's Discussion and Analysis

June 30, 2012 and 2011

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 2012 decreased by \$31,956,225 or 75.4% from amounts recorded in fiscal year 2011 and net investment income in FY 2011 increased by \$22,434,423 or 112.6% from amounts recorded in fiscal year 2010. During FY 2012 and FY 2011, the System experienced positive returns on investments.

For fiscal years 2012 and 2011, the Retiree Health Fund Medical Plan investments generated 0.41% and 0.48%, respectively, rate of return. The Retiree Health Fund Medical Plan annualized rate of return was 0.69% over the last three years and 1.19% over the last five years. For fiscal years 2012 and 2011, the Retiree Health Fund LTC Plan investments generated 3.97% and 21.77% rate of return, respectively. The Retiree Health Fund LTC Plan annualized rate of return was 12.51% over the last three years and 2.69% 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 2012 and 2011, the GeFONSI investments generated 1.52% and 1.72% rate of return, respectively. The GeFONSI annualized rate or return was 2.21% over the last three years and 3.33% 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 comprises the costs of operation.

	Deductions				2010
	2012	2011	Increase (decrease)		
			Amount	Percentage	
Healthcare benefits	\$ 34,389,584	39,307,350	(4,917,766)	(12.5)%	\$ 38,686,919
Administrative	1,422,009	1,280,370	141,639	11.1	1,314,443
Total	<u>\$ 35,811,593</u>	<u>40,587,720</u>	<u>(4,776,127)</u>	<u>(11.8)%</u>	<u>\$ 40,001,362</u>

Benefit expense decreased by \$4,917,766 or 12.5% and increased by \$620,431 or 1.6% from fiscal years 2011 and 2010, respectively. The Plan's benefit consultants continue to identify and develop premiums necessary to cover claims costs.

STATE OF ALASKA
RETIREE HEALTH FUND
(A Pension Trust Fund of the State of Alaska)
Management's Discussion and Analysis
June 30, 2012 and 2011

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, 2012 and 2011

	2012				2011			
	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 (note 3):								
Investment in State of Alaska General Fund and other nonsegregated investments pool	\$ —	18,433,457	—	18,433,457	—	15,894,741	—	15,894,741
Short-term fixed income pool	12,532,851	—	60,193,962	72,726,813	11,617,849	—	31,747,070	43,364,919
Total cash and cash equivalents	12,532,851	18,433,457	60,193,962	91,160,270	11,617,849	15,894,741	31,747,070	59,259,660
Investments (notes 3 and 4):								
Broad market fixed income pool	—	—	145,141,415	145,141,415	—	—	86,000,717	86,000,717
Intermediate-term fixed income pool	—	—	—	—	—	—	64,728,105	64,728,105
Domestic equity pool	—	—	47,056,911	47,056,911	—	—	41,687,248	41,687,248
International equity pool	—	—	6,574,886	6,574,886	—	—	22,444,914	22,444,914
International equity pool-SOA	—	—	13,713,482	13,713,482	—	—	—	—
Total investments	—	—	212,486,694	212,486,694	—	—	214,860,984	214,860,984
Other:								
Premiums receivable	93,808	41,620	62,397	197,825	168,804	35,094	60,832	264,730
Interest and dividends receivable	4,845	—	22,855	27,700	1,211	—	2,379	3,590
Other receivables	132,058	—	—	132,058	—	—	—	—
Other assets	33,879	338,569	46,917	419,365	32,346	281,717	37,392	351,455
Total other	264,590	380,189	132,169	776,948	202,361	316,811	100,603	619,775
Total assets	12,797,441	18,813,646	272,812,825	304,423,912	11,820,210	16,211,552	246,708,657	274,740,419
Liabilities:								
Claims payable (note 5)	165,000	2,976,000	14,037,000	17,178,000	151,000	3,543,000	18,993,000	22,687,000
Accrued expenses	18,981	87,254	27,339	133,574	13,585	79,454	25,928	118,967
Due to State of Alaska General Fund	—	536,012	9,680	545,692	2,034	339,591	7,613	349,238
Total liabilities	183,981	3,599,266	14,074,019	17,857,266	166,619	3,962,045	19,026,541	23,155,205
Total net assets held in trust for postemployment healthcare benefits	\$ 12,613,460	15,214,380	258,738,806	286,566,646	11,653,591	12,249,507	227,682,116	251,585,214

