



**ALASKA STATE PENSION INVESTMENT BOARD**

**Military Retirement System**

**Invested Assets**

**June 30, 2005 and 2004**

**(With Independent Auditors' Report Thereon)**

**ALASKA STATE PENSION INVESTMENT BOARD**

**Military Retirement System**

**Invested Assets**

**June 30, 2005 and 2004**

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## **Independent Auditors' Report**

Alaska State Pension Investment Board and  
State of Alaska, Department of Revenue  
Division of Treasury:

We have audited the accompanying schedules of invested assets of the Military Retirement System as of June 30, 2005 and 2004 and of investment income and changes in invested assets of the Military Retirement System for the years then ended (schedules). These schedules are the responsibility of the Division of Treasury's management. Our responsibility is to express an opinion on these schedules 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 schedules 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 Military Retirement System's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the schedules. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall schedule presentation. We believe that our audits provide a reasonable basis for our opinion.

The accompanying schedules were prepared to present the invested assets of the Military Retirement System, which is established under the State of Alaska National Guard and Naval Militia Retirement System (NG & NMRS). The schedules are not intended to present the financial status of NG & NMRS.

In our opinion, the schedules referred to above present fairly, in all material respects, the invested assets of the Military Retirement System as of June 30, 2005 and 2004, and the investment income and changes in invested assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

**KPMG LLP**

August 25, 2005

ALASKA STATE PENSION INVESTMENT BOARD

MILITARY RETIREMENT SYSTEM

SCHEDULES OF INVESTED ASSETS

June 30, 2005 and 2004

	<u>2005</u>	<u>2004</u>
<b>Investments (at Fair Value)</b> (Notes 4, 7)		
<b>Cash and Cash Equivalents</b>		
Short-term Fixed Income Pool (Note 3)	\$ 24,556	\$ 25,875
Securities Lending Collateral (Note 7)	<u>1,572,835</u>	<u>2,591,169</u>
Total Cash and Cash Equivalents	<u>1,597,391</u>	<u>2,617,044</u>
<b>Marketable Debt Securities</b> (Note 3)		
Domestic Fixed Income Pool	<u>8,261,554</u>	<u>7,409,156</u>
<b>Equity Securities</b> (Note 3)		
Domestic Equity Pool	4,511,413	4,348,896
International Equity Pool	<u>1,803,186</u>	<u>1,689,134</u>
Total Equity Securities	<u>6,314,599</u>	<u>6,038,030</u>
<b>Total Invested Assets</b>	<u>16,173,544</u>	<u>16,064,230</u>
Securities Lending Collateral (Note 7)	<u>1,572,835</u>	<u>2,591,169</u>
<b>Total Net Assets</b>	<u>\$ 14,600,709</u>	<u>\$ 13,473,061</u>

See accompanying notes to schedules

ALASKA STATE PENSION INVESTMENT BOARD

MILITARY RETIREMENT SYSTEM

SCHEDULES OF INVESTMENT INCOME  
AND CHANGES IN INVESTED ASSETS

Years ended June 30, 2005 and 2004

	<u>2005</u>	<u>2004</u>
<b>Investment Income</b>		
Short-term Fixed Income Pool	\$ 1,635	\$ 511
Securities Lending (net of \$22,347 and \$12,165 expense)	2,562	3,020
Domestic Fixed Income Pool	605,206	87,846
Domestic Equity Pool	192,465	750,830
International Equity Pool	<u>222,915</u>	<u>405,215</u>
<b>Total Investment Income</b>	1,024,783	1,247,422
<b>Total Invested Assets, Beginning of Year</b>	13,473,061	12,731,964
<b>Net Contributions (Withdrawals)</b>	<u>102,865</u>	<u>(506,325)</u>
<b>Total Invested Assets, End of Year</b>	<u>\$ 14,600,709</u>	<u>\$ 13,473,061</u>

See accompanying notes to schedules

# **Military Retirement System Invested Assets**

## **Notes to Schedules June 30, 2005 and 2004**

### **(1) THE ACCOUNTING ENTITY**

The Military Retirement System Invested Assets (MRS Invested Assets) is the investment portfolio of the State of Alaska National Guard and Naval Militia Retirement System (NG & NMRS). NG & NMRS is a single-employer defined benefit system established for the payment of retirement, disability and death benefits to, or on behalf of, qualified members of the Alaska National Guard, Alaska Naval Militia and Alaska Air Guard. These Schedules are those of MRS Invested Assets and not NG & NMRS taken as a whole. Fiduciary responsibility for MRS Invested Assets resides with the Alaska State Pension Investment Board (Board), pursuant to Alaska Statutes 37.10.210-390.

