

**State of Alaska  
Department of Revenue  
State Investment Review Meeting  
December 16, 2020**

**MEETING SUMMARY**

**Meeting Details:**

Start Time: 10:00 a.m.

End Time: 11:24 a.m.

**Department of Revenue Staff present:**

Lucinda Mahoney, Commissioner  
Zachary Hanna, Chief Investment Officer  
Victor Djajalie, State Investment Officer  
Casey Colton, State Investment Officer  
Scott Jones, Head of Operations and Analytics  
Michelle Prebula, State Investment Officer  
Mark Moon, State Investment Officer  
Emily Howard, State Investment Officer  
Alysia Jones, ARMB Liaison Officer

Mike Barnhill, Deputy Commissioner  
Pamela Leary, Director of Treasury  
Shane Carson, State Investment Officer  
Sean Howard, State Investment Officer  
Kayla Wisner, State Comptroller  
Stephen Sikes, State Investment Officer  
Nick Orr, State Investment Officer  
Brian Fechter, Administrative Services Director

**IAC Members present:**

William Jennings  
Jerrold Mitchell  
Ruth Ryerson

**I. Introduction and II. Expanded Role of the Investment Advisory Council**

Commissioner Mahoney welcomed the Investment Advisory Committee (IAC) members to the first State Investment Review meeting. She explained the Commissioner of Revenue is the sole fiduciary for nearly 7 billion dollars and in an effort to be transparent and obtain advisement, the Department of Revenue would like to expand the role of the IAC to provide advisory services on these funds that are outside of the Alaska Retirement Management Board's (ARMB) assets.

Chief Investment Officer (CIO) Zachary Hanna confirmed all three IAC members signed the amended contracts outlining the change in services and compensation.

Commissioner Mahoney expressed her appreciation to the IAC members for their willingness to serve in this capacity. Given its newness, the Commissioner and Department intend to be flexible as the group works through this process.

**III. State Investments**

**A. Overview State Funds and Asset Allocation**

CIO Hanna provided an overview of the investments that the Division of Treasury manages for the State as well as an overview of the annual asset allocation process that was used in June 2020 for the FY2021 asset allocations that are currently in place.

The Commissioner of Revenue is the fiduciary for \$6.9 in State assets, comprised of 25 funds, with roughly 200 individual accounts participating in these investment pools. The staff reviews and makes recommendations on the investment policy and asset allocation of each fund annually, using rigorous policies in formulating investment policy statements and in management of funds.

CIO Hanna explained that, similar to the Alaska Retirement Management Board, staff uses Callan LLC's capital market assumptions to develop annual 10-year projections for risk, return, and correlations. CIO Hanna explained Callan's building block approach and timeline for developing capital market assumptions. He also shared Callan's Periodic Table of Investment Returns to illustrate how volatile some of the asset classes can be.

CIO Hanna stated that the asset allocation approach for FY2021 was to optimize the portfolio based upon Callan's CMAs. The short-term expected returns are used to set early expectations for funds that are invested more heavily in bonds, for budget related purposes. For longer forecasts, the short-term expected returns are often married with the long-term expected return because it led to more balanced portfolios.

CIO Hanna also provided a brief summary of the Department's investment policy. Dr. Jennings asked if the funds are separate pools. CIO Hanna responded affirmatively, noting that some of the funds include multiple accounts with one pool number

CIO Hanna walked through the following funds, explaining investment objectives and background, risk tolerance, policy risk/ loss range, time horizon, asset allocation, short and long term expected returns, expected risk, and probability of loss for each fund.

- Short Term Funds
- Constitutional Budget Reserve Fund (CBRF)
- General Fund and Other Non-segregated investments (GeFONSI)
- International Airport Revenue Fund GeFONSI II
- Power Cost Equalization (PCE) Endowment
- Retiree LTC Insurance
- Public School Trust Fund
- Alaska Higher Education Investment Fund
- Illinois Creek Mine Reclamation Investment Policy
- Education Endowment

Dr. Jennings asked about custody arrangements and retention of Callan. CIO Hanna explained that all the funds are custodied at State Street, similar to the ones the ARMB oversees. CIO Hanna also said that the Department does not retain Callan separately, nor rely on them for any advice related to non-ARMB funds, beyond information that is publicly available.

Dr. Jennings also asked about cross-sectional fairness and how some participants in GeFONSI might be benefitting from a longer-term pool. CIO Hanna responded that participants in GeFONSI and GeFONSI II are all part of the State budget and part of the General Fund.

Ryerson asked who is conducting performance analytics for these funds. CIO Hanna responded that the Middle Office staff, headed by Scott Jones, is responsible for handling analytics and does a fair amount that goes into the Callan analytics as well. CIO Hanna suggested performance analytics be a topic of discussion for a future State Investment Review meeting.