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, 2012 and 2011

	2012				2011			
	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	\$ 1,517,260	—	—	1,517,260	1,479,396	—	—	1,479,396
Member health insurance premiums	1,216,213	35,115,892	22,293,617	58,625,722	1,206,295	30,672,814	20,790,459	52,669,568
Total contributions	<u>2,733,473</u>	<u>35,115,892</u>	<u>22,293,617</u>	<u>60,142,982</u>	<u>2,685,691</u>	<u>30,672,814</u>	<u>20,790,459</u>	<u>54,148,964</u>
Medicare retiree drug subsidy (note 6)	81,361	—	—	81,361	97,449	—	—	97,449
Early retiree reinsurance program (note 7)	159,646	—	—	159,646	—	—	—	—
Investment income:								
Net appreciation in fair value	—	—	4,830,185	4,830,185	—	—	37,150,407	37,150,407
Interest	50,092	238,913	4,336,897	4,625,902	78,570	249,010	2,614,668	2,942,248
Dividends	—	—	1,006,890	1,006,890	—	—	2,344,163	2,344,163
Total investment income	<u>50,092</u>	<u>238,913</u>	<u>10,173,972</u>	<u>10,462,977</u>	<u>78,570</u>	<u>249,010</u>	<u>42,109,238</u>	<u>42,436,818</u>
Less investment expense	3,623	—	55,250	58,873	4,936	—	71,553	76,489
Net investment income	<u>46,469</u>	<u>238,913</u>	<u>10,118,722</u>	<u>10,404,104</u>	<u>73,634</u>	<u>249,010</u>	<u>42,037,685</u>	<u>42,360,329</u>
Other income	164	4,655	113	4,932	43	960	169	1,172
Total additions	<u>3,021,113</u>	<u>35,359,460</u>	<u>32,412,452</u>	<u>70,793,025</u>	<u>2,856,817</u>	<u>30,922,784</u>	<u>62,828,313</u>	<u>96,607,914</u>
Deductions:								
Benefits (note 5)	1,884,809	31,380,348	1,124,427	34,389,584	2,042,481	30,498,683	6,766,186	39,307,350
Administrative	176,435	1,014,239	231,335	1,422,009	146,512	926,398	207,460	1,280,370
Total deductions	<u>2,061,244</u>	<u>32,394,587</u>	<u>1,355,762</u>	<u>35,811,593</u>	<u>2,188,993</u>	<u>31,425,081</u>	<u>6,973,646</u>	<u>40,587,720</u>
Net change in fiduciary net assets	959,869	2,964,873	31,056,690	34,981,432	667,824	(502,297)	55,854,667	56,020,194
Net assets held in trust for postemployment healthcare benefits:								
Net assets, beginning 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
Net assets, end of year	<u>\$ 12,613,460</u>	<u>15,214,380</u>	<u>258,738,806</u>	<u>286,566,646</u>	<u>11,653,591</u>	<u>12,249,507</u>	<u>227,682,116</u>	<u>251,585,214</u>

See accompanying notes to financial statements.

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

Notes to Financial Statements

June 30, 2012 and 2011

(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, 2012 and 2011, there were approximately 36,400 and 35,300 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).

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

Notes to Financial Statements

June 30, 2012 and 2011

(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, 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 the State's Department of Revenue, Treasury Division, or by contracted external investment managers. The Fund invests in the State's internally managed General Fund and Other Non-segregated Investments (GeFONSI), Short-term Fixed Income Pools and Broad Market Fixed Income Pools. GeFONSI consists of investments in the Short-term Fixed Income Pool, the 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.

Valuation and Income Allocation

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.

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

Notes to Financial Statements

June 30, 2012 and 2011

(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, Short-Term Liquidity, 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, Health Smart, 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.

