



THE STATE
of ALASKA
GOVERNOR BILL WALKER

Department of Revenue

TAX DIVISION

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March 2, 2018

The Honorable Anna MacKinnon
Alaska State Senate
Chairperson, Senate Finance Subcommittee for the Department of Revenue
State Capitol Room 516
Juneau, AK 99801

Dear Senator MacKinnon:

The purpose of this letter is to provide you with responses to a question asked of the Department of Revenue (DOR) during Deputy Director Brandon Spanos' presentation to the Department of Revenue Subcommittee on February 21, 2018. Please see the question in italics and our response immediately below.

1. *Is there a statutory limit on the price of a raffle ticket in Alaska?*

Raffles are overseen by the Tax Division as part of our mission to regulate charitable gaming. A raffle is one of many types of gaming activities available to permittees. The regulations applying to raffles appear in 15 AAC 160.640-675.

There is not a general limit on the price of a raffle ticket. There is one specific regulation which applies to "special-draw raffles." This is a type of raffle where the winner is determined by means other than drawing from a container. One example of such a raffle would be the "rubber duck derby," where the winner(s) are the first numbered ducks to cross the finish line. A special draw raffle, just as a ticket-drawing raffle, must rely on random chance. For this type of raffle, per 15 AAC 160.652(d):

(d) The price of a raffle ticket may not exceed \$100.

For all other types of raffles, there is no price limit for a single raffle ticket.

I hope you find this information to be useful. Please do not hesitate to contact me if you have further questions.

Sincerely,

A handwritten signature in blue ink, appearing to read "Ken Alper".

Ken Alper
Tax Director

Responses to Questions asked during and after February 21, 2018 Senate Finance Sub
Committee Budget presentation by the Treasury Division

Question 1:

Chair MacKinnon requested clarity regarding the owner of the savings attained in the 2017 refinancing of the Goose Creek Correctional Facility.

Response:

Matanuska Susitna Borough is the issuer of the lease revenue bonds that funded the Goose Creek Correctional Facility, as well as the subsequent refinancing issues in 2015 and 2016 (FY 2017), but the State is the obligated party for the repayment of the bonds. Per the authority provided in substantive legislation the State entered into a lease-purchase agreement with Matanuska Susitna Borough and those lease payments are the only security pledged to the bond issue. Accordingly, the State worked collaboratively with the Matanuska Susitna Borough staff and Assembly to secure an underwriter syndicate, obtain all needed State and Borough legal authorizations, disclose information related to the State of Alaska, the project, and to a lesser extent the Borough to potential investors, obtain credit ratings based on the State of Alaska's credit, and sell bonds. These bonds are considered "net tax supported obligations of the State" and the State makes payments directly to the trustee for the bondholders. The FY 2017 refinancing was for \$59.3 million, approximately one-third of the callable bonds maturing between 2020 and 2025. An additional \$101.8 million of callable bonds maturing between 2026 and 2032 were refunded in 2015 (FY 2015). The \$59.3 of bonds weren't included in the 2015 refinancing as the savings targets of the State couldn't be met for the maturities at that time.

Question 2:

Rob Carpenter, Legislative Finance, requested clarity in explaining how Treasury determined savings associated with Internal Management.

Response:

The Treasury Division continues to strive to improve on its ability to deliver investment results to its clients, the State of Alaska and the Alaska Retirement Management Board. The Division recognizes that the results that matter are those that are delivered after deducting expenses. For that reason, the Division focuses on net-of-fee investment returns.

A significant investment expense is investment manager fees. In recent years, the Division has taken several steps to lower investment manager fees, including:

- successfully lowered existing fee structures for several externally-managed mandates;
- initiated direct investments and co-investments in private equity limited partnerships and absolute return strategies, bypassing a layer of expense;
- launched an internally-managed high yield mandate, leveraging the skills of the existing fixed income team;

Responses to Questions asked during and after February 21, 2018 Senate Finance Sub
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- with support from the Legislature, built out an equity team and tasked it with managing eight new equity mandates, displacing externally managed active and passive mandates.

Measuring fee savings is more challenging than it might first appear. As funds grow, so do externally managed assets and the fees associated with them. As the Treasury moves toward more internally managed assets, fund fiduciaries may look to get more return from external managers through more complex investment strategies and choose to pay more to do so which may offset savings. Another difficulty involves identifying appropriate alternatives to the internal mandate. This involves determining how many managers are chosen to manage assets, whether the mandate is passive or active and whether fees are based on assets or performance.

