

**ALASKA STATE LEGISLATURE
HOUSE STATE AFFAIRS STANDING COMMITTEE**

March 2, 2004
8:00 a.m.

MEMBERS PRESENT

Representative Bruce Weyhrauch, Chair
Representative Jim Holm, Vice Chair
Representative John Coghill
Representative Bob Lynn
Representative Paul Seaton
Representative Ethan Berkowitz
Representative Max Gruenberg

MEMBERS ABSENT

All members present

COMMITTEE CALENDAR

HOUSE BILL NO. 422

"An Act repealing the special subaccount established in the constitutional budget reserve fund; relating to the powers of the Department of Revenue for the investment of amounts in the constitutional budget reserve fund; and providing for an effective date."

- HEARD AND HELD

HOUSE BILL NO. 466

"An Act relating to investments of Alaska permanent fund assets; and providing for an effective date."

- HEARD AND HELD

HOUSE BILL NO. 423

"An Act relating to accidents involving the vehicle of a person under the influence of an alcoholic beverage; and providing for an effective date."

- HEARD AND HELD

OVERVIEW: DEPARTMENT OF PUBLIC SAFETY

- CANCELLED

PREVIOUS COMMITTEE ACTION

BILL: HB 422

SHORT TITLE: BUDGET RESERVE FUND INVESTMENT

SPONSOR(S): FINANCE

02/02/04	(H)	READ THE FIRST TIME - REFERRALS
02/02/04	(H)	STA, FIN
02/10/04	(H)	STA AT 8:00 AM CAPITOL 102
02/10/04	(H)	Scheduled But Not Heard
02/26/04	(H)	STA AT 8:00 AM CAPITOL 102
02/26/04	(H)	Heard & Held
02/26/04	(H)	MINUTE(STA)
03/02/04	(H)	STA AT 8:00 AM CAPITOL 102

BILL: HB 466

SHORT TITLE: PERMANENT FUND INVESTMENTS

SPONSOR(S): RULES BY REQUEST OF LEG BUDGET & AUDIT

02/16/04	(H)	READ THE FIRST TIME - REFERRALS
02/16/04	(H)	STA, FIN
02/26/04	(H)	STA AT 8:00 AM CAPITOL 102
02/26/04	(H)	Scheduled But Not Heard
03/02/04	(H)	STA AT 8:00 AM CAPITOL 102

BILL: HB 423

SHORT TITLE: TAXICAB DRIVER LIABILITY

SPONSOR(S): REPRESENTATIVE(S) ANDERSON

02/02/04	(H)	READ THE FIRST TIME - REFERRALS
02/02/04	(H)	JUD
02/02/04	(H)	STA REFERRAL ADDED AFTER JUD
02/09/04	(H)	REFERRAL ORDER CHANGED
02/09/04	(H)	STA, JUD
02/10/04	(H)	STA AT 8:00 AM CAPITOL 102
02/10/04	(H)	<Bill Hearing Postponed>
03/02/04	(H)	STA AT 8:00 AM CAPITOL 102

WITNESS REGISTER

TOMAS H. BOUTIN, Deputy Commissioner

Office of the Commissioner

Department of Revenue

Juneau, Alaska

POSITION STATEMENT: Answered questions on behalf of the department during the hearing on HB 422.

JAMES ARMSTRONG, Staff
to Representative Bill Williams
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Testified on behalf of the House Finance
Committee, sponsor.

ROBERT D. STORER, Executive Director
Alaska Permanent Fund Corporation (APFC)
Department of Revenue
Juneau, Alaska

POSITION STATEMENT: Testified on behalf of the department
during the hearing on HB 466.

RONALD W. LORENSEN, Attorney at Law
Simpson, Tillinghast, Sorensen & Longenbaugh, P.C.
Juneau, Alaska

POSITION STATEMENT: Addressed the changes sought in HB 466.

JIM SHINE JR., Staff
to Representative Tom Anderson
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Presented HB 423 on behalf of
Representative Anderson, sponsor.

DARWIN BIWER, Board Member
Cabaret Hotel Restaurant & Retailers Association
Anchorage, Alaska

POSITION STATEMENT: Spoke in support of HB 423 and answered
questions from the committee.

ACTION NARRATIVE

TAPE 04-25, SIDE A

Number 0001

CHAIR BRUCE WEYHRAUCH called the House State Affairs Standing
Committee meeting to order at 8:00 a.m. Representatives
Weyhrauch, Holm, Seaton, and Lynn were present at the call to
order. Representatives Coghill, Berkowitz, and Gruenberg
arrived while the meeting was in progress.

HB 422-BUDGET RESERVE FUND INVESTMENT

Number 0060

CHAIR WEYHRAUCH announced that the first order of business was HOUSE BILL NO. 422, "An Act repealing the special subaccount established in the constitutional budget reserve fund; relating to the powers of the Department of Revenue for the investment of amounts in the constitutional budget reserve fund; and providing for an effective date."

TOMAS H. BOUTIN, Deputy Commissioner, Office of the Commissioner, Department of Revenue, stated he would address the four questions about HB 422 that Representative Berkowitz had emailed to the Department of Revenue. The first question that he addressed related to the current and projected returns for the Constitutional Budget Reserve Fund (CBRF), and the returns for the subaccount that HB 422 would be eliminating. Mr. Boutin stated that the Department of Revenue usually doesn't get together and make projections for the funds. He pointed out that the Department of Revenue does make projections on returns for the general fund and the CBRF in the Revenue Sources Book. He said the last time that the Department of Revenue did an official projection on the CBRF was for the Fall 2003 Revenue Sources Book. Citing the information on page 7 of the Revenue Sources Book, Mr. Boutin stated that the three-year return on the subaccount has been 1.8 percent and has shown "textbook volatility," which can be expected from an account that has higher risk. He stated that the three-year annualized report for the CBRF showed that the account had a 5.9 percent return.

Number 0260

MR. BOUTIN addressed the question regarding when the [CBRF] account would be completely "down" and require entry into the subaccount. He noted that the [2003] fall revenue forecast shows the entire CBRF running out in May 2007. Mr. Boutin explained that Commissioner [William] Corbus had made a presentation recently in Fairbanks on [the status of] the entire CBRF. Mr. Boutin stated that the department prepared the handout for that presentation and that he had some copies available. He noted that [the one-page handout included in the committee packet, which shows two CBR subaccount graphs] explained in detail how the CBRF is forecasted today to "run down."

CHAIR WEYHRAUCH stated that the annual return rate for the subaccount cited in the annual report 2003 seemed aberrant and he asked why that was.

MR. BOUTIN stated that equities had really taken off recently, which is reflected in the rate. He cited the subaccount graphs in the packet and noted that the subaccount went below the initial investment shortly after its inception and has just recently recovered and risen above the initial \$400 million investment.

Number 0412

MR. BOUTIN addressed another question, regarding the amount of money that the Department of Revenue felt was prudent to require as a minimum balance for the CBRF, and how they derived that balance. He stated that the number the administration is using is a \$1-billion minimum balance. He explained that \$400 million is required just for cash flow purposes, and the other \$600 million is a result of the price volatility of oil. He said that the Office of Management & Budget (OMB) decided on the \$600-million figure.

Number 0506

MR. BOUTIN addressed the final question previously submitted by Representative Berkowitz, relating to the state's bond rating and how it would be affected by the passage of HB 422. He said that the transfer of funds from the subaccount to the CBRF would have no impact on the bond rating, especially since this particular move would have the entire fund at a fixed income, which suggests more liquidity. He said that he talked with "government finance associates" and asked them about the credit rating implications that HB 422 would carry with it. He said that government finance associates didn't see any impact on the state's bond rating.