Alaska Statutes 14.25.180, 26.05.228(c) and 37.10.071 provide that investments shall be made with the judgment and care under circumstances then prevailing that an institutional investor of ordinary professional prudence, discretion and intelligence exercises in managing large investment portfolios.

The Department of Revenue, Treasury Division (Treasury) provides staff for the Board. Treasury has created a pooled environment by which it manages the investments the Board has fiduciary responsibility for. Actual investing is performed by investment officers in Treasury or by contracted external investment managers. The Board has developed investment guidelines, policies and procedures for Treasury staff and external investment managers to adhere to when managing investments. Specifically, the Securities Lending Collateral, External Domestic Fixed Income Pool, Domestic Equity Pool and the International Equity Pool are managed by external management companies. Treasury manages the Alaska Retirement Fixed Income Pool and cash holdings of certain external domestic equity managers in addition to acting as oversight manager for all externally managed investments.

The Short-term Fixed Income Pool is a State pool managed by Treasury.

### **(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

#### **Basis of Accounting**

The schedules are prepared using the accrual basis of accounting for investment income. Assets are reported at fair value in accordance with Governmental Accounting Standards Board (GASB) Statement No. 31. Investment purchases and sales are recorded on a trade-date basis. Net withdrawals represent contributions from employers and employees, net of benefits paid to NG & NMRS participants as well as administrative and investment management expenses. Contributions, benefits paid and all expenses are recorded on a cash basis.

#### **Valuation**

Marketable debt securities are valued each business day using prices obtained from a pricing service when such prices are available; otherwise, such securities are valued at the mid-point between the bid and asked price or at prices for securities of comparable maturity, quality and type.

Domestic and international equity securities are valued each business day using prices obtained from a pricing service or prices quoted by one or more independent brokers.

Securities expressed in terms of foreign currencies are translated into U.S. dollars at the prevailing exchange rates. Forward currency contracts are valued at the mid-point of representative quoted bid and asked prices.

# **Military Retirement System Invested Assets**

## **Notes to Schedules June 30, 2005 and 2004**

### **(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

#### **Income Allocation**

Income in the fixed income and domestic and international equity pools is allocated to pool participants daily on a pro rata basis.

#### **Reclassifications**

Certain reclassifications not affecting net changes in invested assets have been made to 2004 amounts in order to conform to the 2005 presentation.

### **(3) POOLED INVESTMENTS**

#### **Short-term Fixed Income Pool**

MRS Invested Assets include participation in the State's internally managed Short-term Fixed Income Pool which was established March 15, 1993, with a start up and maintained share price of \$1. Treasury staff determines the allocation between permissible securities. Each participant owns shares in the pool, the number of which fluctuates daily with contributions and withdrawals. Participant shares also change at the beginning of each month when income is paid. At June 30, 2005 and 2004, MRS Invested Assets included a 0.001% direct ownership in the Short-term Fixed Income Pool which included interest receivable of \$29 and \$18, respectively. MRS Invested Assets included a .01% and .02% indirect ownership in the Short-term Fixed Income Pool at June 30, 2005 and 2004, respectively.

#### **Domestic Fixed Income Pool**

The Domestic Fixed Income Pool is comprised of an internally managed and an externally managed pool.