Deputy Commissioner Barnhill asked why the ARMB is not the fiduciary of the Retiree Health Insurance and Retiree Long-Term Care funds and suggested consideration be given to transferring governance to the ARMB since it is part of the retirement system.

Commissioner Mahoney circled back to Ms. Ryerson's question regarding performance analytics and whether she felt an independent group should be calculating the performance. Ms. Ryerson said other funds that she is familiar with have an independent consultant and expressed concern for the potential to have staff evaluating themselves. CIO Hanna clarified that the Middle Office staff report to Director Leary, not the CIO, and explained that the Department moved in the direction of an in-house performance analytics group based upon a cost-benefit analysis.

### **B. September 30, 2020 Performance**

CIO Hanna shared the September 30, 2020 Performance Report, also referred to as the Commissioner's Report. This is a standard report that includes funds' asset allocations, market value information, as well as performance and benchmark information and is provided to the Commissioner on a monthly basis. CIO Hanna suggested a summary of the report be reviewed by this group at their quarterly meetings, with the full report included in an appendix for those wishing to view it in its entirety.

CIO Hanna reported the performance of both the broad market fixed income and short-term fixed income pool have exceeded the index over the last quarter by three basis points and four basis points respectively and outperformed the index over the past year. Mr. Djajalie explained that their strong performance can be attributed to significantly increasing corporate bond exposure and extending original posture modestly during the period. For the short-term fixed income pool, he said they invest in high-quality asset backed securities, high-quality short corporates, and for liquidity purposes, repurchase agreements.

Dr. Jennings noted the amount within short-term funds appeared to be much more substantial than the short-term funds managed by the ARMB and asked if there was a dedicated staff person focused on short-term funds. Mr. Djajalie explained fixed income is managed by a five-person team, and that Emily Howard is the primary person managing the short-term funds.

CIO Hanna reported on equity performance, pointing out that the relative performance versus the benchmark should be close now that both domestic and international equity pools are passively managed. There was some negative tracking error for the one-year data for both domestic and international equity pools due to cash drag and an underperforming active manager in international. He also discussed the relative performance of each fund to its benchmark, the external management fees for each fund and pointed out the top 5 accounts for GeFONSI and GeFONSI II.

Director Leary directed the IAC members to the Treasury website for additional information on investment policies, monthly reports, and asset allocations for each of the funds. She also commented on the performance calculations. Director Leary explained that the Middle Office developed out of custodial discussions in 2016. She stated that the Middle Office staff replicate the performance analysis previously done by State Street. Director Leary noted it is a cost savings of approximately \$400,000 annually. She also encouraged the IAC members to provide feedback regarding content for the Commissioner's Report.

### **C. Non-Routine Investments**

The Department does not currently have, nor is presently contemplating any non-routine investments opportunities, however they are occasionally presented with investment opportunities that fall outside the scope of its existing investment opportunity set. CIO Hanna said he hoped future meetings could be one

avenue for discussion of such opportunities when they arise. He also provided a summary of the non-routine investment process.

Dr. Jennings asked about the size of projects and whether outside consultants, such as Callan were included in the review process. CIO Hanna responded that the size of the total State funds has decreased significantly and that the need for liquidity from those funds has gone up. He also confirmed that outside experts were consulted during consideration of non-routine investments and a separate contract was established specifically for those services.

Dr. Jennings suggested seeking advice from external experts and auditors as required in advance of investing in any potential opportunities.

#### **IV. State IAC Comments**

Ms. Ryerson asked if the Department receives a lot of political pressure on non-routine investments, noting that it is fairly standard. CIO Hanna confirmed that there had been some in the past. Ms. Ryerson also asked if all of the funds were custodied separately at State Street. Director Leary responded affirmatively.

Dr. Jennings observed that some of the account names and asset allocation appeared to be endowment-oriented and said most endowment pools are moving towards numbers in the lower half of the four to five percent range as opposed to five percent. He also said the difference in arithmetic and geometric returns, the volatility drag, means you can't spend five percent from a portfolio that is designed to deliver on average five percent, otherwise you end up depleting the portfolio. Dr. Jennings suggested saving that discussion for a future meeting.

Dr. Mitchell commented that the presentation was very orderly and anticipated having a slew of questions for staff at the next meeting.

#### **V. Future Agenda Items & Calendar Review**

The group reviewed a draft schedule of quarterly meetings and standing agenda items as well as discussed potential future topics and presentations. CIO Hanna requested the IAC members review their calendars and follow up with Ms. Jones regarding any scheduling conflicts.

#### **VI. Other Matters for Discussion**

Commissioner Mahoney reiterated that the intent for today's meeting was to be a high-level introduction for the IAC members and thanked them for their participation in the meeting.

There being no further items for discussion, the meeting adjourned at 11:24 a.m.