The Treasury benchmarks savings by looking at what it would have paid external managers to manage its assets instead of having them managed internally. To develop proxies for what it would pay, it looks at what it pays its current managers in the defined benefit and contribution plans and the results of a fee study conducted in 2017 by its general consultant Callan, LLC.

The attached chart presents the results of the analysis that was performed. It shows the funds managed internally at the Treasury, including asset type and valuation at 12/31/17, as well as the basis point fee used to calculate the estimated savings. The remarks column includes data that was used in determining the basis points used in the analysis.

Fund Name	Asset Type	12/29/2017 NAV	Est. Savings (bps)	Estimated Savings	Remarks
Absolute Return Direct - ARMB	Absolute Return	1,430,059,059	64	9,152,377.98	Estimate of cost of external management. 2017 Callan fee survey median fee = 104 bps.
Short-term Fixed Income Pool - ARMB & State of AK	Fixed Income	4,492,515,009	19	8,535,778.52	2017 Callan fee survey median fee = 19 bps.
US Treasury Fixed Income Pool - ARMB	Fixed Income	2,662,490,032	19	5,058,731.06	2017 Callan fee survey median fee = 19 bps.
Short-term Liquidity Fund - State of AK	Fixed Income	357,568,528	19	679,418.20	2017 Callan fee survey median fee = 19 bps.
Medium-term Fixed Income - State of AK	Fixed Income	1,197,204,312	19	2,274,688.19	2017 Callan fee survey median fee = 19 bps.
Long-term Fixed Income - State of AK	Fixed Income	1,802,057,258	19	3,423,908.79	2017 Callan fee survey median fee = 19 bps.
Stoxx USA 900 Min. Variance - ARMB	Equity	382,073,304	15	573,109.95	2017 Callan fee survey median active fee = 29 bps. Median passive fee = 1 bps.
Dow Jones Dividend 100 Index Fund - ARMB	Equity	364,076,281	15	546,114.42	2017 Callan fee survey median active fee = 29 bps. Median passive fee = 1 bps.
Scientific Beta - ARMB	Equity	332,616,789	15	498,925.18	2017 Callan fee survey median active fee = 29 bps. Median passive fee = 1 bps.
S&P 600 - ARMB	Equity	156,456,154	15	234,684.23	2017 Callan fee survey median active fee = 29 bps. Median passive fee = 1 bps.
U.S. REIT Fund - State of AK	Equity	167,093,869	15	250,640.60	2017 Callan fee survey median active fee = 29 bps. Median passive fee = 1 bps.
S&P 500 Equal Weight - ARMB	Equity	329,251,764	15	493,877.65	2017 Callan fee survey median active fee = 29 bps. Median passive fee = 1 bps.
Russell 1000 Growth - ARMB	Equity	968,687,878	0.5	48,434.39	Estimate of cost of external management. 2017 Callan fee survey median passive fee = 1 bps.
Russell 1000 Value - ARMB	Equity	772,077,418	0.5	38,603.87	Estimate of cost of external management. 2017 Callan fee survey median passive fee = 1 bps.
Russell 200 - ARMB	Equity	373,420,923	0.5	18,671.05	Estimate of cost of external management. 2017 Callan fee survey median passive fee = 1 bps.
Private Equity Direct - ARMB	Private Equity	418,691,962	29	1,214,206.69	Estimate of cost of external management. 2017 Callan fee survey median passive fee = 87 bps.
US TIPS - ARMB	Real Assets	56,474,520	13	73,416.88	Estimate of cost of external management. 2017 Callan fee survey median fee = 44 bps.
U.S. REIT Fund - ARMB	Real Assets	364,012,708	15	546,019.06	2017 Callan fee survey median active fee = 29 bps. Median passive fee = 1 bps.
		16,626,847,758		33,661,606.92	

ALASKA RETIREMENT MANAGEMENT BOARD

Liquidity Analysis

Zachary Hanna, CFA
Deputy Chief Investment Officer

Overview

- **Understanding the ARMB's liquidity needs**
 - The ARMB has a relatively low allocation to cash and fixed income
 - The ARMB has a somewhat high relative allocation to illiquid alternatives
 - The DB plans are closed with increasing cash needs over time

- **Questions to explore:**
 - Does the ARMB have enough liquidity now?
 - How do the ARMB's liquidity needs change over time?
 - If liquidity needs increase over time, how does that impact earnings?