#### **Retirement Fixed Income Pool**

MRS Invested Assets include participation in the Board's internally managed Retirement Fixed Income Pool which was established March 1, 1996, with a start up share price of \$1,000. The share price at June 30, 2005, was \$1,848. Treasury staff determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each participant. The net asset value per share is determined by dividing the total fair value of the net assets of the pool by the number of shares of the pool outstanding on the valuation date. Contributions to and withdrawals from the pool are based on the beginning of the day net asset value per share on the day of the transaction. At June 30, 2005 and 2004, MRS Invested Assets included a 0.31% and 0.24% ownership in the Retirement Fixed Income Pool, respectively.

#### **External Domestic Fixed Income Pool**

MRS Invested Assets include participation in the Board's externally managed Domestic Fixed Income Pool which was established June 25, 1999, with a start up share price of \$1,000. The share price at June 30, 2005, was \$1,546. Each manager independently determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each participant. The net asset value per share is determined by dividing the total fair value of the net assets of the pool by the number of shares of the pool outstanding on the valuation date. Contributions to and withdrawals from the pool are based on the beginning of the day net asset value per share on the day of the transaction. At June 30, 2005 and 2004, MRS Invested Assets included a 0.25% and 0.19% ownership in the External Domestic Fixed Income Pool, respectively.

# **Military Retirement System Invested Assets**

## **Notes to Schedules June 30, 2005 and 2004**

### **(3) POOLED INVESTMENTS (Cont.)**

#### **Domestic Equity Pool**

Effective July 1, 2005, the Domestic Equity Pool was replaced with an External Large Cap Domestic Equity Pool and an External Small Cap Domestic Equity Pool. At June 30, 2004, MRS Invested Assets included a 0.09% ownership in the Domestic Equity Pool.

#### **Large Cap Domestic Equity Pool**

MRS Invested Assets include participation in the Board's externally managed Large Cap Domestic Equity Pool which was established July 1, 2004, with a start up share price of \$1,000. The share price at June 30, 2005, was \$1,050. Each manager independently determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each participant. The net asset value per share is determined by dividing the total fair value of the net assets of the pool by the number of shares of the pool outstanding on the valuation date. Contributions to and withdrawals from the pool are based on the beginning of the day net asset value per share on the day of the transaction. At June 30, 2005, MRS Invested Assets included a 0.09% ownership in the Large Cap Domestic Equity Pool.

#### **Small Cap Domestic Equity Pool**

MRS Invested Assets include participation in the Board's externally managed Small Cap Domestic Equity Pool which was established July 1, 2004, with a start up share price of \$1,000. The share price at June 30, 2005, was \$1,019. Each manager independently determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each participant. The net asset value per share is determined by dividing the total fair value of the net assets of the pool by the number of shares of the pool outstanding on the valuation date. Contributions to and withdrawals from the pool are based on the beginning of the day net asset value per share on the day of the transaction. At June 30, 2005, MRS Invested Assets included a 0.08% ownership in the Small Cap Domestic Equity Pool.

#### **International Equity Pool**

MRS Invested Assets include participation in the Board's externally managed International Equity Pool which was established January 1, 1992, with a start up share price of \$1,000. The share price at June 30, 2005, was \$2,622. Each manager independently determines the allocation between permissible securities. Ownership in the pool is based on the number of shares held by each participant. The net asset value per share is determined by dividing the total fair value of the net assets of the pool by the number of shares of the pool outstanding on the valuation date. Contributions to and withdrawals from the pool are based on the beginning of the day net asset value per share on the day of the transaction. At June 30, 2005 and 2004, MRS Invested Assets included a 0.09% and 0.08% ownership in the International Equity Pool, respectively.



