

**ALASKA STATE LEGISLATURE**  
**SENATE STATE AFFAIRS STANDING COMMITTEE**

February 24, 2004

3:37 p.m.

**TAPE (S) 04-9&10**

**MEMBERS PRESENT**

Senator Gary Stevens, Chair  
Senator John Cowdery, Vice Chair  
Senator Bert Stedman  
Senator Gretchen Guess  
Senator Lyman Hoffman

**MEMBERS ABSENT**

**COMMITTEE CALENDAR**

SENATE BILL NO. 227

"An Act relating to municipal initiative and referendum elections."

HEARD AND HELD

SENATE BILL NO. 326

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

HEARD AND HELD

SENATE BILL NO. 352

"An Act amending the Public Employment Relations Act to exclude from collective bargaining individuals who perform confidential or managerial duties for a public employer and relating to those exclusions; and providing for an effective date."

HEARD AND HELD

**PREVIOUS COMMITTEE ACTION**

BILL: SB 227

SHORT TITLE: MUNI INITIATIVE AND REFERENDUM ELECTIONS

SPONSOR(S): SENATOR(S) STEVENS G

05/15/03	(S)	READ THE FIRST TIME - REFERRALS
05/15/03	(S)	CRA, STA
02/18/04	(S)	CRA AT 1:30 PM FAHRENKAMP 203
02/18/04	(S)	Moved SB 227 Out of Committee
02/18/04	(S)	MINUTE(CRA)
02/19/04	(S)	CRA RPT 4DP 1NR

02/19/04 (S) DP: STEDMAN, LINCOLN, WAGONER,  
02/19/04 (S) STEVENS G; NR: ELTON  
02/24/04 (S) STA AT 3:30 PM BELTZ 211

BILL: SB 326

SHORT TITLE: PERMANENT FUND INVESTMENTS

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

02/13/04 (S) READ THE FIRST TIME - REFERRALS  
02/13/04 (S) STA, FIN  
02/24/04 (S) STA AT 3:30 PM BELTZ 211

BILL: SB 352

SHORT TITLE: MANAGERS NOT EMPLOYEES UNDER P.E.R.A.

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

02/23/04 (S) READ THE FIRST TIME - REFERRALS  
02/23/04 (S) STA  
02/24/04 (S) STA AT 3:30 PM BELTZ 211

**WITNESS REGISTER**

Doug Letch

Staff to Senator Gary Stevens

Alaska State Capitol

Juneau, AK 99801-1182

**POSITION STATEMENT:** Answered questions on SB 227 for Senator Gary Stevens, sponsor

Scott Bendt-Ericksen

Ketchikan Gateway Borough

344 Front Street

Ketchikan, AK 99901

**POSITION STATEMENT:** Testified in support of SB 227

Robert Storer

Executive Director

Alaska Permanent Fund Corporation

P.O. Box 25500

Juneau, AK 99802-5500

**POSITION STATEMENT:** Explained SB 326

Ron Lorenson

Outside Counsel

Alaska Permanent Fund Corporation

P.O. Box 25500

Juneau, AK 99802-5500

**POSITION STATEMENT:** Answered questions on SB 326

Kevin Jardell  
Assistant Commissioner  
Department of Administration  
PO Box 110200  
Juneau, AK 99811-0200

**POSITION STATEMENT:** Introduced SB 352

Art Chance  
Labor Relations Director  
Department of Administration  
PO Box 110200  
Juneau, AK 99811-0200