Uses of Liquidity

- Liquidity is needed to make benefit payments, fund new investments, and rebalance the portfolio.

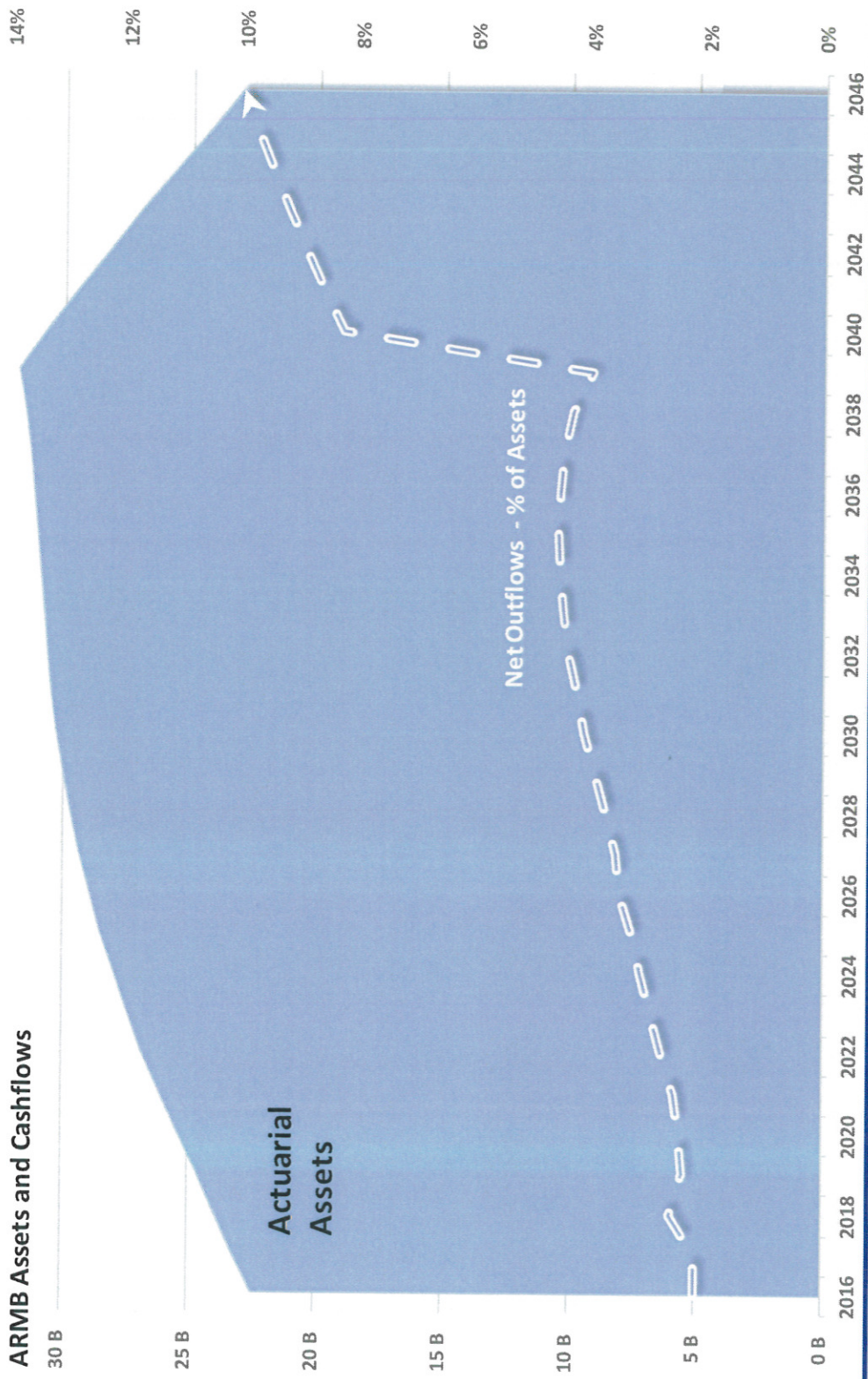
- Under normal market conditions, there are many sources of liquidity:
 - Incoming contributions to the plans
 - Portfolio yield – income and dividends
 - Sales of liquid assets, both equities and fixed income

- Under market stress conditions, significant liquidity may be needed to buy equities or to opportunistically buy other impacted assets