# Military Retirement System

## Invested Assets

### Notes to Schedules

#### June 30, 2005 and 2004

#### (4) DEPOSITS AND INVESTMENT RISK

At June 30, 2005, MRS Invested Assets included the following:

	Fair Value			
	Fixed Income Pools		Other	Total
	Short-term	Domestic		
Deposits	\$ -	\$ -	\$ 4,115	\$ 4,115
Overnight Sweep Account	266	3,491	-	3,757
Money Market Fund	-	-	1,572,835	1,572,835
Short-term Investment Fund	-	-	30,431	30,431
Commercial Paper	14,607	34,419	-	49,026
U. S. Treasury Bills	11,553	-	-	11,553
U. S. Treasury Notes	10,034	445,117	-	455,151
U. S. Treasury Bonds	-	538,614	-	538,614
U. S. Treasury Strips	-	110,972	-	110,972
U.S. Government Agency				
Discount Notes	2,552	29,899	-	32,451
U.S. Government Agency	-	538,781	-	538,781
Municipal Bonds	-	3,617	-	3,617
Mortgage-backed	29,160	3,999,250	-	4,028,410
Other Asset-backed	81,777	454,787	-	536,564
Corporate Bonds	37,089	1,861,083	-	1,898,172
Yankees:				
Government	-	40,673	-	40,673
Corporate	1,420	27,760	-	29,180
Domestic Equity Pool:				
Limited Partnership	-	-	249,462	249,462
Equity	-	-	4,203,693	4,203,693
International Equity Pool:				
Convertible Bonds	-	-	423	423
Equity	-	-	1,768,680	1,768,680
Net Pool related assets (liabilities)	1,917	58,052	7,015	66,984
Net Other Assets (Liabilities)	(165,819)	115,039	50,780	-
MIL Invested Assets	\$ 24,556	\$ 8,261,554	\$ 7,887,434	\$ 16,173,544

## **Military Retirement System Invested Assets**

### **Notes to Schedules June 30, 2005 and 2004**

#### **(4) DEPOSIT AND INVESTMENT RISK (Cont.)**

##### **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 in maturity or fourteen months expected average life. Floating rate securities are limited to three years in maturity or three years expected average life. Treasury utilizes the actual maturity date for commercial paper and twelve-month prepay speeds for other securities. At June 30, 2005, the expected average life of individual fixed rate securities ranged from one day to ten months and the expected average life of floating rate securities ranged from less than one year to three years.

##### **Domestic Fixed Income Pool**

Through the Board's investment policy, Treasury manages the exposure to fair value losses arising from increasing interest rates by limiting the effective duration of the domestic fixed income portfolio to  $\pm 20\%$  of the Lehman Brothers Aggregate Bond Index. The effective duration for the Lehman Brothers Aggregate Bond Index at June 30, 2005, was 4.16 years.

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, options and other variable cash flows for purposes of the effective duration calculation.

## Military Retirement System Invested Assets

### Notes to Schedules June 30, 2005 and 2004

#### (4) DEPOSIT AND INVESTMENT RISK (Cont.)

##### Interest Rate Risk (cont.)

At June 30, 2005, the effective duration of the domestic fixed income portfolio, by investment type, was as follows:

	<b>Effective Duration</b> <b>(in years)</b>
U.S. Treasury Notes	3.27
U.S. Treasury Bonds	10.10
U.S. Treasury Strips	17.29
U.S. Government Agency	5.69
Municipal Bonds	13.95
Mortgage-backed	2.50
Other Asset-backed	1.19
Corporate Bonds	5.27
Yankees	
Government	6.98
Corporate	7.68
Portfolio Effective Duration	3.99

##### 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:

With the exception of the sweep account, 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 A1 or equivalent. For securities with long-term credit ratings, they may be purchased if the median rating of Standard & Poor's Corporation, Moody's and Fitch is A3 or equivalent. Asset-backed and non-agency mortgage securities may be purchased if only rated by one of the rating agencies mentioned above if they are rated AAA. Unexpected daily cash surpluses that arise in this pool are invested overnight in the custodian's repurchase agreement sweep account. Treasury does not have a policy to limit credit risk associated with the sweep account.

## Military Retirement System Invested Assets

### Notes to Schedules June 30, 2005 and 2004

#### (4) DEPOSIT AND INVESTMENT RISK (Cont.)

##### Credit Risk (Cont.)

The Board's investment policy has the following limitations with regard to credit risk:

##### Domestic Fixed Income:

Commercial paper must carry a rating of at least A1 or equivalent;

Corporate debt securities must be investment grade;

Corporate, asset-backed and non-agency mortgage securities must be investment grade. Investment grade is defined as the median rating of 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. Corporate bonds may be purchased if rated by two of these agencies.