**POSITION STATEMENT:** Testified on SB 352

Jeffery Prather  
Juneau, AK 99801

**POSITION STATEMENT:** Did not support SB 352

Kevin Brennan  
Kodiak, AK 99615

**POSITION STATEMENT:** Did not support SB 352

Leslie Simmons  
Anchorage, AK 99501

**POSITION STATEMENT:** Did not support SB 352

Dean Williams  
No address provided

**POSITION STATEMENT:** Did not support SB 352

Steve Hoffman  
Ketchikan, AK 99901

**POSITION STATEMENT:** Did not support SB 352

Ole Larson  
Palmer, AK 99645

**POSITION STATEMENT:** Did not support SB 352

Bruce Senkow  
Fairbanks, AK 99701

**POSITION STATEMENT:** Did not support SB 352

Shannon Fleming  
Juneau, AK 99801

**POSITION STATEMENT:** Did not support SB 352

George Pappas

Kodiak, AK 99615

**POSITION STATEMENT:** Did not support SB 352

Gerry Guay

Anchorage, AK 99501

**POSITION STATEMENT:** Did not support SB 352

Doris Tanner

Willow, AK 99688

**POSITION STATEMENT:** Did not support SB 352

June Pennell-Stephens

Fairbanks, AK 99701

**POSITION STATEMENT:** Did not support SB 352

**ACTION NARRATIVE**

**TAPE 04-9, SIDE A**

**CHAIR GARY STEVENS** called the Senate State Affairs Standing Committee meeting to order at 3:37 p.m. Present were Senators Guess, Hoffman, Stedman, Cowdery and Chair Gary Stevens.

**SB 227-MUNI INITIATIVE AND REFERENDUM ELECTIONS**

CHAIR GARY STEVENS announced SB 227 to be up for consideration and that he was the sponsor. He paraphrased the following sponsor statement:

Senator Bill 227 is "An Act relating to municipal initiative and referendum elections."

The bill was introduced to help local governments who are facing cost increases and having to avoid costly special initiative elections and referendums that voters bring forward.

In many cases the issues are not so pressing that they cannot wait for the regular municipal election. Special elections are costly and often have a lower voter turnout than regular elections.

Under current law, municipalities are forced to hold initiative elections and referendums within 75 days

and because elections are normally held in October, it is often quite costly and burdensome to the municipalities.

Recently, the Fairbanks North Star Borough had over 46 petitions filed in four months. There was only one special election, but it cost \$35,000 plus volunteer help and the workload on municipal employees. Still there was the potential to have many more special elections at enormous cost to the municipality.

This bill would result in cost savings to communities that choose to wait until the next general election to consider the issue then saving both time and money for the municipalities.

This legislation would give the governing body the option of calling a special election if the council or assembly wanted to have the initiative or referendum considered in a more timely basis. Examples might be for bonding issues, special initiatives that are not particularly time-sensitive. In those cases, any local governing assembly can vote to hold a special election so there is that option - special election or regular election.

The bill is supported by the Municipal League, the Fairbanks North Star Borough, the Kenai Peninsula Borough, and the Alaska Association of Municipal Clerks. It streamlines the special initiative and referendum process by giving local governments an option to cut costs and hold a special election during their annual election cycle.

SENATOR GRETCHEN GUESS observed there would be a 13-month wait if the next regular election fell less than 60 days after a petition was certified.

She said she would like further explanation of the local control option.

CHAIR GARY STEVENS initially pointed out that Anchorage isn't affected because it is a first class city. Then he explained that municipalities could continue with a special election or referendum if they chose to do so or they could elect to postpone until the regular October election. This simply gives

another option so municipalities aren't forced to hold special elections on every issue that comes before them.

SENATOR BERT STEDMAN remarked that the issue of cost savings can be substantial and this gives cities more fiscal control.

CHAIR GARY STEVENS told Senator Guess he would come back to her in awhile if she had more questions.

SENATOR JOHN COWDERY noticed that there was a change from 45 to 60 days and he wondered what had to be prepared within 60 days of the election.

CHAIR GARY STEVENS told him everything that's associated with a regular election has to be done including ballot preparation and staff arrangements.

JOHN COWDERY asked if all polling stations would stay the same.

CHAIR GARY STEVENS said they would.

SENATOR GUESS asked what would happen if a petition was certified 30 days before the regular election.

CHAIR GARY STEVENS read Section 1, but wasn't clear about her question.

SENATOR LYMAN HOFFMAN said the language creates a disqualifying window for petitions that are certified less than 60 days prior to a regular election.

SENATOR COWDERY wasn't certain that he read Section 1 correctly.

CHAIR GARY STEVENS asked his staff whether he had clarification.

DOUG LETCH, staff to Senator Gary Stevens, said "it comes down to local option that does exist that says that if you have a more pressing matter that comes before the governing body they do have that option of putting on a special election." He thought the Kenai clerks might be able to elaborate.

