APPENDIX X

MEMORANDUM

STATE OF ALASKA
Department of Revenue

To: File

From: Wilson L. Condon
Commissioner
Department of Revenue

Date: August 10, 1999

Telephone: 465-2301

Subject: Constitutional Budget Reserve Fund

Commissioner's Amended Decision and Justification for Managing the Constitutional Budget Reserve Fund in the Treasury Division of the Department of Revenue

AS 37.10.430(a) enacted by the Alaska Legislature in 1996 provides:

> The Department of Revenue may transfer management responsibility over all or a portion of the Budget Reserve Fund (Article IX, Section 17, Constitution of the State of Alaska) to the Alaska Permanent Fund Corporation.

I have decided to reaffirm my earlier decision that the Department of Revenue should retain the management of all of the Constitutional Budget Reserve Fund (CBRF).

My decision is based on a review of the state's Reserves Policy and an analysis of the mission of the Permanent Fund Corporation in light of that Reserves Policy. The policy is based on three points as follows:

1. Permanent Fund Corporation Does Not Have Investment Arrangements in Place to Accommodate Multiple Asset Allocations and Daily Cash Flow Requirements.

The Permanent Fund Corporation's investment arrangements are not currently configured to accommodate the needs of an asset allocation different from those of the Permanent Fund. If the CBRF were invested with the Permanent Fund Corporation, the purposes and policies of the CBRF and the Permanent Fund Corporation would conflict. If the CBRF were invested directly as a commingled fund, the asset allocation of the CBRF would no longer reflect the asset allocation necessary to fill the state's Reserves Policy. If, on the other hand, the CBRF were invested by the Corporation, but as a separate fund with a unique asset allocation, the Corporation would no longer be able to rely on a single asset allocation arrangement for the funds it manages.

Investing the CBRF using a different asset allocation from that of the Permanent Fund would currently be more expensive for the Permanent Fund than for Treasury. This is so because the Permanent Fund Corporation does not currently have a series of readily available pooled funds like the ones now managed by Treasury (See Section 2 below).

In addition, the Permanent Fund has been invested in a manner to meet one cash flow draw each year - the Permanent Fund Dividend payment. The CBRF must be invested so that it is accessible to meet the daily cash flow requirements of the state.

2. Treasury Currently Has the Tools in Place to Meet the Objectives of the Reserves Policy and the CBRF.

First, the Treasury Division has created a series of pooled Funds that are ideally suited to accommodate the proposed CBRF asset allocation. (See Sections X and XI and Appendix Y of the Treasury Division's Policies and Procedures Manual.) Because Treasury has been required to accommodate a wide variety of investment mandates over the years, it has developed investment vehicles that can accommodate those differing mandates. The asset allocation analysis and decision set forth in Appendix Y of the Treasury Division's Policies

and Procedures Manual justifies leaving the CBRF investment responsibility with the Treasury Division. The Permanent Fund Corporation cannot, at this time, provide the necessary asset allocation opportunities.

Second, Treasury has staff members responsible for managing daily cash flows, and it invests some portion of its funds with daily cash flow requirements in mind. Without increasing the size of their staff, the Permanent Fund Corporation cannot easily provide the necessary arrangements for managing daily cash flows.

Third, Treasury can provide these services at a relatively low cost because the institutional arrangements for implementing the pertinent investment policies are already in place with respect to other Funds managed by Treasury. Using these arrangements will give the CBRF the obvious benefit of the economies of scale attendant to large institutional arrangements.

3. Treasury's Returns Are Competitive With Those of the Permanent Fund.

The return experience of the investment pools into which Treasury proposes to invest CBRF assets provide competitive returns with the counterpart portions of the Permanent Fund portfolio. Where the Permanent Fund does not have a counterpart portion, Treasury's returns exceed the benchmarks.

DEPARTMENT OF REVENUE - PERMANENT FUND CORPORATION
RELATIVE RETURNS
(Expressed as Annual Returns)
As of June 30, 1997

Core Fixed Income (Long-Term Fixed Income)	1 Year	3 Years	5 Years
Treasury [1]	7.95	8.35	7.69
PFC [2]	7.78	8.22	7.05
Benchmark [3]	7.75	8.34	7.23

[1] Public Employees' Retirement, Callan Associates Performance Reports
[2] In-House Bond (Total Fund), Callan Associates Performance Reports
[3] Lehman Government/Corporate Index

Intermediate-Term Fixed Income	1 Year	3 Years
Treasury [1]	6.77	6.73
PFC	N/A	N/A
Benchmark [2]	6.55	6.56

Short-Term Fixed Income	1 Year	3 Years
Treasury [3]	5.73	5.76
PFC	N/A	N/A
Benchmark [4]	5.50	5.58

[1] Intermediate-Term Pool, Established July 1, 1994, State Street Analytics Performance Reports
[2] Lehman 1-3 Year Treasury Index
[3] Short-Term Pool, Established February 1, 1993, State Street Analytics Performance Reports
[4] 91 Day U.S. Treasury Bill

If there is a material change in either the Department of Revenue's or the Permanent Fund Corporation's capabilities or roles, the Commissioner of Revenue will review this determination. In addition, the Commissioner will review this determination annually.