##### Domestic and International Equity:

Corporate debt obligations must carry a rating of at least A or equivalent.

At June 30, 2005, MRS Invested Assets consisted of securities with credit quality ratings issued by nationally recognized statistical rating organizations as follows (using Standard & Poor's Corporation rating scale):

	Rating <sup>1</sup>	Fixed Income Pool		International Equity
		Short-term	Domestic	
Short-term Investment				
Account	Not Rated	-	-	1%
Commercial Paper	A	8%	1%	-
U. S. Government Agency				
Discount Notes	Not Rated	1%	-	-
U. S. Government Agency	Not Rated	-	6%	-
Mortgage-backed	AAA	15%	13%	-
Mortgage-backed (Agency)	Not Rated	-	34%	-
Other Asset-backed	AAA	39%	6%	-
Other Asset-backed	A	3%	-	-
Corporate Bonds	AAA	1%	3%	-
Corporate Bonds	AA	11%	3%	-
Corporate Bonds	A	9%	7%	-
Corporate Bonds	BBB	-	10%	-
Yankees:				
Government	BBB	-	1%	-
Corporate	A	1%	-	-
No credit exposure		12%	16%	99%
		<u>100%</u>	<u>100%</u>	<u>100%</u>

<sup>1</sup>Rating modifiers are not disclosed.

Securities lending collateral was invested in a registered 2(a)-7 money market fund that was not rated.

# Military Retirement System Invested Assets

## Notes to Schedules June 30, 2005 and 2004

### (4) DEPOSIT AND INVESTMENT RISK (Cont.)

#### Custodial Credit Risk – Deposits

Custodial credit risk is the risk that deposits may not be returned in the event of a bank failure. The Board does not have a policy in relation to custodial credit risk for deposits. At June 30, 2005, MRS Invested Assets had the following uncollateralized and uninsured deposits:

	<u>Amount</u>
International Equity Pool	\$ <u>4,024</u>

#### Foreign Currency Risk

Foreign Currency Risk is the risk that changes in exchange rates will adversely impact the fair value of an investment.

The Board's policy with regard to foreign currency risk in the International Equity Pool is to permit MRS to hold up to fifteen percent of total investments in international equity.

At June 30, 2005, MRS investment in the International Equity Pool had exposure to foreign currency risk with the following deposits:

<u>Currency</u>	<u>Amount</u>
Australian Dollar	\$ 33
Canadian Dollar	28
Danish Krone	170
Euro Currency	602
Hong Kong Dollar	231
Japanese Yen	1,593
New Zealand Dollar	3
Norwegian Krone	336
Pound Sterling	312
Singapore Dollar	4
South Korean Won	1
Swiss Franc	5
	\$ <u>3,318</u>

## Military Retirement System Invested Assets

### Notes to Schedules June 30, 2005 and 2004

#### (4) DEPOSIT AND INVESTMENT RISK (Cont.)

##### Foreign Currency Risk (cont.)

At June 30, 2005, MRS investment in the International Equity Pool had exposure to foreign currency risk with the following investments:

<u>Currency</u>	<u>Amount</u>	
	<u>Convertible Bonds</u>	<u>Equity</u>
Australian Dollar	\$ -	\$ 29,656
Canadian Dollar	-	27,650
Danish Krone	-	3,856
Euro Currency	-	664,110
Hong Kong Dollar	-	18,106
Japanese Yen	-	359,917
New Zealand Dollar	-	6,672
Norwegian Krone	-	17,026
Pound Sterling	-	351,729
Singapore Dollar	-	24,894
South African Rand	-	6,334
South Korean Won	-	13,177
Swedish Krona	-	15,554
Swiss Franc	423	146,244
	<u>\$ 423</u>	<u>\$ 1,684,925</u>

##### Concentration of Credit Risk

Treasury's policy with regard to concentration of credit risk for the Short-term Fixed Income Pool is to prohibit the purchase of more than five percent of the portfolio's assets in corporate bonds of any one company or affiliated group.

