

Public Employees' Individual Retirement
Account Fund/Deferred Compensation Plan
(A Component Unit of the State of Alabama)

FINANCIAL STATEMENTS

For the Fiscal Year Ended September 30, 2016

201 South Union Street • P. O. Box 302150 • Montgomery, Alabama 36130-2150
(334) 517-7000 or 1-877-517-0020 • <http://www.rsa-al.gov>

Public Employees' Individual Retirement Account Fund/Deferred Compensation Plan
Notes to the Financial Statements
For the Fiscal Year Ended September 30, 2016

A. Investment Risks, Continued

The following table provides information as of September 30, 2016, concerning the fair value of investments and interest rate risk:

<u>Type of Investment</u>	INVESTMENTS				<u>Total Fair Value</u>	<u>Cost</u>
	Maturity in Years at Fair Value					
	<u>Less Than 1</u>	<u>1-5</u>	<u>6-10</u>	<u>More Than 10</u>		
<i>Fixed Maturity</i>						
Domestic						
Money Market Funds	\$ 90,824,477	\$ -	\$ -	\$ -	\$ 90,824,477	\$ 90,824,477
Commercial Paper	15,999,727	-	-	-	15,999,727	15,999,727
U.S. Agency	8,640,418	36,843,637	30,567,400	-	76,051,455	74,333,120
U.S. Government Guaranteed	31,292,411	161,453,732	141,436,710	54,055,050	388,237,903	373,221,559
Corporate Bonds	151,220,256	157,667,690	153,464,083	138,782,506	601,134,535	573,385,743
Private Placements	-	-	-	4,564,648	4,564,648	4,564,648
GNMAs	-	-	271,679	13,073,865	13,345,544	13,180,240
CMO	-	4,681,440	3,187,706	192,457,040	200,326,186	196,155,552
Total Domestic Fixed Maturity	<u>\$ 297,977,289</u>	<u>\$ 360,646,499</u>	<u>\$ 328,927,578</u>	<u>\$ 402,933,109</u>	1,390,484,475	1,341,665,066
<i>Equities</i>						
Preferred						
					13,402,191	11,251,000
Domestic						
Total Equities					<u>560,653,042</u>	<u>375,365,427</u>
Total Investments					<u>\$ 1,964,539,708</u>	<u>\$ 1,728,281,493</u>

Public Employees' Individual Retirement Account Fund/Deferred Compensation Plan
Notes to the Financial Statements
For the Fiscal Year Ended September 30, 2016

A. Investment Risks, Continued

The following table provides information as of September 30, 2016, concerning credit risk:

RATINGS OF FIXED MATURITIES

<u>Moody's</u>	<u>Cost</u>	<u>Fair Value</u>	<u>Fair Value as a Percentage of Total</u>
Aaa ¹	\$ 661,330,569	\$ 682,876,483	49.11
Aa1	11,192,491	11,909,180	0.86
Aa2	3,334,975	3,945,117	0.28
Aa3	7,063,130	7,838,001	0.56
P-2	15,999,727	15,999,727	1.15
A1	43,297,758	45,392,180	3.26
A2	22,382,723	21,874,221	1.57
A3	72,195,886	78,087,461	5.62
Baa1	111,681,733	118,016,077	8.49
Baa2	81,579,406	86,141,178	6.20
Baa3	61,428,132	63,094,116	4.54
Ba1	28,716,787	29,872,686	2.15
Ba2	15,117,153	15,716,243	1.13
B1	10,493,716	10,006,239	0.72
B2	3,615,731	2,973,785	0.21
B3	2,114,803	2,288,385	0.16
Not Rated ²	190,120,346	194,453,396	13.99
Total Fixed Maturities	<u>\$ 1,341,665,066</u>	<u>\$ 1,390,484,475</u>	<u>100.00</u>

<u>Standard & Poor's</u>	<u>Cost</u>	<u>Fair Value</u>	<u>Fair Value as a Percentage of Total</u>
AAA	\$ 7,951,706	\$ 8,442,544	0.61
AA+ ¹	659,264,574	680,754,888	48.96
AA	3,334,975	3,945,117	0.28
AA-	42,245,335	45,242,959	3.25
A-2	15,999,727	15,999,727	1.15
A+	7,421,904	8,329,527	0.60
A	48,091,538	49,632,136	3.57
A-	64,537,354	69,343,755	4.99
BBB+	107,215,420	112,954,196	8.12
BBB	110,147,651	114,251,978	8.22
BBB-	59,740,283	61,740,309	4.44
BB+	4,338,981	4,760,525	0.34
BB	4,159,532	4,173,780	0.30
BB-	12,272,602	11,343,400	0.82
B-	2,114,803	2,288,385	0.16
Not Rated ²	192,828,681	197,281,249	14.19
Total Fixed Maturities	<u>\$ 1,341,665,066</u>	<u>\$ 1,390,484,475</u>	<u>100.00</u>

¹ Includes securities guaranteed by the U.S. Government.

² Primarily consists of private placements.