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

Notes to Financial Statements

June 30, 2012 and 2011

(3) Deposit and Investment Risk

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

Investment type	Fair value					Total
	Fixed income pools					
	Short-term Fixed	Short-term Liquidity	Intermediate- term Fixed	Broad market	Other	
Commercial paper	\$ 3,285,656	—	4,785	186,474	—	3,476,915
Corporate bonds	8,789,236	—	1,222,505	28,759,649	—	38,771,390
Deposits	385,823	—	—	—	—	385,823
Mortgage-backed	819,034	—	299,249	49,921,852	—	51,040,135
Other asset-backed	34,025,878	—	32,880	3,827,462	—	37,886,220
U.S. government agency	1,156,947	—	391,337	5,706,159	—	7,254,443
U.S. Treasury Bills	51,022,785	1,251,675	651,890	1,639,934	—	54,566,284
U.S. Treasury bonds	—	—	—	7,972,735	—	7,972,735
U.S. Treasury notes	—	—	5,396,186	30,859,415	—	36,255,601
U.S. Treasury strip	—	—	4,810	—	—	4,810
Yankees:						
Government	2,022,224	—	—	6,769,775	—	8,791,999
Corporate	—	—	49,184	3,032,438	—	3,081,622
Domestic equity	—	—	—	—	47,056,911	47,056,911
International equity	—	—	—	—	20,288,368	20,288,368
Total invested assets	101,507,583	1,251,675	8,052,826	138,675,893	67,345,279	316,833,256
Pool related net assets (liabilities)	(2,725,608)	205	(7,384)	(10,425,805)	—	(13,158,592)
Other pool ownership	(16,891,325)	—	—	16,891,325	—	—
Net invested assets	\$ 81,890,650	1,251,880	8,045,442	145,141,413	67,345,279	303,674,664

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

Notes to Financial Statements

June 30, 2012 and 2011

(3) Deposit and Investment Risk (cont.)

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

Investment type	Fair value				
	Fixed income pools			Other	Total
	Short-term	Intermediate-term	Broad market		
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

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, 2012, 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.

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

Notes to Financial Statements

June 30, 2012 and 2011

(3) Deposit and Investment Risk (cont.)

Short-Term Liquidity Fixed Income Pool

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

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

Broad Market Fixed Income Pool – $\pm 20\%$ of the Barclays Capital U.S. Aggregate Bond Index. The effective duration for the Barclays Capital U.S. Aggregate Bond Index at June 30, 2012, was 5.07 years.

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

Notes to Financial Statements

June 30, 2012 and 2011

(4) Deposit and Investment Risk (cont.)

At June 30, 2012, the effective duration by investment type was as follows:

	<u>Effective duration (in years)</u>	
	<u>Intermediate- term fixed income pool</u>	<u>Broad market fixed income pool</u>
Cash Equivalent	0.26	0.26
Corporate bonds	1.62	6.93
Mortgage-backed	1.28	1.70
Other asset-backed	2.43	1.89
U.S. government agency	1.24	5.40
U.S. Treasury bill	0.30	0.43
U.S. Treasury bonds	—	15.53
U.S. Treasury notes	2.78	5.23
U.S. Treasury strip	5.26	—
Yankees:		
Corporate	2.63	4.20
Government	1.72	7.30
Portfolio effective duration	2.23	4.28

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. Commercial paper must be rated at least P-1 by Moody's and A-1 by Standard and Poor's. Asset-backed and non-agency mortgage securities must be rated A3 or equivalent. The A3 rating is defined as the median rating of the following three rating agencies: Standard & Poor's Corporation, Moody's and Fitch. Asset-backed and non-agency mortgage securities may be purchased if only rated by one of these agencies if they are rated AAA.

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

STATE OF ALASKA
RETIREE HEALTH FUND
(A Pension Trust Fund of the State of Alaska)
Notes to Financial Statements
June 30, 2012 and 2011

(3) Deposit and Investment Risk (cont.)

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 non-agency mortgage securities must be rated investment grade. The investment grade rating is defined as the median rating of the following three rating agencies: Standard & Poor's Corporation, Moody's and Fitch. Asset-backed and non-agency mortgage securities may be purchased if only rated by one of these agencies if they are rated AAA.

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

Notes to Financial Statements

June 30, 2012 and 2011

(3) Deposit and Investment Risk (cont.)