Number 0646

REPRESENTATIVE BERKOWITZ asked for further clarification on the \$1-billion figure that the administration was using as the minimum amount needed for the CBRF. He said that he had been to the Conference of Alaskans and he saw no direct relationship illustrated between the \$1-billion figure and anything else. He stated that at the Fiscal Policy Caucus, it seemed that it was determined that \$1.5 billion was a better number. Representative Berkowitz said that some people want to link the minimum balance in the CBRF to general fund spending, so there would be a cushion that is rationally related to the state's expenditures.

Number 0702

MR. BOUTIN explained that where there was a zero aggregate draw from the CBRF throughout the year, there would still be a need for \$400 million for cash flow purposes. He explained further that early on in the fiscal year, the state borrows from the CBRF to pay for fire suppression and federal projects. He added that when the state is reimbursed by the federal government, it then replenishes the money borrowed. He said that this is a typical year, except for the recent oil prices, and \$100 million was just reinvested in the CBRF, and there is expected to be another \$100-million deposit made into the CBRF this fiscal year.

MR. BOUTIN referred to [the second page - entitled, "General Fund Cash Sufficiency With CBRF Borrowing" - of a seven-page handout included in the committee packet], which he said was prepared for the Conference of Alaskans by the Department of Revenue. He used that graph to illustrate how the account is drawn from and replenished and why the need for a \$400-million balance for cash flow purposes is a reasonable number. He further explained that the OMB came up with the \$600-million figure by assessing the 80 percent confidence level for oil price volatility. He said that it determined that a \$600-million balance was necessary to account for a one-year change in oil prices and the time necessary for the legislature to deal with an oil price shock. He said that these factors were the reasons the \$1-billion minimum was set, adding that it wasn't linear programming or operations research, just pretty simple calculus that established that number.

Number 0951

REPRESENTATIVE BERKOWITZ asked if there were any statistics pertaining to the performance of the CBRF or the subaccounts for the current year.

MR. BOUTIN indicated that the most current figures that he has are found in the graph with the end date of December 31, 2003. He stated that the subaccount had earned a 19.17 percent profit for that year.

REPRESENTATIVE BERKOWITZ asked if Mr. Boutin had the current balances of each account.

MR. BOUTIN said that he didn't have that information with him.

CHAIR WEYHRAUCH asked if the May 2007 projections mentioned earlier would be extended, since the account has been getting such a high return.

Number 1041

MR. BOUTIN estimated that in the upcoming spring forecast, the rates will look better than the fall forecast, unless there was a drastic plummet in oil prices. He said that he didn't want to "forecast a forecast," but he felt that because of that, the May 2007, depletion forecast could potentially be pushed back a little. He pointed out that the depletion date wasn't that sensitive to earnings on the CBRF, stating that it is sensitive to expenditures versus revenues.

Number 1112

CHAIR WEYHRAUCH asked if there were going to be any additional fees for management of this money.

MR. BOUTIN responded that the Department of Revenue manages about \$18 billion, most of which is pension funds. He stated that they manage \$6 billion of fixed income "in house." He said that other types of investments, real estate, private equity, and equity are managed by external sources. He said that the Department of Revenue will save \$125,000 by moving this account to a fixed income account and keeping it "in house"

CHAIR WEYHRAUCH asked if the Department of Revenue would need to add more employees to manage the larger amount of money.

MR. BOUTIN stated that the Department of Revenue, Treasury Division, has recently become the student loan money manager [for the state] and has looked to add a fixed income analyst position because of that.

CHAIR WEYHRAUCH explained that he had inquired about hiring additional staff because, based on his experience, usually when a bill is passed that takes thousands of dollars to manage there is a need to hire more people. Chair Weyhrauch said that he wanted clarification that that wouldn't be the case, although the Department of Revenue would be dealing with millions of dollars.

Number 1224

REPRESENTATIVE SEATON commented on what he felt was an underlying concern from the committee, stating he feels that because the rate of return was so high this last fiscal year, the committee is attempting to be "market timers" and assume that it will continue to do as well. He stated that they weren't in a position to do that.

MR. BOUTIN agreed and said, "We are not market timers."

Number 1289

REPRESENTATIVE HOLM asked for clarification about the statement Mr. Boutin made earlier regarding the cash flow needing to be \$400 million and the OMB needing \$600 [million]. Citing [the fourth page of the previously mentioned] packet prepared for the Conference of Alaskans by the Department of Revenue, Representative Holm asked why the figures represented there were different - \$700 million from the OMB and \$300 million for cash flow. He stated that he didn't see a reason that the \$400-million figure was needed. Representative Holm backed this point up further by noting pages 10 and 11, of the same document, seemed to show that the balance never falls more than \$150 million below zero. He asked why the Department of Revenue sought \$400 million for cash flow purposes, when the information presented doesn't support that.

MR. BOUTIN responded that he didn't feel that there was a true science to forecasting the market. He said that if someone was going to argue that \$1 billion wasn't the right minimum balance amount, but \$900 million or \$1.1 billion is instead, he doubted that there would be that much of an argument from the Department of Revenue.

REPRESENTATIVE HOLM asked, "So its not that critical of a number then?"

MR. BOUTIN responded that it was critical to have a balance; if there was no balance it would effect the credit rating that Representative Berkowitz was inquiring about in earlier testimony. He said that he didn't think that a transfer like the one that is suggested in HB 422 would effect the credit rating, stating that the credit rating agencies are much easier to predict than oil volatility.

Number 1443

CHAIR WEYHRAUCH asked if June 30, 2004, should be the effective date of HB 422.

MR. BOUTIN responded that because the Department of Revenue doesn't have the management fees for the subaccount in the budget for fiscal year 2005, the sooner that HB 422 can become effective, the better. He stated that the way a fund is run, the money is tapered out of the fund; therefore, it will take some time and there will probably be some costs absorbed in fiscal year 2005. Those costs will increase the longer HB 422 is not in effect.

CHAIR WEYHRAUCH asked if HB 422 should have an immediate effective date.

MR. BOUTIN stated that if HB 422 had an immediate effective date, it would give the Department of Revenue more flexibility. He stated that flexibility is always a good thing when managing money.

Number 1510

CHAIR WEYHRAUCH asked if having the title read: "An Act repealing the special subaccount under the authority of the Constitutional Budget Reserve Fund." would be more appropriate than the current title, since the subaccount is not created in the fund as a constitutional matter.

MR. BOUTIN said that he hadn't looked at the title from that perspective, but that Chair Weyhrauch was correct. He added that, during the last hearing on HB 422, Chair Weyhrauch asked if the effect needed could be done as an executive order. He stated that he had spoken with Jim Baldwin, the Assistant Attorney General, and Mr. Baldwin answered that this wasn't an executive branch management issue, but a fund established by law, so a change in statute was necessary.

REPRESENTATIVE BERKOWITZ asked if Mr. Boutin was aware of any analysis that has been done that would project what would occur if the bulk of the CBRF was deposited into the Permanent Fund.

Number 1640

MR. BOUTIN said he wasn't aware of any analysis done on that matter.

Number 1652

REPRESENTATIVE GRUENBERG asked if it would give the Department of Revenue the flexibility it needed if the legislature granted the department the authority to access the subaccount, without repealing AS 37.10.430, subsection (c).

Number 1756

MR. BOUTIN stated that the Department of Revenue's motivation was based on the fact that the CBRF was regularly being drawn from, which doesn't suggest to the Department of Revenue that the money should be invested in any other account than fixed income. He stated that although the subaccount is earning a higher rate at this time, the Department of Revenue is not a market timer, and so, based on the use of the fund, it makes more sense to have that money in a fixed account. He used the example that the CBRF would never be invested in real estate because the fund isn't being used in that way. He said that the Department of Revenue currently has long-term investments, but he doesn't see the CBRF as a fund where long-term investments are appropriate.