CHAIR GARY STEVENS said a Ketchikan Gateway Borough representative was online and might be able to answer the question.

SCOTT BENDT-ERICKSEN, attorney with the Ketchikan Gateway Borough, thanked the Chair for introducing the legislation and

said municipal attorneys and clerks support the bill and the concept. He said he did have some specific suggestions and he though he could answer some of the questions that were raised.

The reason for the change from 45 to 60 days is because elections require pre-clearance from the Justice Department and it would be difficult to complete the clearance in less than 60 days. With regard to Senator Guess's question, he said that if a petition is certified less than 60 days prior to a regular election, it could be as long as 14 months before that initiative measure appears on the ballot.

MR. BENDT-ERICKSEN suggested changing the word "regular" on page 1, line 5 to "regular or special" or simply remove the word "regular" to make it clear that there was an option.

He also suggested that if there isn't a regular election within 75 days of a petition being certified, there should be some provision for the measure to be suspended until there is a vote on the referendum petition.

The balance of Mr. Bendt-Ericksen's testimony was indiscernible.

CHAIR GARY STEVENS asked him to comment to the issue of voter turnout in regular elections versus special elections.

MR. BENDT-ERICKSEN stated that special elections frequently have half or less than half the turnout of regular elections.

SENATOR COWDERY noted that most of the language on line 6 was not new but it was confusing nonetheless. He then asked what the outer limit might be.

MR. BENDT-ERICKSEN replied the greatest length of time would be about 14 months. If a petition weren't certified until 59 days before the next regular election, it wouldn't go on that regular election. It would go on the regular election one year later. A special election could be called if the matter was pressing.

CHAIR GARY STEVENS restated the timeframe, which would be between 60 days and 14 months and then made the point that a local governing body could make the decision to have a special election.

SENATOR GUESS asked which statute gives municipalities the local option because it isn't contained in the bill.

MR. LETCH supplied, "Title 29, line [chapter] 60."

CHAIR GARY STEVENS asked Mr. Bendt-Ericksen to explain the issue of referendums.

MR. BENDT-ERICKSEN explained that a referendum typically comes about because someone wants to repeal or undo an action of a governing body. He continued, " Under the current provisions, if the referendum petition is submitted before the effective date then the issue can be suspended until the vote. If the measure has already gone into effect, then it's not suspended until there is a vote on the issue."

CHAIR GARY STEVENS announced he would hold the bill to address the issues that were raised.

### **SB 326-PERMANENT FUND INVESTMENTS**

CHAIR GARY STEVENS announced SB 326 to be up for consideration. He asked Mr. Storer to step forward.

ROBERT STORER, executive director of the Alaska Permanent Fund Corporation sat down and introduced himself and Ron Lorensen who is outside counsel to the permanent fund.

MR. STORER described the request to increase the investment flexibility of the permanent fund as a timely and important issue. As background he reported that AS 37.13.120 sets out statutory investing guidelines for the board to follow including adherence to the prudent-investor rule. He noted that the permanent fund is one of the last public funds, including those managed by the Department of Revenue, that is guided by statute.

He maintained that, "The challenges for managers of the permanent fund are to be able to manage the fund in a contemporary way in what is in fact a very dynamic industry, and deal with legislative changes that allow us to meet that challenge."

MR. STORER noted that he would address his comments to the Investment Flexibility handout that members had in their packets. The following is his verbatim testimony.

Over the next couple of pages you'll see the history of some of the legislative changes that the permanent fund has asked for and received support for. The

bottom of page 3, which was SB 156, was approved in 1999. In 1999 the Permanent Fund Board of Trustees were allowed one exemption from the statutory list and it's what we call the "basket clause."

SB 156 actually did a couple of things. One was increase our statutory limitation investing in the stock market from 50 to 55 percent. But it also allowed the administrators of the permanent fund to make investments outside of the statutory list, but still following the prudent investor rule. The prudent investor rule really defines a process that allows one to make an informed decision. That's the criteria that is involved in the prudent investor rule.

The permanent fund was given permission to invest up to 5 percent of the fund outside of the statutory list. To suggest that we took this ability and ran out and got into all kinds of investments is not so. In fact, we are just now four years later, after a lot of evaluation of different opportunities; we are just about to implement some of the strategies that are embedded in the basket clause. I think that is an important issue. When we ask for permission, we still approach our responsibility prudently.