- Only contributions, yield, and the sale of the highest quality fixed income can typically be used for liquidity during significant market stress

ARMB Assets and Cashflows Over Time

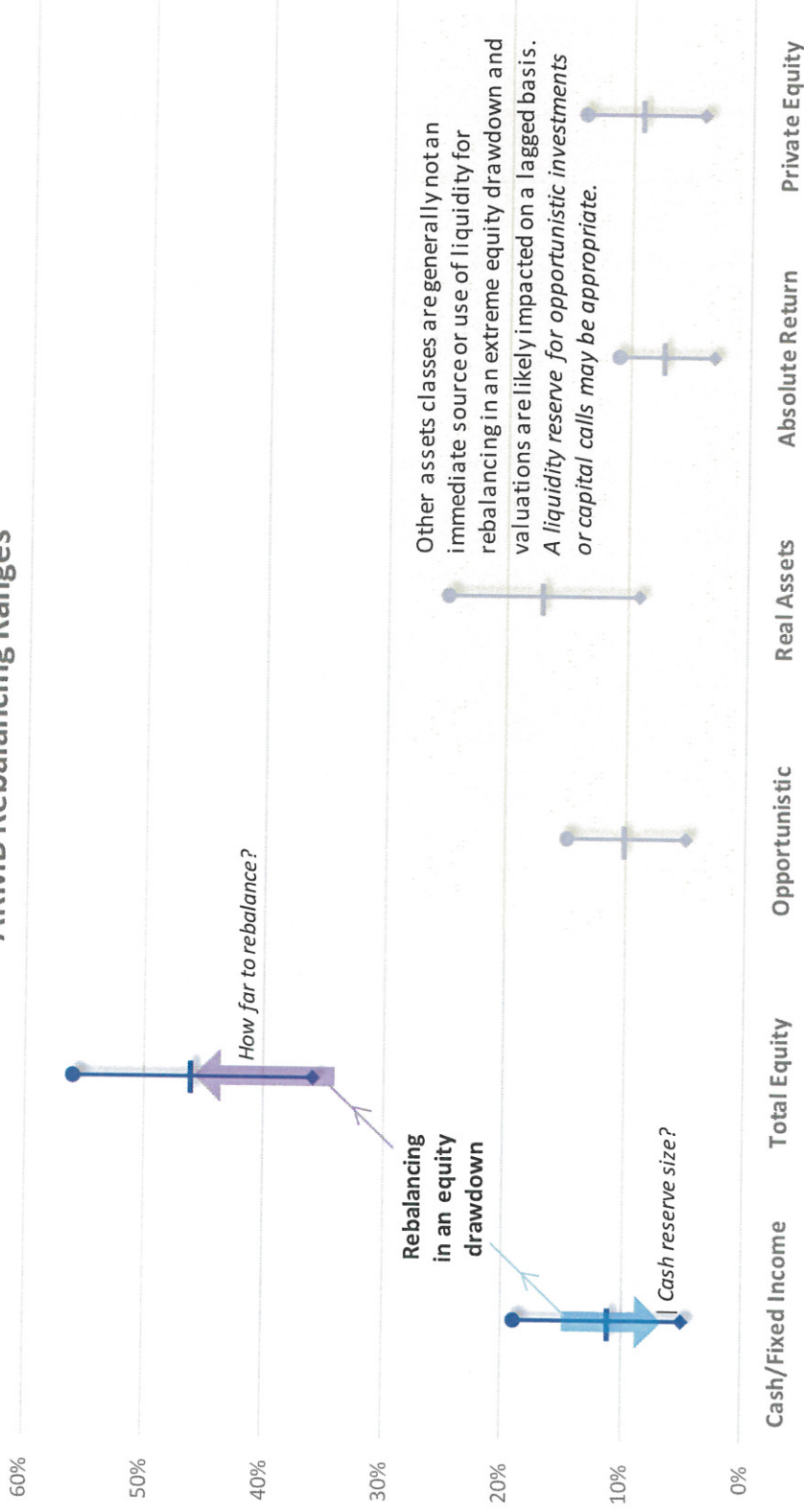
- Based on actuarial assumptions, the ARMB's assets should continue to grow through 2039
- Outflows, net of contributions and yield, start at 2.2% of assets and grow to 4.5% over this period
- Assets decrease and net outflows increase rapidly after 2039