REPRESENTATIVE GRUENBERG stated that Mr. Boutin's logic was flawless, if the Department of Revenue proceeds from that premise. He said that if the department maintains the premise that they try to maintain a balance in the CBRF, the reasoning is flawed. He stated that by keeping the statute on the books but granting the Department of Revenue access to the money, it would give the Department of Revenue the flexibility it needed. He stated that he thought the statute should exist if there were policy changes in the future.

Number 1925

MR. BOUTIN replied that regardless of the balance in the CBRF, the fact that there are drawdowns from the account suggests that it has to have high liquidity, and HB 422 allows for that liquidity.

REPRESENTATIVE GRUENBERG said that he feels that it would be in the Department of Revenue's best interest to maintain the flexibility of having the subaccount there, but having access to it, rather than eliminating it. He asked Mr. Boutin why the Department of Revenue felt it was necessary to foreclose the subaccount and eliminate the ability for the department of Revenue to make discretionary decisions.

MR. BOUTIN said that he didn't see the utility in maintaining the subaccount, based on the way the fund is used. He said that he felt that it was better to invest the CBRF in a manner that is appropriate to how [the state] uses it. He stated that if, in the future, the CBRF is used differently, it will be another issue; however, that doesn't seem to be on the horizon right now.

Number 2117

REPRESENTATIVE BERKOWITZ commented on the statements made about the need for the CBRF based on the cash flow inequalities throughout the fiscal year. He said he felt that there wouldn't be a cash flow problem if there was a balanced fiscal regime. He followed up that comment by illustrating the three cases that could come about, involving the CBRF. He stated that the first case would be where the CBRF has a lot of money and the subaccount would prove useful. The second case would be where there is a \$1-billion CBRF and the money needed for cash flow purposes is covered by the \$1-billion minimum. The third case would be where the CBRF was approaching zero and the assets in the subaccount would be liquidated. He then asked why this legislation needed to be introduced at all, since the Department of Revenue was going to manage the entire CBRF in the best interest [of the state] given the constraints at the time.

Number 2210

MR. BOUTIN responded that, like a private company, the Department of Revenue has a need for cash. He stated that the cash inflows and outflows are not balanced, so cash needs to be available [to cover that imbalance]. He clarified that the \$1-billion minimum would include the subaccount, and he said that in order to account for the cash flow and the price shocks, that money should be readily available in fixed income, rather than in real estate or equities, for example.

REPRESENTATIVE BERKOWITZ stated that it wouldn't be prudent for the Department of Revenue to manage the fund in liquid assets if the fund was going to be drawn from. He voiced his opinion that repealing this statute [as proposed by HB 422] would have no bearing on how the Department of Revenue manages the fund. He added that the statute exists for direction of the fund during flusher times.

Number 2324

REPRESENTATIVE GRUENBERG turned to Section 3 of the bill. He asked if [the department] would need statutory authority in order to transfer some of the money out of the fund, or whether that authority would be inherent.

MR. BOUTIN responded that when language has been carefully drafted by attorneys, he should not attempt to try to change it on the spot. He added that he is not certain what problem Representative Gruenberg is addressing and he would want to read the language and consider if "it does the same thing under all circumstances."

CHAIR WEYHRAUCH noted that the bill will have further consideration in the House Finance Committee.

Number 2435

JAMES ARMSTRONG, Staff to Representative Bill Williams, Alaska State Legislature, testified on behalf of the House Finance Committee, sponsor, which is co-chaired by Representative Williams. Mr. Armstrong suggested having a trigger mechanism that would "collapse" the subaccount into the main account when the main account falls below a certain number, such as "\$300 million for cash flow purposes." He observed, "I mean, if the stock market does 10 percent the next four years, it could make \$160 million."

CHAIR WEYHRAUCH said that seems to conflict with what Mr. Boutin previously indicated, regarding the need to work with money managers and the efficiencies that may be inherent in the ability to give notice and react to the state's fiscal situation. He stated that if this were contained in a longer-term investment portfolio, then there certainly wouldn't be the flexibility that Mr. Boutin and the state is looking towards. He mentioned a trigger mechanism that could happen in an instant in a catastrophic market situation.

Number 2505

REPRESENTATIVE BERKOWITZ responded that the trigger mechanism is there. He explained that if prudence dictates that the fund be drawn to zero, then it will be drawn to zero. If, in the course of drawing it to zero, the assets of the subaccount have to be liquidated, then that's what is going to happen. He reiterated that he does not see the need for HB 422. He expressed his opinion that this proposed legislation signals a pessimism on

the part of the administration about its ability to solve the fiscal gap.

CHAIR WEYHRAUCH responded that he doesn't think it signals that at all. For example, he said, if there is a five-year investment portfolio with a penalty for early withdrawal, it does the citizens and the CBR no good to use the early withdrawal to pay a penalty. He noted that the statute was passed during flush times and a long bull market. He indicated that any pessimism is not reflective of the administration but is reflective of reality.

REPRESENTATIVE BERKOWITZ disagreed. He stated that the reality of the situation is that [the legislature] is going to solve the fiscal gap one way or the other. He said that the current administration has said that it wants a \$1-billion minimum in the CBR. He stated that if the administration wants that minimum - an amount that he said he thinks is too low - then there is no need to invade the subaccount. Furthermore, if the subaccount is not invaded, then it should be invested in a way that prudence dictates. Representative Berkowitz clarified as follows:

In a lot of ways, all this subaccount does - and I was there for the debate - [is it] authorizes prudent investment rather than simple liquidity. That's what the change inherent in the subaccount is. And ... it just seems to me that if there's a need to invade the principle of the subaccount, that's what's going to happen. And they don't need the authority that's inherent in repeal of a statute. But they need ... the existence of the statute for flusher times, in order to authorize better yielding investments.

CHAIR WEYHRAUCH said a lot of people have discussed how to cushion the budget. He said, "It's case by case, person by person."

Number 2643

REPRESENTATIVE SEATON said:

If we're talking about a five-year investment horizon for this account, [and] we look back at the last three years' average return of 1.8 percent, I don't care how good one year was in that horizon, that has not been a good investment for us compared to what they've done

with the regular fund. So, we can pick a year and say, "Oh, it was great - 10.2 percent in one year, " but when you look at the three-year annualized, it's terrible. And so, why [would we] say, "Do we want to maintain that investment?" It's supposed to be in higher yield, which would mean higher risk generally; especially it's higher risk if you're saying that at some point during that time, prudent investing is going to mean you have to liquidate some of it when it's not the appropriate time.

So, it seems to me that we have our prudent investor here from [the] Department of Revenue, that manages the retirement accounts and everything else, saying that with the direction that the CBR is used [and] with the projections of what the CBR is going to there for, it's easier -- we're listening to our investors saying its not prudent to have this subaccount invested in longer-term strategy, because no longer are we looking at the CBR; we're not looking at replacing the \$5 billion or \$7 billion that we owe the CBR. If we had a structure that was putting that money back into the CBR, we would be talking about something quite different. I haven't heard that from anyone in the legislature - that we are reconstituting and "re-depositing" money into the CBR in any significant amount. So, it seems to me that we have to listen to our prudent investors who are coming to us and saying that they don't figure a five-year time horizon when we have a shorter-than-five-year use of that fund horizon, currently

REPRESENTATIVE BERKOWITZ noted that Mr. Boutin is not the investor - that's not what he does. He noted that the committee has not seen forward-looking projections. He said, "If we're here in a fiduciary capacity, looking at what the expectations are going to be for the subaccount as opposed to the main account, I think we ought to see what the forward-looking projections are." He said it is not prudent or fiscally responsible for the legislature to take a backwards look at the past three year's biggest bear markets seen in "our lifetime" and make a determination that that's what the long-term effects are going to be.