Public Employees' Individual Retirement Account Fund/Deferred Compensation Plan
Notes to the Financial Statements
For the Fiscal Year Ended September 30, 2016

B. Fair Value Measurement

The PEIRAF/DCP categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy prioritizes the inputs to valuation used to measure the fair value of the asset, giving the highest priority to quoted prices in an active market for identical assets (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The inputs to the three levels of the fair value hierarchy are described as follows:

- Level 1:** Quoted (unadjusted) prices in an active market for identical assets or liabilities.
- Level 2:** Significant other inputs which are observable either directly or indirectly, including quoted prices for similar assets or liabilities, quoted prices for identical or similar assets or liabilities in a less active market, or other market-corroborated inputs.
- Level 3:** Valuations derived from valuation techniques using significant unobservable inputs for the asset or liabilities.

The categorization of investments within the hierarchy is based upon pricing transparency of the instrument and should not be perceived as the particular investment's risk.

Investments in equity securities classified as Level 1 are valued using quoted prices in an active market for those securities.

Investments in securities classified as Level 2 are valued using non-proprietary information that is readily available to market participants from multiple independent sources, which are known to be actively involved in the market. Pricing inputs may include market quotation, yields, maturities, call features, and ratings.

Investments in private equity, debt, and direct investments in Real Estate are classified as Level 3 due to lack of observable pricing inputs and are valued using annual appraisals based on a combination of market data and projected cash flows.

Public Employees' Individual Retirement Account Fund/Deferred Compensation Plan
Notes to the Financial Statements
For the Fiscal Year Ended September 30, 2016

B. Fair Value Measurement, Continued

The following table provides information as of September 30, 2016, concerning fair value measurement:

	9/30/2016	Fair Value Measurements Using		
		Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<i>Fixed Maturity</i>				
Domestic				
Money Market Funds	\$ 90,824,477	\$ -	\$ 90,824,477	\$ -
Commercial Paper	15,999,727	-	15,999,727	-
U.S. Agency	76,051,455	-	76,051,455	-
U.S. Government Guaranteed	388,237,903	-	388,237,903	-
Corporate Bonds	601,134,535	93,786,994	507,347,541	-
Private Placements	4,564,648	-	-	4,564,648
GNMAs	13,345,545	-	13,345,545	-
CMOs	200,326,185	-	200,326,185	-
Total Domestic Fixed Maturity	<u>1,390,484,475</u>	<u>93,786,994</u>	<u>1,292,132,833</u>	<u>4,564,648</u>
<i>Equities</i>				
Preferred	13,402,191	13,402,191	-	-
Domestic	560,653,042	560,653,042	-	-
Total Equities	<u>574,055,233</u>	<u>574,055,233</u>	<u>-</u>	<u>-</u>
Total Investments	<u>1,964,539,708</u>	<u>667,842,227</u>	<u>1,292,132,833</u>	<u>4,564,648</u>
Securities Lending Collateral	159,267,125	-	159,267,125	-
Total Fair Value	<u>\$ 2,123,806,833</u>	<u>\$ 667,842,227</u>	<u>\$ 1,451,399,958</u>	<u>\$ 4,564,648</u>

Public Employees' Individual Retirement Account Fund/Deferred Compensation Plan
Notes to the Financial Statements
For the Fiscal Year Ended September 30, 2016

C. Concentration of Investments

As of September 30, 2016, the PEIRAF/DCP owned debt securities of the Federal National Mortgage Association (Fannie Mae), which represented approximately, 8.34% of the total fair value of investments.

D. Securities Lending Program

The PEIRAF/DCP is authorized by the Board of Control to participate in a securities lending program. The PEIRAF/DCP's custodian, State Street Bank and Trust Company (State Street), administers the program. Certain securities from the PEIRAF/DCP are loaned to borrowers approved by the PEIRAF/DCP for collateral that will be returned for the same securities in the future. Approved borrowers provide acceptable collateral in the form of cash (U.S. dollar and foreign currency), U.S. and non U.S. equities, assets permissible under Rule 15c3-3 of the Exchange Act of 1934, and other collateral as the parties may agree to in writing from time to time. All security loans are open loans and can be terminated on demand by the PEIRAF/DCP or borrower. The initial collateral received shall have (depending on the nature of the loaned securities and the collateral received), a value of 102% or 105% of the fair value of the loaned securities, or such other value, not less than 102% of the fair value of the loaned securities, as may be applicable in the jurisdiction in which such loaned securities are customarily traded. Pursuant to the terms of the applicable securities loan agreement, State Street shall, in accordance with State Street's reasonable and customary practices, mark loaned securities and collateral to their fair value each business day based upon the fair value of the collateral and the loaned securities at the close of business, employing the most recently available pricing information and shall receive and deliver collateral in order to maintain the value of the collateral at no less than 100% of the fair value of the loaned securities.

The PEIRAF/DCP cannot pledge or sell collateral securities received unless the borrower defaults. Cash collateral is invested in the State Street Quality D Short-Term Investments Fund (QDF). The collateral fund is separated into two pools, a liquidity pool and a duration pool. The split allows greater flexibility in managing the available liquidity in the investment in the fund and the outstanding balance of securities on loan.