ARMB Rebalancing

- Rebalancing is important to maintain the ARMB's strategic asset allocation and risk posture
- Public equities have a collective target of 46% and a rebalancing range of $\pm 10\%$
- Cash/Fixed Income has a target of 11% and can go down 6% to the lower band of 5%

ARMB Rebalancing Ranges

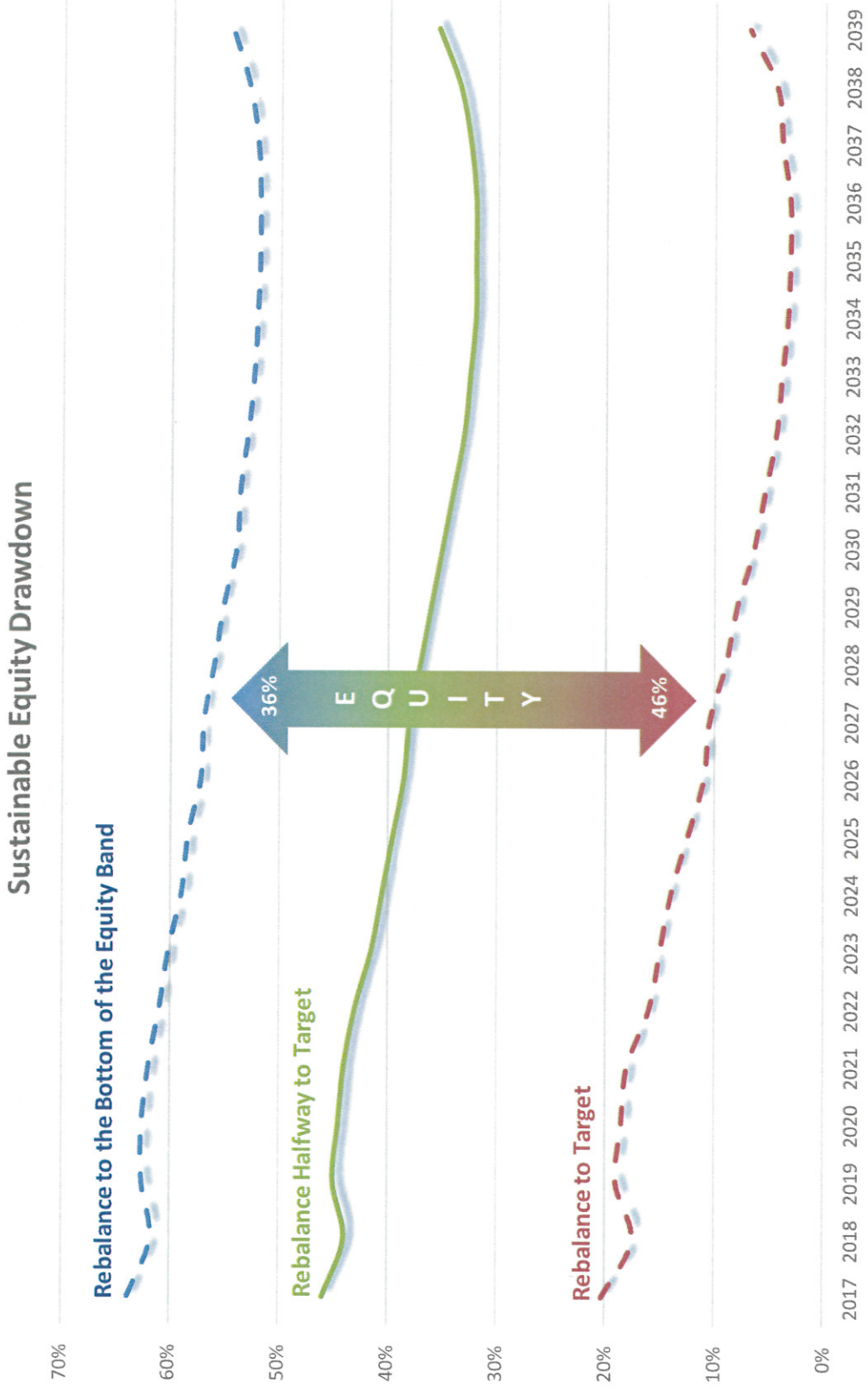


Liquidity Stress Analysis

- Liquidity to make benefit payments and maintain the asset allocation is most constrained during times of market stress
- The ability of the system to meet liquidity needs under varying degrees of market stress and liquidity levels was analyzed
- The analysis provides insight into how much stress can be sustained, how much liquidity is needed over time, and the return implications of increasing liquidity needs over time
- Assumptions:
 - Cash reserves for one year of benefit payments net of contributions and yield
 - An additional cash reserve of 1% to allow for alternative investments net outflows
 - Illiquid assets were modeled with an observed equity beta of 0.40 to allow for the denominator impact of the lagged write-down of these assets. Fixed income was modeled with zero correlation to equities.