Number 2780

MR. BOUTIN stated that the commissioner of [the Department of revenue] is the fiduciary for "this account." The projection that is used to decide how the account will be used is the fall revenue forecast. He noted that in several weeks there will be a spring revenue forecast. He said, "The information that we have, I have shared with you, and I think it's all here."

CHAIR WEYHRAUCH said there has been some indication that an immediate effective date would be beneficial.

Number 2826

CHAIR WEYHRAUCH moved [Amendment 1], to modify Section 4 [on page 2, line 3], to make the bill effective immediately.

CHAIR WEYHRAUCH noted that Representative Berkowitz had objected.

REPRESENTATIVE BERKOWITZ said he doesn't see "the emergency in an immediate effective date." He strongly suggested that if an effective date is chosen, it should be to a trigger point in the CBR, not tied to a "date certain."

Number 2875

CHAIR WEYHRAUCH offered his understanding that if an Act has an immediate effective date, it takes a two-thirds vote of the legislature [to pass]; however, if it doesn't have an immediate effective date, it would take effect 90 days after passage.

REPRESENTATIVE BERKOWITZ said, "After the signature."

CHAIR WEYHRAUCH noted that even if the immediate effective date failed, "this" effective date would effect sooner than if there were no effective date.

REPRESENTATIVE BERKOWITZ responded, "If the effective date prevails on the floor."

Number 2918

REPRESENTATIVE SEATON noted, "Part of what we're trying to do is ... to allow an orderly phase-out of these longer-term investments." He stated that he is not sure how the effective date will influence that.

Number 2927

MR. BOUTIN said the department would direct the manager to begin "getting out as they see appropriate." He indicated that the management fees for fiscal year (FY) 2005 were not included. Even if the bill is enacted, he said, the department would still not be through with its management fee responsibility by July 1 and would have to find the money for approximately 60 days "as we take her out of it."

CHAIR WEYHRAUCH said it sounds like the department could implement its management responsibilities, whether the effective date is immediate or July 1.

MR. BOUTIN concurred.

CHAIR WEYHRAUCH withdrew Amendment 1.

Number 2975

REPRESENTATIVE BERKOWITZ asked, "What precludes you from directing the fund managers to do just that anyway?"

[Not on tape, but taken from the Gavel to Gavel recording on the Internet, was Mr. Boutin's response as follows: "Well, as we understand existing statute, we have this ... sub fund invested at a five-year time horizon, which suggests to us mostly equity. And so, we believe that precludes us from doing ... now what this bill would allow."]

TAPE 04-25, SIDE B

Number 2959

REPRESENTATIVE COGHILL turned to [page 1, line 11, Section 2 of the bill], which shows that [AS 37.10.430(c)] would be repealed. AS 37.10.430(c) read as follows:

(c) A special subaccount is established in the budget reserve fund (art. IX, sec. 17, Constitution of the State of Alaska). Money in the subaccount shall be invested to yield higher returns than might be feasible to obtain with other money in the budget reserve fund. In establishing or modifying the investment policy for the subaccount in the constitutional budget reserve fund, the commissioner of revenue shall assume that those funds will not be needed for at least five years. Income earned on

money in the subaccount shall be retained in the subaccount by the department.

REPRESENTATIVE COGHILL offered his understanding that [that statute] is a directive that states that the department shall assume that the funds will not be needed for at least five years. He noted that if it is not repealed, the directive would remain. He added, "So, that would definitely change your management style."

MR. BOUTIN said he believes that's certainly true.

REPRESENTATIVE GRUENBERG turned to a one-page memorandum included in the committee packet, from Tam Cook [director of Legislative Legal and Research Services]. It is a legal opinion [regarding Section 1 of the bill]. He indicated that he had spoken with Mr. Boutin about the memorandum. Representative Gruenberg stated that he sees no need for Section 1, because "you have that authority anyway."

Number 2916

REPRESENTATIVE GRUENBERG moved to adopt Amendment 2, which would strike Section 1 of the bill [and renumber the other sections accordingly].

CHAIR WEYHRAUCH note that [Section 1] would be unnecessary if Section 2 is enacted.

REPRESENTATIVE GRUENBERG responded that it's unnecessary anyway.

MR. BOUTIN concurred.

CHAIR WEYHRAUCH asked if there was any objection to Amendment 2. He clarified Amendment 2.

Number 2865

CHAIR WEYHRAUCH objected to Amendment 2 for discussion purposes.

REPRESENTATIVE GRUENBERG, in response to a question from Representative Coghill, clarified that Section 1 is found on page 1, lines 5-10 of HB 422.

Number 2844

CHAIR WEYHRAUCH withdrew his objection. He asked if there was further objection.

REPRESENTATIVE SEATON asked if a title change would be required.

Number 2831

REPRESENTATIVE GRUENBERG responded that he would allow the bill drafter to change the title, if necessary.

CHAIR WEYHRAUCH, in response to Representative Seaton's question, said, "It may, depending on how discussion goes on this amendment."

Number 2820

REPRESENTATIVE GRUENBERG said, "Part of my amendment is to authorize any title change necessary."

Number 2812

CHAIR WEYHRAUCH asked again if there was any objection to adopting Amendment 2 [with the authorization for a title change]. There being none, it was so ordered.

Number 2789

CHAIR WEYHRAUCH moved to adopt Amendment 3 [AS 37.10.430(c), with handwritten changes], as follows:

(c) Money in the budget reserve fund (art. IX, sec. 17, constitution of the State of Alaska) may be invested to yield higher returns than might be feasible to obtain with other money in the budget reserve fund. In establishing or modifying the investment policy for money in the constitutional budget reserve fund, the commissioner of revenue shall assume that those funds may be needed to meet cash flow needs and prudent financial management of the state's budget.

Number 2768

REPRESENTATIVE BERKOWITZ objected. He pointed out that the fund is not all money, but is also made up of equities and bonds, for example.

CHAIR WEYHRAUCH suggested that the word "fund" could be used instead of the word "money".

REPRESENTATIVE GRUENBERG said, "Yeah, it would be the CBR fund."

CHAIR WEYHRAUCH read the Amendment 3, as amended, to incorporate the foregoing suggestion, as follows:

The budget reserve fund (art. IX, sec. 17, Constitution of the State of Alaska) may be invested to yield higher returns than might be feasible to obtain with other money in the budget reserve fund. In establishing or modifying the investment policy for the constitutional budget reserve fund, the commissioner of revenue shall assume that those funds may be needed to meet cash flow needs and prudent financial management of the state's budget.

CHAIR WEYHRAUCH stated that that language comes from a letter of intent from the House Finance Committee sponsor statement.

REPRESENTATIVE GRUENBERG pointed to the part of Amendment 3 that read, "yield higher returns than might be feasible to obtain with other money in the budget reserve fund." He suggested that the word "money" be changed to "assets".

CHAIR WEYHRAUCH agreed. He asked if there was further discussion on Amendment 3, [as amended].

Number 2699

REPRESENTATIVE BERKOWITZ moved to adopt another amendment to Amendment 3, to change the words "may be" to "shall be".

REPRESENTATIVE GRUENBERG offered his understanding that that was the intent of the original [AS 37.10.430(c)].

CHAIR WEYHRAUCH objected for purposes of discussion. He opined, "I think we want to optimize returns so that we can meet the state's budget, while getting a reasonable return on investment. And that leaves us a lot more discretionary with the managers of the fund and their fiduciary duty, as opposed to tying their hands by ... giving them a ... specific directive"

REPRESENTATIVE HOLM said it seems to him that "we're" not particularly interested in getting the greatest investment, but

rather in making the fund liquid. He posited that "shall" would defeat the purpose of what the bill is trying to accomplish.

Number 2614

REPRESENTATIVE SEATON said:

I disagree with agreeing that the shorter-term and longer-term alignments within the department of the management of those funds is where that should be; that if we are in a situation where there is more money in the CBR and revenues project, say, [an] eight-year horizon at some time, then it's perfectly logical of them to do it. So I think the "may" is (indisc. - overlapping conversation).