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

<u>Investment Type</u>	<u>Rating</u>	<u>Short-term Fixed Income Pool</u>	%	<u>Short-term Liquidity Fixed Income Pool</u>	%	<u>Intermediate- term Fixed Income Pool</u>	%	<u>Broad Market Fixed Income Pool</u>	%
Commercial Paper	Not Rated	3.33		—		0.06		0.12	
Corporate Bond	AAA	—		—		0.66		0.65	
Corporate Bond	AA	4.94		—		7.54		3.03	
Corporate Bond	A	3.60		—		3.52		10.01	
Corporate Bond	BBB	—		—		1.21		4.91	
Corporate Bond	BB	—		—		—		0.20	
Corporate Bonds	Not Rated	0.35		—		0.06		0.13	
Government Agency	AA	1.17		—		4.75		0.33	
Government Agency	A	—		—		0.06		—	
Mortgage-backed	AAA	0.46		—		1.73		3.05	
Mortgage-backed	AA	—		—		1.27		26.94	
Mortgage-backed	A	—		—		—		0.78	
Mortgage-backed	BBB	—		—		—		0.04	
Mortgage-backed	CCC	—		—		0.02		—	
Mortgage-backed	Not Rated	0.37		—		0.61		2.81	
Other Asset-backed	AAA	26.15		—		0.27		1.65	
Other Asset-backed	AA	1.90		—		—		—	
Other Asset-backed	A	0.08		—		—		—	
Other Asset-backed	CCC	—		—		—		0.03	
Other Asset-backed	Not Rated	6.30		—		0.13		0.11	
Other Pool Ownership	Not Rated	—		0.11		2.42		11.12	
U.S. Treasury Bill	AA	51.67		99.87		7.91		1.08	
U.S. Treasury Bond	AA	—		—		—		5.25	
U.S. Treasury Notes	AAA	—		—		65.44		20.32	
U.S. Treasury Strip	AAA	—		—		0.06		—	
Yankees:									
Corporate	AAA	—		—		0.50		0.81	
Corporate	AA	1.42		—		0.66		1.21	
Corporate	A	0.62		—		0.30		1.33	
Corporate	BBB	—		—		0.32		1.10	
Government	AA	—		—		0.54		0.64	
Government	A	—		—		0.01		0.15	
Government	BBB	—		—		—		0.32	
Government	Not Rated	—		—		0.04		2.07	
No Exposure		(2.36)		0.02		(0.09)		(0.19)	
		<u>100.00</u>	%	<u>100.00</u>	%	<u>100.00</u>	%	<u>100.00</u>	%

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

Notes to Financial Statements

June 30, 2012 and 2011

(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 2012 and invested assets included the following holdings at June 30, 2012, for the Plan's investment in the International Equity Pool:

	Policy	Actual
Retiree Health Insurance Fund, Long Term Care	9% ± 4%	7.44%

At June 30, 2012, the Plan had exposure to foreign currency risk as follows (in thousands):

Currency	Fair value
Deposits:	
Euro Currency	\$ 5,832
Japanese Yen	9,495
	15,327
Investments – International equity:	
Australian Dollar	873,545
Canadian Dollar	319,687
Danish Krone	147,692
Euro Currency	4,043,429
Japanese Yen	2,054,911
New Zealand Dollar	116,042
Pound Sterling	3,489,938
Swedish Krona	529,184
Swiss Franc	485,102
	12,059,530
Total	\$ 12,074,857

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

Notes to Financial Statements

June 30, 2012 and 2011

(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 five percent of a pool's holdings in corporate bonds of any one company or affiliated group.

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

(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, 2012:

	<u>Changes in fair value</u>		<u>Fair value at June 30, 2012</u>		
	<u>Classification</u>	<u>Amount</u>	<u>Classification</u>	<u>Amount</u>	<u>Notional</u>
FX Forwards	Investment Revenue	\$ (3,917)	Long-Term Instruments	—	—

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

Net realized gain on foreign currency	\$ 156,298
---------------------------------------	------------

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, 2012, the International Equity Pool had no outstanding contracts.

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

Notes to Financial Statements

June 30, 2012 and 2011

(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 are as follows:

	2012	2011
Beginning 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, beginning of year	23,036,238	22,755,773
Benefit deductions	34,389,584	39,307,350
Benefits paid	(40,238,142)	(39,026,885)
Total, end of year	\$ 17,187,680	23,036,238
End of year:		
Due to State of Alaska General Fund for outstanding warrants	\$ 9,680	349,238
Incurred but not reported	17,178,000	22,687,000
Total, end of year	\$ 17,187,680	23,036,238

(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.

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

Notes to Financial Statements

June 30, 2012 and 2011

(7) Early Retiree Reinsurance Program

The Early Retiree Reinsurance Program (ERRP) a temporary program that provides reimbursement to participating employment-based plans for a portion of the costs of health benefits for retirees age 55 and older who are not eligible for Medicare, and their spouses and surviving spouses and dependents. The amount of the reimbursement to the Plan is up to 80% of claims cost for health benefits between \$15,000 and \$90,000. The program was authorized by the Affordable Care Act as part of the U.S. Government Health Reform package. The Plan started participation in the ERRP program beginning calendar year 2012. The program ends on January 1, 2014. The EERP amount for fiscal year 2012 was \$159,646.