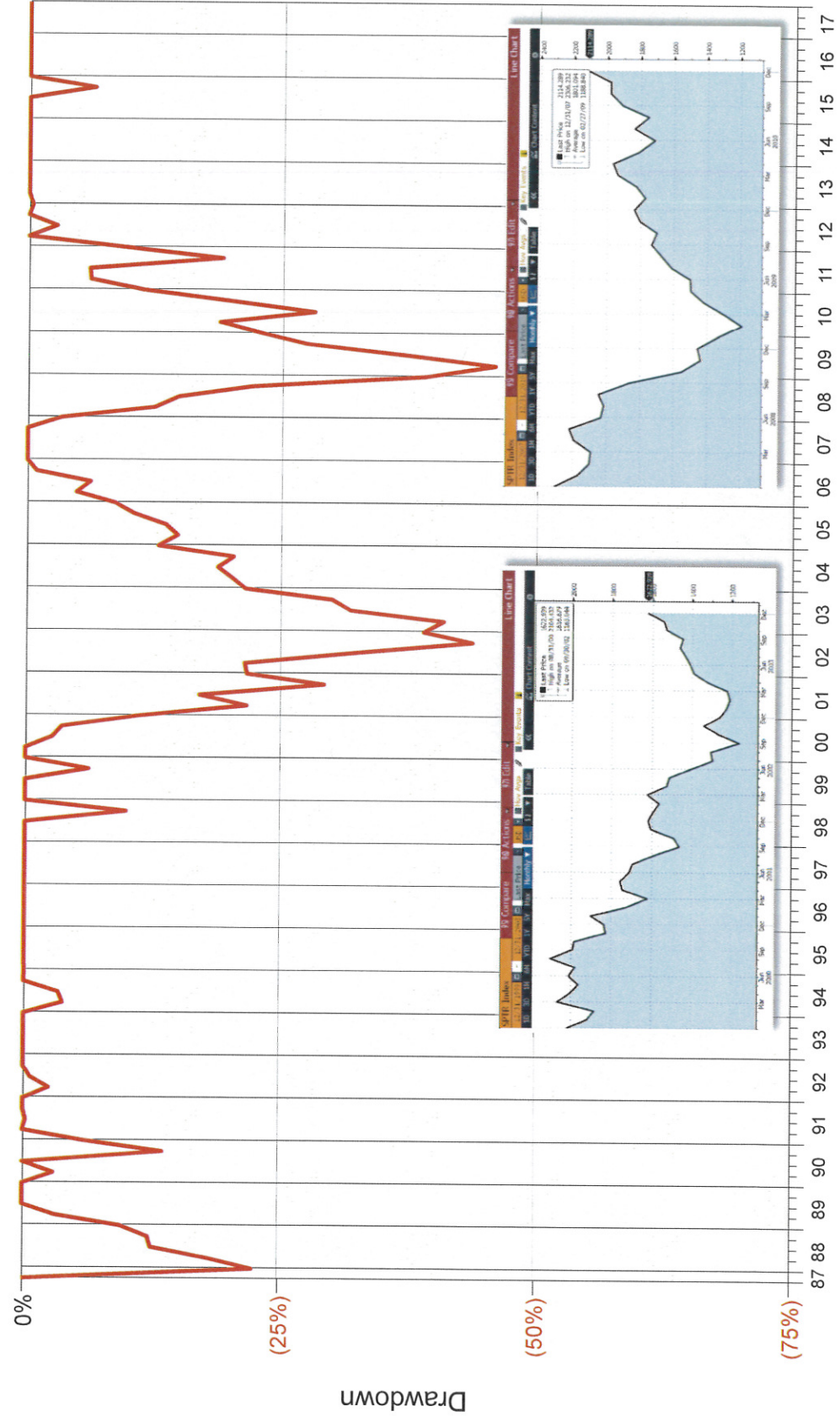
Liquidity Analysis: Sustainable drawdown with current liquidity

- The equity drawdown that can be sustained with existing liquidity varies materially with how far toward target equity is rebalanced