CHAIR WEYHRAUCH requested that Representative Berkowitz withdraw his amendment so that the committee could adopt [Amendment 3, as amended], at which point, he suggested, Representative Berkowitz could "amend to add the 'shall'."

REPRESENTATIVE BERKOWITZ said he would do that.

Number 2533

CHAIR WEYHRAUCH asked if there was further objection to [Amendment 3, as amended].

REPRESENTATIVE BERKOWITZ objected.

CHAIR WEYHRAUCH, in response to a request for clarification from Representative Seaton, read the second half of [Amendment 3, as amended].

REPRESENTATIVE GRUENBERG pointed to "the commissioner of revenue shall assume that those funds". He suggested that "funds" should be changed to "assets".

CHAIR WEYHRAUCH agreed to the change for purposes of consistency. He said, "I'll take that as a friendly amendment."

REPRESENTATIVE GRUENBERG asked about Chair Weyhrauch's choice of the term "cash flow needs". He asked if there might be other needs, as well as cash flow needs, that the committee should include. He also remarked that he thinks the "special account" should be kept.

REPRESENTATIVE SEATON said he agrees with the elimination of the subaccount and allowing the department to invest prudently. He mentioned the structure and the time horizon. He said he thinks the committee needs to "take a look at this and get it structurally correct."

Number 2451

CHAIR WEYHRAUCH announced that Amendment 3, [as amended], and HB 422 would be set aside.

REPRESENTATIVE BERKOWITZ said it's clear at this point that he is an advocate of the subaccount, but it seems that the "primary rub against it has to do with the five-year look forward, and that's the offending sentence."

CHAIR WEYHRAUCH told Mr. Boutin that although this process seems frustrating, it will save time on the House floor.

Number 2424

MR. BOUTIN stated that he doesn't see the utility in having a subaccount in the CBR at this stage. He noted that "all of this money is invested under the prudent investor rule."

Number 2407

CHAIR WEYHRAUCH announced that HB 422 was heard and held.

HB 466-PERMANENT FUND INVESTMENTS

[Contains discussion of HB 156.]

Number 2383

CHAIR WEYHRAUCH announced that the next order of business was HOUSE BILL NO. 466, "An Act relating to investments of Alaska permanent fund assets; and providing for an effective date."

Number 2365

ROBERT D. STORER, Executive Director, Alaska Permanent Fund Corporation (APFC), Department of Revenue, stated that the department is held to the prudent investor rule. He said the permanent fund "has an extra layer"; in addition to the prudent investor rule, there is a statutory list that defines what may be invested in. He indicated that the list includes one clause

that "gives a little additional flexibility." He noted that the modern prudent investor rule started with the enactment of [the Employee Retirement and Income Security Act of 1974] (ERISA). He explained that although ERISA has to do with private pension plans and corporations, everyone uses ERISA where applicable in regard to public funds. Mr. Storer read selections from [29 U.S.C. 1104 - Fiduciary Duties], which read in part as follows:

(a) Prudent man standard of care

(1)

Subject to sections 1103(c) and (d), 1342, and 1344 of this title, a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and

...

(B)

with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;

(C)

by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so;

MR. STORER said that although it was typical in the 70s for a public fund to have a statutory list defining what investments can be made, currently virtually all public funds have eliminated the statutory list and "just follow the prudent investor guideline."

Number 2186

MR. STORER directed the committee's attention to a [six-page] handout [included in the committee packet], entitled, "Alaska Permanent Fund." He noted that pages two and three of the handout show all the times that the legislature has expanded the investment flexibility and given the [APFC] more latitude to achieve its investment goals. He indicated his understanding

that it is a "misstatement" on the bottom of page three that it reads that HB 156 was sponsored by the Senate Finance Committee in 1999. Notwithstanding that, he highlighted that paragraph, which read as follows:

HB 156 allowed the Fund to leverage real estate investments and increased asset allocation limit for stocks to 55 percent of the total market value of the Fund. HB 156 also created the "basket clause" that allows up to 5 percent of the Fund to be invested in alternative investments or to be applied to existing asset allocations to expand their limits. In addition, HB 156 allowed the Permanent Fund to be the sole owner of any real estate property, regardless of value.

MR. STORER noted that page four of the handout shows the history of the fund's various asset allocations. For example, he noted that during the early 70s and 80s, the permanent fund was invested exclusively in fixed income securities, "even though it's a long term fund." He revealed that he began working with the APFC in May of 1983, and in June of that year, the [APFC] funded its first "equity managers." He remarked that as of late 1987 the fund was invested in only about 13 percent in the U.S. equity market alone and the [APFC] did not have permission to invest in the international equity market. He stated, "What you see ... right now in the asset allocation is slightly more conservative than other public funds, but a mature fund that ... constructs their portfolios, essentially, the way most public funds invest their money."

Number 2061

MR. STORER said HB 466 proposes an increase in investment flexibility. The changes, he noted, will potentially allow the [APFC] to increase its returns and to meet future needs in terms of increasing diversification, as well as to implement strategies more efficiently at a lower cost and address contemporary needs as they occur.

MR. STORER revealed that next week the [APFC] will propose a change in its asset allocation, which is something it does every March after a review of the capital market in the beginning of the year. He turned to [a one-page handout included in the committee packet], entitled "Fund's asset allocation and control bands." He explained that the column of numbers on the left is the target number - for example, 37 percent U.S. equity market,

while the column of numbers on the right shows bands - for example, plus or minus 7 percent. He explained that the [APDC] tries to create targets and then create "bands around those targets." The corporation does not want to balance "a lot," because that can result in creating transaction costs; however, it does want to "discipline it mechanically," which "forces you to rebalance."

Number 1922

MR. STORER stated that the September quarter of 2002 was the worst quarter in the history of the permanent fund, with a negative 7.5 percent rate of return due primarily to a plummeting stock market, which forced the [APFC] to add about \$750 million in the equity market to "get back closer to target." He added, "We got permission from the board around October 10. I think we missed the bottom of the bear market by about four days and so we captured very high returns." He noted that "this was not any special insight on what was going on in the bear market," but was an example of how a disciplined approach works. He stated that his point in bringing this up is that "after four years of study, we're about to implement some strategies that will use the basket clause."

Number 1861

MR. STORER continued as follows:

We are ... banging up against our statutory limitations very soon. ... That means if the equity market continues - if these strategies that we ... employ using the basket clause work - we will be forced to liquidate the assets. Not because the capital markets tell us to do [so], not because our advisors are saying we need to liquidate or take profits or redirect that money. We will be forced to liquidate because statutes will not allow us to gain the benefits of the ... full rising market. So, there is a big negative, I believe, to our statutory limitations, which forces us to take potential gain off the table, because of statutory limitations, not what the financial markets are telling us.

Number 1794

MR. STORER turned attention to the last page of the of the previously noted six-page handout, which addresses potential

questions. He noted that one question may be, "Will you ... take on too much risk?" He continued:

We've all said we have this target [of] hitting a 5 percent real rate of return over time, and we're comfortable making that statement. But what if, to achieve a higher rate of return, ... our constitutional amendment doesn't pass and we, one way or another, ... believe we should strive for a higher rate of return ... and accept more risk than is prudent?" And that is a risk. You can't say, "That will never happen, it has never happened, I see no evidence it will happen."

I ... have worked with about every trustee of the permanent fund with the exception of about four in the beginning. ... I've worked with every executive director. I've worked for or with every chief investment officer [of] the Alaska Permanent Fund, and I will tell you, in the history of the permanent fund, there has never been an inclination of striving for too much risk. When you become a fiduciary and have responsibility of managing the fund, it's inherent in the process that you take your responsibility very, very seriously, and so there's no history - no suggestion - that the permanent fund would be prepared to reach too far for a return.