The Board's policy with regard to concentration of credit risk for the Domestic Fixed Income Pool is to prohibit the purchase of more than five percent of the portfolio's assets in corporate bonds of any one company or affiliated group.

At June 30, 2005, MRS invested assets included \$2.5 million in Federal National Mortgage Association securities and \$0.9 million in Federal Home Loan Mortgage Corporation which represented 16% and 5% of total MRS invested assets, respectively.

## Military Retirement System Invested Assets

### Notes to Schedules June 30, 2005 and 2004

#### (5) FOREIGN EXCHANGE, FOREIGN EXCHANGE CONTRACTS AND OFF-BALANCE SHEET RISK

The International Equity Pool's investment income includes the following at June 30:

	<u>2005</u>	<u>2004</u>
Realized Gain on Foreign Currency	\$ 134,365	\$ 84,165
Unrealized Gain on Foreign Currency	-	18
Realized Gain on Foreign Exchange Contracts	91	103

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 maturity periods for these contracts range from eight to one hundred and twenty-four days. MRS had net unrealized gains (losses) with respect to such contracts, calculated using forward rates at June 30, as follows:

	<u>2005</u>	<u>2004</u>
Net Contract Sales	\$ 8,719	\$ 5,580
Less: Fair Value	<u>8,342</u>	<u>5,647</u>
Net unrealized gains (losses) on contracts	<u>\$ 377</u>	<u>\$ (67)</u>

The counterparties to the foreign currency forward contracts consist of a diversified group of financial institutions. Credit risk exposure exists to the extent of non-performance 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.

#### (6) COMMITMENTS AND CONTINGENCIES

The Board entered into an agreement through an external investment manager to provide capital funding for a domestic equity limited partnership. At June 30, 2005, MRS Invested Asset's share of the unfunded commitment totaled \$147,095. This commitment can be withdrawn annually in December with ninety days notice.

## **Military Retirement System Invested Assets**

### **Notes to Schedules June 30, 2005 and 2004**

#### **(7) SECURITIES LENDING**

Alaska Statute 37.10.071 authorizes the Board to lend assets, under an agreement and for a fee, against deposited collateral of equivalent fair value. The Board has entered into an agreement with State Street Corporation (the Bank) to lend equity and domestic fixed income securities. The Bank, acting as the Board's agent under the agreement, transfers securities to broker agents or other entities for collateral in the form of cash or securities and simultaneously agrees to return the collateral for the same securities in the future.

At June 30, 2005 and 2004, the fair value of securities on loan allocable to MRS Invested Assets totaled \$1,535,521 and \$2,088,449, respectively. There is no limit to the amount that can be loaned and the Board is able to sell securities on loan. International equity security loans are collateralized at not less than 105 percent of their fair value. All other security loans are collateralized at not less than 102 percent of their fair value. Loaned securities and collateral is marked to market daily and collateral is received or delivered the following day to maintain collateral levels.

Cash collateral is invested in a registered 2(a)-7 money market fund, which is valued at amortized cost. Maturities of investments in the money market fund generally did not match the maturities of the loaned securities because the lending agreements are terminable at will. Securities collateral may be pledged or sold upon borrower default. Since the Board does not have the ability to pledge or sell securities collateral unless the borrower defaults, they are not recorded on the financial schedules. Securities on loan, cash collateral and cash collateral payable are recorded on the financial schedules. The Bank, MRS and the borrower receive a fee from earnings on invested collateral. The Bank and MRS share a fee paid by the borrower for loans not collateralized with cash.

There is limited credit risk associated with the lending transactions since the Board is indemnified by the Bank against any loss resulting from counterparty failure or default on a loaned security or its related income distributions. The Bank further indemnifies the Board against loss due to borrower rebates in excess of earnings on cash collateral. Indemnifications are subject to limitation relating to war, civil unrest or revolution, or beyond the reasonable control of the Bank.

For the year ended June 30, 2005 and 2004, there were no losses incurred as a result of securities lending transactions and there were no significant violations of legal or contractual provisions nor failures by any borrowers to return loaned securities.