



Alaska State Legislature

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JUNEAU, ALASKA 99811
OFFICIAL BUSINESS

FREE CONFERENCE COMMITTEE REPORT

FCCS for HCS for SB 161

In making their decision on the Alaska Permanent Fund, the Free Conference Committee has focused on a single question --- the management of the Fund's principal.

It is to be an inviolate trust which, in the words of this bill, conserves "...a portion of the state's revenues from mineral resources to benefit all generations of Alaskans..." (page 4).

It is to be an independent trust, yet made accountable in various ways to "...maintain safety of principal while maximizing total return..." (page 4),

The contribution rate has been set at 50% of mineral lease bonuses (except from the Beaufort Sea, which has been left at 25%) and 50% of mineral lease royalties and net profits from the Beaufort Sea and other future sales. The rate for Prudhoe Bay remains at 25% plus any other money appropriated annually by the Legislature.

Three major concerns --- safety of principal, accountability, and legislative oversight --- are addressed by the legislation.

Safety of Principal

The Free Conference Committee Permanent Fund bill provides a framework for fiscally conservative and responsible management of the Fund's principal. It assures and emphasizes the safety of the assets while providing the responsible managers with sufficient investment latitude to achieve superior results. Under the terms of this bill, the Alaska Permanent Fund would consist of a wide variety of quality, high-grade investments.

The Fund is designed to be a trust which focuses on the safety of principal first and the maximization of earnings second (page 4). It is a trust held to a more restricted list of investments than most other fiduciary trusts including the Alaska State Pension Funds and it confirms in law the

current state practice of evaluating performance according to nationally recognized and accepted standards. The investment managers are required to maintain investment diversification and are allowed to determine the investment mix of short, intermediate, and long-term investments. The flexibility allowed enables the managers to achieve a sound rate of return on investments.

The bill provides the investment managers with the authority to place funds in direct obligations of the United States Treasury, federal agency securities, certificates of deposit, high-grade corporate bonds, quality short-term investments, and federally guaranteed loans (pages 8-9). The fund is directed to give preference to Alaska investments as long as they meet the standards of quality set out in the bill. Specifically, deposits can be made in Alaska banks, *- based* mutual savings banks, savings and loan associations, and credit unions. Residential real estate (owner-occupied single family dwellings, duplexes, and condominiums) may also be purchased if the mortgage is privately insured by a *- what % of ak. mortgages are privately insured?* company doing business in Alaska (page 9). The order in which the investments are listed is not meant to express a *- based on 100%* priority for one type of investment over another.

where? - Importantly, the bill has a minimum of investment restrictions yet provides a very definite and certain framework. It does not authorize investments in stock or bullion, restricts the purchase of corporate bonds to 25% of the Fund's total investments, and limits the purchase of loans and mortgages to 25% of the total. Purchases of residential mortgages may be a further 15% of total assets. The bill allows the Fund to use the futures market to protect investments from the severe declines in value that are being suffered today. These futures contracts, however, may be used only to hedge and not to speculate. The bill also prohibits the Fund from either borrowing or guaranteeing the obligations of others (page 8).

The bill also provides for the handling of gains and losses and income (page 11). Any losses not offset by gains on the sale of securities shall be deducted from income and added to the Fund principal; this protects the Fund principal from erosion. Losses from sales of securities are spread over a period of time equal to the remaining life; this encourages the managers to get rid of bad investments. Capital gains are added to the Fund principal, helping to offset the effects of inflation. The Fund income is defined as the interest received on the investments, and the amount of income available for disbursement will be determined on an averaging basis; this insures a relatively steady income flow.

Accountability

It was the aim of the Committee to establish a management system for the Alaska Permanent Fund which would be protected from political influences but, at the same time, responsive to changes in state policy and accountable to the people through their elected officials. In short, the aim was insulation without isolation. It was agreed that the best way of achieving these ends was not to place the management within the Department of Revenue, but to create a public corporation distinct from state government. Although the Department of Revenue currently manages the pension funds as well as the general fund, it was agreed that the Permanent Fund, with its fundamentally different goals and large size, should not be in the hands of the same people whose primary duty is managing money for day-to-day use by the state. The Corporation is placed within the Department of Revenue for administrative matters such as payroll, but has a legal existence independent of and separate from the state.