Number 1700

How will the board of trustees use this flexibility? That becomes a tougher question. One is obviously because [of] the statutory limitations; we would use it to allow our investments [to] rise to what we hope are their potential. As I noted at the beginning of my presentation, we're trying to set the permanent fund up to meet future flexibility, and so there's a "nonpredictive" element about how you would use it. ...

If you ask me right now what [we would] look at, one of course is being able to increase our returns by letting our winners continue on. We might look at some high yield. High yield is: the pejorative term is "junk bonds." There's really two categories of high yields; you can really divide a line between the two. ...There is a category of high yield that's very

close to investment-grade corporate debt. They've worked out their problems and they are in the process of probably being upgraded and become investment debts. That's a more conservative approach, if that's not an oxymoron. Then there's the other, where you're taking bigger bets on companies that have huge problems and then you expect equity-like returns. We may, over the next year - and I've not posed this question with the board - but we may start taking a look at the more conservative approach. Be mindful that we will educate ourselves for as much as a year or two years on a subject before we discard it or make sense [of it]. As I noted, we got permission for the basket clause in 1999. We are only now, after years of study, beginning to implement some of the strategies that use the basket clause. So, when I say ... something like that, I'm saying this is something we may evaluate.

Number 1549

MR. STORER turned to the question of derivatives. He explained that derivatives are financial instruments where "their return is derived from some other investment instrument." For example, he noted that a measure for large-cap equities is the S&P [Standard & Poors] 500 index. He noted that there are futures and forward contracts that base their return on the performance of the S&P 500 index. He continued as follows:

We use derivatives now, in a sense. We will hedge currency. When we bank an international investment we may hedge that currency risk before we buy the currency to pay off the security. Our managers do that. So, there are any number of ways to use derivatives; they all aren't all bad. When you see derivatives and you see negative headlines, ... typically it's because they've used derivatives for leveraging the portfolio in a rather significant manner, and it's not the use of the derivative so much as increasing the risk by using the leverage.

Number 1456

CHAIR WEYHRAUCH asked Mr. Storer if the basket clause got its name when it was adopted in 1999, or was it a term that "just grew."

MR. STORER offered his belief that it became a term of art "during that process."

CHAIR WEYHRAUCH said when he hears the word "basket," he thinks of a basket used in a grocery store and "picking and choosing small amounts to go throughout the line." He asked Mr. Storer, "Is that how the public would view what a basket clause is, in terms of the larger scale when you're dealing with investments in the permanent fund?"

MR. STORER mentioned diversification. He stated, "So, even if one gets the ability through the basket clause to make investments, we are still driven by diversification. And our point would be to fill that basket with a bunch of diversified options that would not put risk in any (indisc. - overlapping voices)." In response to a follow-up question from Chair Weyhrauch, he confirmed that "we're asking to make the basket bigger," or to increase the flexibility.

Number 1365

REPRESENTATIVE SEATON asked if part of [the intent] is to be able to maintain assets that have appreciated and may "go up more." He clarified that he is trying to figure out "the 15 percent." He asked, "Does that mean that the funds could then take international equities to 31 percent, with the 15 percent, less the 16 percent, currently, if the fund thought ... international assets are going up and ... we've had a good run in our investments here and we want them to continue, so we'll use our authority to increase ... that allocation to 30 percent?"

MR. STORER responded that that technically - emphasis on the word "technically" - could be correct. However, he stated that it would also be unlikely, keeping in mind that the goal is a fully diversified portfolio. He revealed that next week the [APDC] will recommend increasing the international equity allocation from 16 to 18 percent. He added, "In fact, I think we're more like 17 [percent] as it now stands. We're also using parts of the basket clause." He continued as follows:

So, the fundamental question would be, "If one used the entire basket clause to increase a single asset class, would it still meet the rules of diversification and [the modern] prudent [investor rule]?" I am well aware of many public funds that have been invested in excess of 25 percent in the

international equity markets, but as a practical matter, that would be unlikely that we would use what I call the privilege of an increased basket clause in any single thing. ... As [of] now we aren't going to use it in a number of options that will behave differently in different market environments.

Number 1234

REPRESENTATIVE SEATON asked for examples of "what these other new investments" are.

Number 1168

MR. STORER responded as follows:

As noted, we do have a 55 percent limitation in the stock market; that is unique in public funds throughout the country where you follow the prudent investor rule. There are no limitations whatsoever. So, I would like to preface my response by saying that even with the increased basket clause, our constraints would still constrain us to being one of the more conservative public funds in the country. So, even if we increase it, we're still not going to have the ability to take as much risk as other public funds may. And of course, risk is not necessarily pejorative; you should be rewarded for being compensated for that risk.

As an immediate objective we will probably use the basket clause to not be forced to sell stocks in the ... equities if we exceed the statutory limit, because we would apply ... that basket clause to the additional equities. ... We don't believe that is bad at all. What we're doing is we're letting ... the markets define when to rebalance, we're not letting ... arbitrary constraints tell us when to apply. So, one immediate use would be simply to benefit from the appreciation of the markets and not be forced to sell for arbitrary reasons.

[Regarding] the balance of it, we would ... educate ourselves on any number of things. I mentioned an example - potentially high yield. We've looked at it modestly. We have looked at private equity and we're starting a modest program in private equity, which, by

definition, that's "nonpublicly" traded investments. ... It's a diversified portfolio that could have some venture capital, some buyouts in it. Typically you expect to earn about 5 percent return in excess of the publicly traded markets [when] you do something like that.

Number 0997

MR. STORER mentioned absolute return strategy and hedge fund. He said that he is about to recommend something that's kind of unique. He continued as follows:

I'm introducing, for the first time ever, ... a pilot program. These are very sophisticated investment approaches; we've studied it for well over a year. And there's a lot more to be learned, but the only way I think we can learn beyond here is live. And so, I'm recommending that we invest a modest amount in a pilot absolute return strategy. We're going to define it as very low risk. Our objective is to have ... targeted risk that is equal to or less than the bond market. That'll be part of the criteria. ... I think everyone in this room will agree that sometimes things exist in government perpetually, and to make it truly a pilot program, I'm recommending a sunset clause ... so that the program will expire within 30 months, so that not only by policy it will die, but our contracts with the experts will expire in 36 months, as well. So, the only way we can continue forward on that one is to take the knowledge we've learned and vote it up, rather than it just [becoming] perpetual. So, that is another use, and I'd like to think that's a conservative approach to a very sophisticated investment strategy. So, those are sort of on the immediate table.

I spoke last week in front of [the Senate State Affairs Standing Committee], and I did the cornucopia of opportunities, most of which I don't personally agree make any sense. When people invest in timber, it usually means timber in Indonesia or overseas. And can you imagine investing in timber in a small way and then [ending] up with an environmental nightmare in a country where you have no control. So, I'm giving you a bad example, in my opinion. So, we have to work through all these things.

Number 0760

REPRESENTATIVE BERKOWITZ said he would quarrel with Mr. Storer's assertion that the list forces conservative investments. Conversely, he said it seems to him to force imprudent investments. He said sometimes there might emerge conflicts between the list in Title 37 and the explanation of what a prudent investor should do in Title 13. He said, "When you're forced to sell assets because you're going up against the upper limits, that's not conservative"

Number 0740

MR. STORER concurred with Representative Berkowitz's statement. He said that he has been "at or near" the permanent fund and has long thought that the statutory list could become so restrictive that "it belongs in the Smithsonian rather than as an investment tool." He stated, "We have not suffered, to date, but I think ... that we need to create a flexibility to manage the fund successfully in the future."