The following describes the QDF's guidelines for the liquidity pool: The QDF's Investment Manager shall maintain the dollar-weighted average maturity of the QDF in a manner that the Investment Manager believes is appropriate to the objective of QDF, provided, that (i) in no event shall any eligible security be acquired with a remaining legal final maturity (i.e., the date on which principal must be repaid) of greater than 18 months, (ii) the Investment Manager shall endeavor to maintain a dollar-weighted average maturity of the QDF not to exceed 75 calendar days, and (iii) the Investment Manager shall endeavor to maintain a dollar-weighted average maturity to final of QDF not to exceed 180 calendar days. Additionally, at the time of purchase, all eligible securities with maturities of 13 months or less shall be rated at least A1, P1, or F1 by at least two of the following nationally recognized statistical rating organizations: Standard & Poor's Corp. ("S&P"), Moody's Investor Services, Inc. ("Moody's"), or Fitch, Inc. ("Fitch"), or be determined by the Investment Manager to be of comparable quality. Additionally, all eligible securities with maturities in excess of 13 months shall be rated at least A-, A3, or A- by at least two of the following nationally recognized statistical rating organizations: S&P, Moody's, or Fitch or be determined by the Investment Manager to be of comparable quality. The QDF may invest up to 10% of its assets at the time of purchase in commingled vehicles managed by the Trustee or its affiliates that conform to the Investment Policy Guidelines.

The following describes the QDF's guidelines for the duration pool: The QDF duration pool includes all asset-backed securities (regardless of maturity) and securities of any type with a remaining maturity of 91 days or greater. Each QDF investor owns a specified percentage interest in the duration pool which is redeemable only in kind, not in cash. The QDF duration pool will not make additional investments.

Public Employees' Individual Retirement Account Fund/Deferred Compensation Plan
Notes to the Financial Statements
For the Fiscal Year Ended September 30, 2016

D. Securities Lending Program, Continued

As of September 30, 2016, the average loan term was 34 days. Cash collateral investments in the QDF are matured as needed to fulfill loan obligations. There is no direct matching of the maturities of the loans with the investments made with cash collateral.

The fair value of the securities on loan was \$461,759,204, and the fair value of the collateral pledged by the borrowers was \$480,876,475, as of September 30, 2016. Since the amounts owed by the PEIRAF/DCP exceeded the amounts the borrowers owed to the PEIRAF/DCP, there was no credit risk exposure as of September 30, 2016. Additionally, there were no significant violations of legal or contractual provisions, no borrower or lending agent default losses, and no recoveries of prior period losses during the fiscal year.

Investments purchased with cash collateral are held by the custodial agent, but not in the name of the PEIRAF/DCP. Securities pledged as collateral are held by the custodial agent, but not in the name of the PEIRAF/DCP. Letters of credit pledged as collateral are issued by the borrower's bank and are irrevocable. Tri-party collateral is held by a third party bank in the name of the custodial agent. State Street, as custodial agent, is authorized to request a third party bank to undertake certain custodial functions in connection with holding of the collateral provided by a borrower. State Street may instruct the third party bank to establish and maintain a borrower's account and a State Street account wherein all collateral including cash shall be maintained by the third party bank in accordance with the terms of the agreement.

The following table provides information as of September 30, 2016, concerning securities lent:

SECURITIES LENDING - INVESTMENTS LENT AND COLLATERAL RECEIVED	
(at Fair Value)	
Type of Investment Lent	Amounts
<i>For Cash Collateral</i>	
Domestic Fixed Maturities	\$ 100,399,085
Domestic Equity	55,396,749
Total Lent for Cash Collateral	155,795,834
<i>For Non-cash Collateral</i>	
Domestic Fixed Maturities	270,247,017
Domestic Equity	35,716,353
Total Lent for Non-cash Collateral	305,963,370
Total Securities Lent	\$ 461,759,204
Type of Collateral Received	
<i>Cash Collateral - Invested in State Street Quality D Fund</i>	\$ 159,267,125
<i>Non-cash Collateral</i>	
Domestic Fixed Securities	
Canadian Dollar	4,610,379
U.S. Dollar	107,460,347
Domestic Equity Securities	
EURO	620,375
U.S. Dollar	37,041,797
International Fixed Maturities & Equity	
U.S. Dollar	171,876,452
Total Non-Cash Collateral	321,609,350
Total Collateral Received	\$ 480,876,475

Public Employees' Individual Retirement Account Fund/Deferred Compensation Plan
Notes to the Financial Statements
For the Fiscal Year Ended September 30, 2016

E. Mortgage-backed Securities

As of September 30, 2016, the PEIRAF/DCP had investments in mortgage-backed securities. Embedded prepayment options cause these investments to be highly sensitive to changes in interest rates. Prepayments by the obligors of the underlying assets reduce the total interest payments to be received. Generally, when interest rates fall, obligors tend to prepay the mortgages thus eliminating the stream of interest payments that would have been received under the original amortization schedule. The resulting reduction in cash flow diminishes the fair value of the mortgage-backed securities.