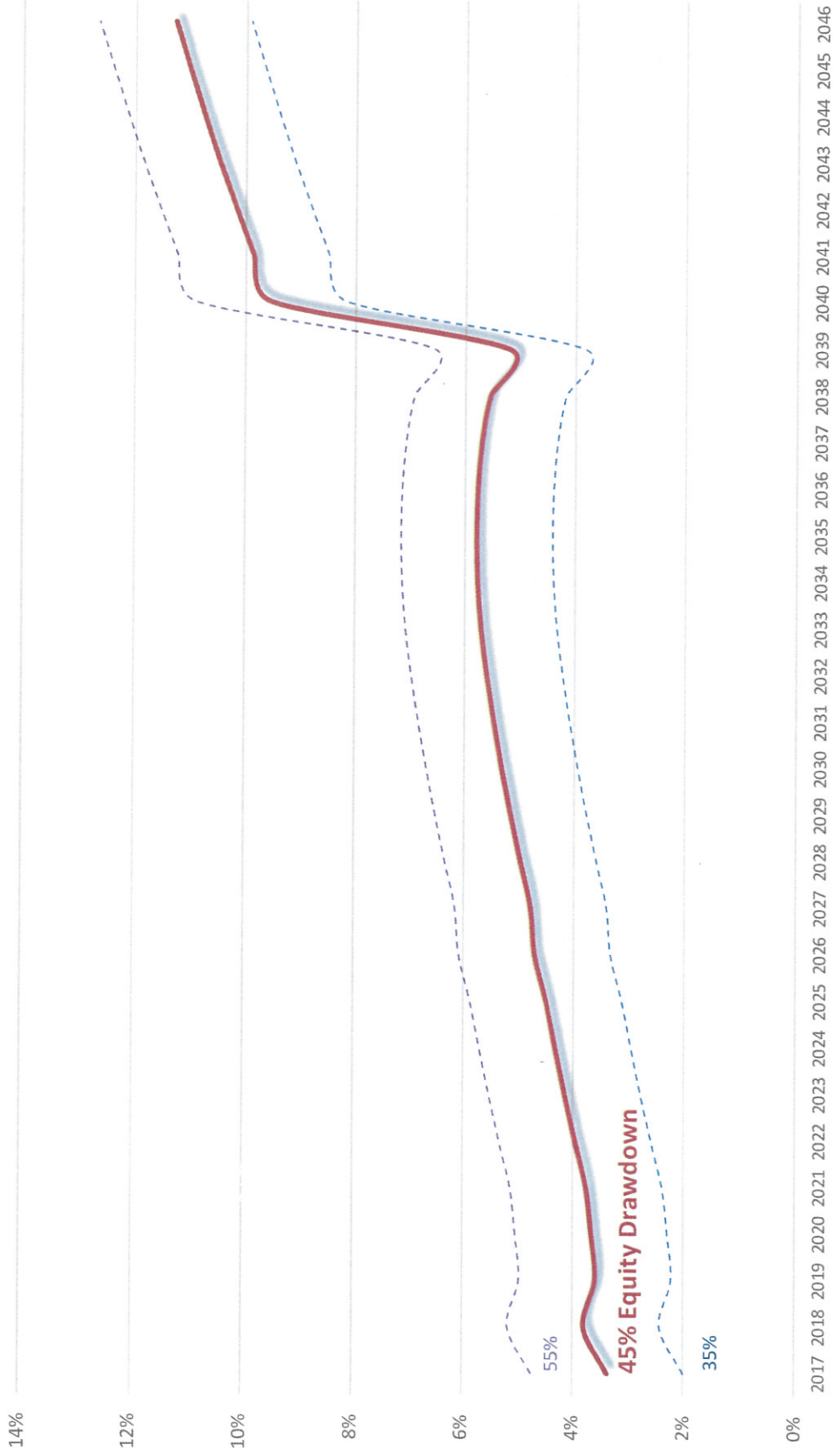
Historic Equity Market Drawdowns

S&P:500 Drawdown for 30 Years Ended September 30, 2017



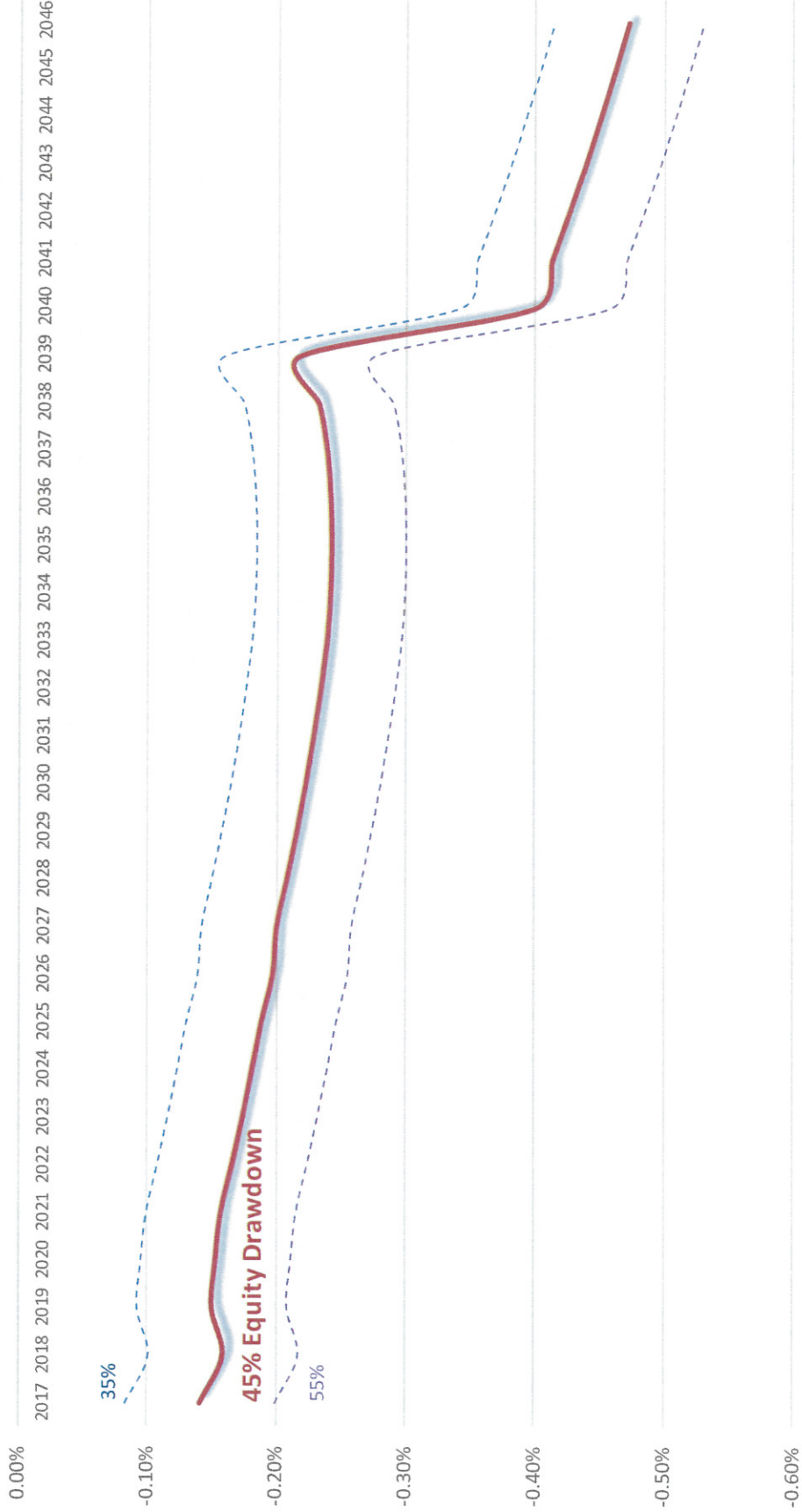
Liquidity Analysis: Extreme Equity Drawdowns with Full Rebalance

Additional Liquidity Needed for Extreme Equity Drawdowns



Liquidity Analysis: Return Implications of Additional Fixed Income

Annual Return Reduction Due to Increased Liquidity for Extreme Equity Drawdowns



Early Conclusions

- Currently, the ARMB has adequate liquidity to meet benefit payments and rebalance through significant market shocks, but not extreme market shocks like 2008.
- To manage through extreme shocks, the ARMB would need to rebalance to less than target or consider using some combination of additional liquidity and derivatives to rebalance.
- The increase in liquidity needs over time appears manageable over the next 20 years. This is partially due to repayment of the unfunded liability through 2039.
- Once the unfunded liability is repaid in 2040, the liquidity needs go up substantially and more material asset allocation changes may be necessary.