Number 0682

REPRESENTATIVE GRUENBERG indicated that he may be offering an amendment that would eliminate the [limitations] and allow the board to just invest under the prudent person rule. He asked Chair Weyhrauch if the bill would not be moved out of committee today, because he indicated that he has questions to ask to which he would like answers at the next meeting.

CHAIR WEYHRAUCH stated that it is not his intention to move the bill today.

Number 0487

RONALD W. LORENSEN, Attorney at Law, Simpson, Tillinghast, Sorensen & Longenbaugh, P.C., told the committee that that firm is outside counsel to the APFC. He stated that he has worked with Mr. Storer and the board on the proposed legislation before the committee. He announced that he would limit his testimony to addressing the changes sought in the bill. Both sections, he noted, would make amendments to AS 37.13.120. He stated that AS 37.13 is the chapter that deals with the APFC and is described as the legal or statutory list. Section 120 is approximately four pages long, he noted, with subsection (g) setting out the legal list of those investments that the [APFC] is authorized to

invest in. Other subsections within Section 120 provide either limitations or guidance with respect to the investments of the fund. For example, he said, subsection (a) is the provision that deals with the prudent investor rule as it applies to the fund, while subsection (k) is the subsection that created the basket clause in 1999. Subsection (k) would be amended by the bill to add references to two additional subsections within Section 120, as exceptions to the operation of the basket clause. Those additions are subsections (h) and (j).

MR. LORENSEN stated that subsection (h) would prohibit the corporation from investing in futures contracts, except in specific circumstances. He continued as follows:

That limitation, although it makes sense in the scheme of the existing statutory list, creates some difficulties in terms of flexibility, with respect to the basket clause. ... The example I have most in mind is in the area of hedge funds, where hedge funds may invest, as part of their strategy, some portion of the funds under management in various forms of futures contracts. This limitation would prohibit the basket clause from being used for those kinds of hedge fund investments. It certainly was not the intention at the time that the basket clause was proposed to the legislature that that limitation exist to apply to the basket clause; it was just, basically, something that hadn't been anticipated or perceived as a problem at the time.

MR. LORENSEN stated that subsection (j) is a provision in Section 120 that states that the [APFC] may not invest in bonds, basically, where the interest payment on a bond has been defaulted in the last five years. And again, that's a prudent rule, with respect to fixed income as a class of investment, but it creates difficulties when you're talking about alternative forms of investment, such as high yield investments, which Mr. Storer's also described as what some people call, "junk bonds," where you're looking for a higher return. And the reason you're looking for a higher return is because you are investing in a class of bonds which is more risky, and frequently ... that risk is demonstrated by the fact that interest payments have not been made within the last five years.

[The committee took a brief at-ease.]

TAPE 04-26, SIDE A

Number 0001

MR. LORENSEN continued as follows:

So, adding [subsection] (j) in Section 2 of the bill, to the exceptions for the operation of the basket clause, would permit a portion of the assets of the permanent fund to be invested in certain alternative investments, which use - as a part of their investment strategy - investing in bonds, which have a higher risk of default, but also the counter veiling consideration is that they have a higher potential for an increased return.

MR. LORENSEN turned to the other change proposed in Section 2 of the bill, which is to increase the limit on the size of the basket clause from 5 percent to 15 percent. He noted that there had already been discussion on the issue. Section 1, he specified, addresses the potential restrictions on the investment ability of the permanent fund in alternative investments. Mr. Lorensen paraphrased Section 1 of the bill, which read as follows:

***Section 1.** AS 37.13.120(e) is amended to read:

(e) The corporation may not borrow money or guarantee from principal of the fund the obligations of others except as provided in this subsection. With respect to [REAL PROPERTY] investments of the fund, the corporation may, through an entity in which the investment is made, borrow money if the borrowing is without recourse to the corporation and the fund.

MR. LORENSEN explained that the idea is as long as the fund itself is protected by some intervening legal entity, it is currently permissible "for real estate only" to make investments that might involve borrowing money as part of the investment strategy. He added, "And, of course, there we're talking about leverage, basically." He continued as follows:

Now that we look at various available forms of alternative investments, we see that certain kinds of hedge funds, and potentially also certain kinds of private equity funds, do - as a part of their investment strategy - invest ... through limited partnerships. It's never the [APFC] itself that would be the investor, but the [APFC] would purchase an interest in a limited partnership, for instance. And

the limited partnerships, again, may enter into borrowing for leverage purposes, as a part of the investment strategy. And so, here the recommendation is simply to delete the ... limitation on real property and make it available for any kind of investment of the fund, so long as it is done through a separate legal entity and so long as there is no recourse back against the fund.

Number 0356

REPRESENTATIVE LYNN asked how 15 percent was chosen in Section 2 of the bill.

MR. LORENSEN deferred to Mr. Storer.

Number 0419

MR. STORER replied that "we" want as much investment flexibility as possible and the constitution [allows] investments as designated by law, which would be 15 percent. He added, "I would note that if you looked at other public funds, it's silent by virtue of their rules. Their rules would be 100 percent, not 15 percent. So, 15 percent still [is a] far more conservative constraint than others."

REPRESENTATIVE LYNN asked if the 15 percent was "pushing the envelope" or whether it was "still plenty of room."

MR. STORER responded that he personally doesn't think it's pushing the envelope at all. Conversely, he opined it's the maximum that "we" can use and still fall within the direction that the constitution allows. He observed that where he has seen public funds that have no constraints, those funds are still managed in well-diversified portfolios. He said he doesn't see undue risk in being allowed that extra flexibility.

Number 0610

REPRESENTATIVE GRUENBERG asked, "What do you mean by 'not withstanding these other subsections'?"

Number 0652

MR. LORENSEN replied as follows:

"Notwithstanding", in this context means that even though these limitations exist, they do not apply to the basket clause.

Number 0670

REPRESENTATIVE SEATON, indicating [the language to be deleted regarding] real estate in Section 1 of the bill, asked, "Is that because they're real estate mortgages?"

MR. LORENSEN answered that he thinks real estate mortgages are probably the best example of how real estate investments are made by the permanent fund. He noted that the permanent fund actually has "a fairly low percentage of its assets in real estate that is actually leveraged or is borrowed." He said some of the real estate properties that are purchased by the [APFC] do have a borrowing, leverage, or mortgage component to them, and "this was inserted in 1999 to make it clear that that was permissible, so long as it was done through a separate title-holding entity."

Number 0750

MR. STORER added that the [APFC] leveraged its "direct real estate portfolio approximately 15 percent; it's an incremental return." He stated that that's still conservative by virtually all standards. For example, he proffered that publicly traded real estate investment trusts "tend to run about 40-60 percent leverage." He offered his understanding that most public funds actually use more leverage - particularly in the last few years with the lower interest rate.

REPRESENTATIVE SEATON asked, "Is that, basically, the futures market that we're talking about, whereas real estate is more mortgaged?"

MR. LORENSEN answered no. He continued as follows:

Maybe the best example has nothing to do with either mortgages or real estate, but is in the area of private equity, where ... there are leveraged buyouts and that sort of investment activity as part of the strategy. And so, there will be a borrowing component in these private equity transactions, which is - again - nothing to do with real estate, specifically, but just is a way to finance the underlying transaction. And so, to the extent that a particular private equity

investment involves a leverage aspect, we would like to see this language in place to make it clear that that's permissible. Private equity is now permissible to the extent of the cap created by the basket clause.

Number 0903

MR. STORER added that "we" view "this" as a cleanup to the original intent of the basket clause. He said he hopes the committee agrees.

MR. LORENSEN concurred.

Number 0948

CHAIR WEYHRAUCH announced that HB 466 was heard and held.

HB 423-TAXICAB DRIVER LIABILITY

[Contains discussion of HB 68.]

Number 0960

CHAIR WEYHRAUCH announced that the next order of business was HOUSE BILL NO. 423, "An Act relating to accidents involving the vehicle of a person under the influence of an alcoholic beverage; and providing for an effective date."