The proposed Permanent Fund Corporation, therefore, has its own board of trustees which is made accountable in several ways (page 5). The six members of the board will be appointed by the Governor and consist of the Commissioner of Revenue, two other commissioners, and three public members. They will be confirmed by the Legislature, except for the Commissioner of Revenue who serves by right of his office; the other commissioners are to submit to a separate confirmation for their duties as trustees. Terms are three years; staggered, and members may be reappointed subject to confirmation. Members may be removed from the board by the Governor and the Legislature may override this decision in a Joint Session. The public members of the board may not hold any other state or federal office or employment and must have recognized competence and wide experience in finance, investments, or other business management-related fields. They are subject to the conflict of interest law and must disclose any interest in entities in which corporate assets are invested. They will be paid honorariums competitive with the largest private corporations in the state. It is intended that every two years the Governor shall make recommendations on adjusting the level of the honorarium. The board will employ an executive director who is also subject to the conflict of interest law and responsible for hiring additional staff with the board's approval.

The corporation's operating budget is from the general fund and is subject to the Executive Budget Act (page 10). This provision offers another check on the management and will prevent such things as the hiring of excessive numbers of employees or uncontrolled expense accounts.

Among the board's responsibilities is the publishing of a yearly report (page 11) including a financial statement reviewed by independent auditors, a statement of earnings from each investment, a market-value appraisal of the investments, and a performance evaluation with recommendations for needed changes. These reports, which must be written in easily understandable language, will be available to the Governor, the Legislature, and the public. The income statement and balance sheet will be published yearly in newspapers and every two years in the election pamphlet.

The bill thus insures that the board of trustees of the Alaska Permanent Fund Corporation will be the best investment managers available in the state, will be accountable to both the executive and legislative branches through appointment and budget processes and oversight by the Legislative Budget and Audit Committee, and will keep the public informed about the Fund's investment performance.

Legislative Oversight

The Free Conference Committee found a need for coordinated, continuing oversight of all the state's investment efforts. Accordingly, the review will extend beyond the Alaska Permanent Fund to include the Alaska Renewable Resources Fund, loan programs, the several authorities, and the general fund. As well as building up a body of legislators with detailed knowledge of investments, this new approach will give the Legislature and the broad public better information on the policies and efficiency of the various investment agencies, on the extent to which these agencies conform to statutory intent, and on the extent to which the economic and social goals of the various programs are being achieved.

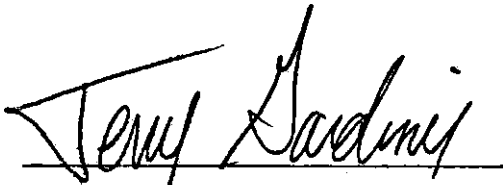
The House Finance Committee had considered providing in the Permanent Fund bill for a new interim committee to handle this oversight function but decided, in the interest of efficiency, to simply expand the powers and duties of the present Legislative Budget and Audit Committee (pages 1-3). As proposed, the Legislative Budget and Audit Committee will review the plans and reports of all state agencies involved in lending or investing, report to the Legislature its findings and recommendations, and provide for audits and performance evaluations of the Alaska Permanent Fund Corporation's investment program.

It is the Committee's intent, however, that these new duties be assigned to the Legislative Budget and Audit Committee on a trial basis and that the committee report back to the Legislature within two years, recommending how best the oversight duty could be carried out and including

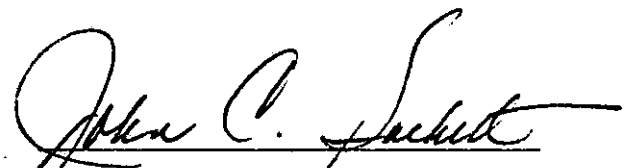
consideration of the option of delegating the responsibilities to a separate committee.

The Future

As stated earlier, this bill addresses only the question of Fund management and leaves the separate question of how to use the Fund earnings to separate legislation. It merely assures that there will be income and does not preclude any options for its use. Unless another determination is made, the Permanent Fund earnings will be deposited in the general fund. No matter what use(s) are decided for the income, the very establishment of a secure trust will be a sign to the national financial community that Alaska is following a responsible fiscal policy.



TERRY GARDINER, Chairman
Conference Committee



JOHN SACKETT, Chairman
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