Number 0985

JIM SHINE JR., Staff to Representative Tom Anderson, Alaska State Legislature, presented HB 423 on behalf of Representative Anderson, sponsor. Mr. Shine read his testimony as follows:

House Bill 423 is a "Good Samaritan" bill for taxicab operators who transport intoxicated persons or who drive an intoxicated person's motor vehicle to their home or another directed location. This legislation would create a deterrent for those who might otherwise drive impaired if unable to find an alternative method of transportation. It grants taxicab companies legal immunity in the event that an accident occurs, except in the case of recklessness, gross negligence, or intentional misconduct.

MR. SHINE, in response to a question from Chair Weyhrauch, confirmed that the order of committee referral was reversed from

how it shows on the bill; therefore, the House State Affairs Standing Committee is the first committee of referral and the House Judiciary Standing Committee is the second. He continued reading his testimony as follows:

There are times when Alaskans find themselves in an "end-of-evening dilemma" - they are over the .08 blood alcohol limit and shouldn't drive, but are worried and reluctant to leave their car unattended overnight. HB 423 resolves this dilemma by allowing a taxicab operator to drive an intoxicated person home while a second operator follows them home in their vehicle.

This legislation would allow the intoxicated person and his or her vehicle to get home safely without the taxicab operator fearing liability. HB 423 promotes responsible behavior and encourages people to do the right thing and not drive while intoxicated.

While annual alcohol-related traffic fatalities have decreased by more than 33 percent over the past few decades, the latest statistics show a recent increase with more than 17,400 people killed and more than half a million others injured in alcohol-related crashes in 2002 in the United States. Alaska had 87 traffic deaths, of which 35 were alcohol-related, [which equated to] 40 percent in 2002. The previous year, there were 47 alcohol-related deaths out of the 89 deaths, which equated to 53 percent.

In order for this program to be successful, cab companies and liquor establishments must work and communicate closely. These establishments will implement the following strategies and policies: Place signs near pay phones, direct lines to cab companies, and other conspicuous areas of the establishment, such as restrooms and exits; train the establishment staff on the availability of this program and how to inform patrons, and how to implement the process; make public service announcements at closing time to help influence patrons to use the program; pay a portion of the cab fare cost agreed upon by establishments and program officials; and track program usage to assess effectiveness to promote and or improve the program.

MR. SHINE noted that the Checker Cab Company in Anchorage has set some guidelines for the program. He shared those written guidelines, which read as follows [some punctuation changed]:

A minimum of six designated taxi drivers on duty every night to be available for this program.

A flat \$40 fee per car delivery made from any licensed establishment to one destination in the Anchorage area, for both the patron and his/her vehicle.

Every car delivery that is done will be logged into a logbook in the dispatch office, to ease in the tracking of the progress of this program and how well it is working to benefit the community.

Training of taxicab drivers and dispatch employees so designated drivers will be able to cover the car deliveries safely.

Promote, with all the taxi drivers' help, how this program is available to all customers heading to any drinking establishment in the Anchorage area. It is a convenient way to enjoy all [licensed] establishments without worrying about retrieving a vehicle the next day.

MR. SHINE continued reading his testimony as follows:

This service will be free to the consumer. The cab companies will receive \$40 for each trip they make. It's a reduced flat rate for transportation anywhere in the Anchorage bowl area. This legislation is supported by Mother's Against Drunk Drivers (MADD), and there is a letter of support in your bill packet.

This bill is identical to House Bill 68, which unanimously passed the House in the 22nd legislature by a vote of 37-0. In the Senate, it passed through the [Senate Transportation Standing Committee], but stalled in the [Senate Judiciary Standing Committee] and was never heard.

MR. SHINE noted that Darwin Biwer was available to testify. He said he would answer questions from the committee, but would defer any technical questions to Mr. Biwer.

Number 1256

DARWIN BIWER, Board Member, Cabaret Hotel Restaurant & Retailers Association (CHARR), explained the formation of HB 423, stating that it was a concept brought forth by two CHARR board members, Rod Pfleiger and John Pattee. He said that HB 423 was another example of the liquor industry trying to promote safe driving; CHARR had supported previous, similar legislation that stalled in the Senate. He said that HB 423 was a "housekeeping" bill, so the liability [insurance] for taxicab companies would be lower. He reiterated that there would be no costs to the consumer with the passage of HB 423; those costs would be [paid] by the liquor companies and [through] donations.

Number 1395

REPRESENTATIVE HOLM first complimented CHARR, specifically in Anchorage, for bringing forth HB 423. He indicated that he had witnessed the successful implementation of a similar process in Canada, where a connection has been made between taxicab companies and liquor establishments.

REPRESENTATIVE HOLM, noting that [drinking and driving] is a statewide problem, and HB 423 is enacting a statewide policy, asked Mr. Biwer how CHARR was interacting with the other communities in Alaska.

MR. BIWER stated that there is a pilot program enacted in Anchorage, and CHARR wanted to implement the program, work the bugs out, and then take it to other communities within the state.

REPRESENTATIVE HOLM thanked Mr. Biwer and stated that he thought that HB 423 was a very responsible thing that establishment owners did to take care of the public.

Number 1509

REPRESENTATIVE BERKOWITZ asked if there was a "sunset date" on the Anchorage pilot program, and he said, if not, CHARR should think about implementing one or going statewide from the start. He also asked who would bear the costs if there was an accident as a result of negligence on the part of a taxi driver.

MR. BIWER stated that he wasn't the person to talk about insurance rates, but he thought that there was a representative from Allstate Insurance that was present, who would be able to

answer that question. He stated that the purpose of HB 423 is to reduce the insurance rates for the taxicab companies to give them incentive to participate in the program.

REPRESENTATIVE BERKOWITZ asked if there have been any assurances from the insurance companies that rates will go down with the passage of HB 423.

MR. BIWER said that the rates for a taxi would be somewhere around \$1000 a month if HB 423 was not passed. He cited that as one of the reasons that HB 423 was introduced; so rates would go down and the pilot program could be implemented.

CHAIR WEYHRAUCH cited the earlier testimony from Mr. Biwer, when he said there would be no costs to the consumer, and asked what costs were involved.

MR. BIWER responded that the cost would be for the cab ride and the two cab drivers. He said that the Anchorage taxicab companies have set a flat rate of \$40, regardless of distance, within the Anchorage bowl area.

REPRESENTATIVE WEYHRAUCH asked for an annual estimate for expenses that would be required industry-wide.

MR. BIWER said that CHARR was going to apply for federal grants, and has had financial commitments from liquor distributors, so there really is no fiscal note. In response to further questions, he stated that many establishments already bear some costs because they pay for cab rides for their patrons. He said that CHARR felt that HB 423 was a better way to go about doing that. He made the comment that this was a pilot program and CHARR doesn't have all the answers to those questions yet.

Number 1737

REPRESENTATIVE GRUENBERG asked what position Frank Dahl held in CHARR.

MR. BIWER responded that Mr. Dahl is on the Board of Directors of Anchorage CHARR.

Number 1800

REPRESENTATIVE SEATON noted that in HB 423 there was no mention if the vehicle driven already had insurance. He stated that this may be a situation where [the legislature] is giving

liability for negligence to a driver of an uninsured vehicle who then gets into an accident. He said that it would seem like there will be some fallback to the people who are paying for the driver. He stated that he didn't think that the legislature was to the point where it would grant someone total immunity just to get an intoxicated person's car home. He stated that it is risking a victims injuries without someone being liable. He asked Mr. Biwer to think about that and address that issue when the committee next discusses HB 423.

[HB 423 was heard and held.]

ADJOURNMENT

Number 1847

There being no further business before the committee, the House State Affairs Standing Committee meeting was adjourned at 10:00 a.m.