Page 4 simply shows if you look at the statutes - and I call it the maturation of the permanent fund - the permissible list. You'll see how the asset allocation of the Alaska Permanent Fund has changed over years. I actually started work ... at the permanent fund in May of 1983. Why do I say that? One, I do have a sense of history and the other is I arrived in May of 1983 and the permanent fund had just received permission to invest in the U.S. stock market and, in fact, they funded their first equity managers in June or July of 1983. You can see the non-U.S. investments occurred in the late 1980s etc.

Why are we proposing - and Ron will tell you the technical aspects - we're proposing a couple of things. The essence and the most important thing may be increasing the "basket clause" from 5 to 15 percent. That is to allow future administrations of the permanent fund to meet what is a very dynamic industry changing its investment options to have the

latitude to address a changing investment world as they occur.

Another [reason] is potentially to allow different instruments that will allow us to increase our return objective over some time. Another one - and it's not necessarily contradictory - is the more investment options you have, the more you can diversify your portfolio or reduce your risk. In a conversation I had with Senator Stedman I believe if you asked us do we have all the diversification we need right now the answer is yes. And we had that conversation. But if you ask me what do we need in the future, we need the flexibility to respond to changing financial markets. To address them in a contemporary manner so we cannot ignore the need for potential expanded diversification in the future.

Last item and it's not on this list but it's a management tool. There are certain things that we could do in the course of business that are not incurring more risk. It's sort of the arcane or complexity of investment management, but it would be ways to implement strategies in a low cost way that we are precluded from currently because of the limitations on the statutory list.

I've added a list of the asset allocation. Every year we visit our asset allocation and we adopt it by resolution. Our March 10 and 11 board meeting we will be making a recommendation for some adjustments to the asset allocations. What you see is our current asset allocation. You'll see it broken down between domestic equities, U.S. stocks; international equities, foreign stocks; U.S. bonds and I would note that the U.S. bonds are all investment grade. Either all U.S. treasuries [which are] agencies of the U.S. government or high grade corporate debt, and then non-dollar bonds, which are mostly sovereign issues by Japan, England etc. and 10 percent allocation to real estate.

I'll use domestic equities as an example. Our target is 37 percent, but we create bands around it. You'll see on domestic equities it's plus or minus 7 percent. Our goal is to create a discipline, that when you reach a certain point - hopefully through appreciation - you automatically rebalance closer to target. By the

same token, when our equity investments go down there is an inflection point where we must rebalance closer to target. That's a tough one because usually it's a lot harder to put new money in a declining stock market because it takes a real discipline. It occurred in October of 2002. No great insight other than the fund went outside its bands, but it turns out we missed the bottom of the bear market by about four days. It was a superb piece of timing, but that was more discipline than it was a particular skill.

The point is we try to have bands that are reasonable but not get into a lot of rebalancing because there are a lot of transaction costs that one occurs when you rebalance so we try to have some reasonable bands around our target.

Why am I noting that? I'm noting that because on the current statutory limitations, we will be - if the board adopts the recommended asset allocation - up near our statutory limitations in both the "basket clause" and equities. What does that mean? That means that our investment managers in the board will not be deciding our asset allocation. Statutes will be deciding our asset allocation. It suggests that right now our stock - our managers - decide when we'd maximize our return. They will then sell that stock and buy other stock, but we will be forced by statutory limitations to limit the upside potential on stocks. Of course, risk is not symmetrical because the stock market can go down so we have some statutory controls on how much we can gain on appreciation, but not so on the down side.

That is another reason why I think it is a compelling argument and I hope you will agree that we need to expand our flexibility. Not in terms of making pure decisions, but simply to let the permanent fund take advantage of the appreciation in the financial markets when they occur.

This is the first opportunity I've had to address the Legislature on this issue. On the last page I tried to think of what would be some of your questions, criticisms - whatever you want to call it - and I came up with three.

The first thing I would ask if I was scrutinizing this is would the fund be taking too much risk if they were given this latitude. Of course we can't speak for future administrators of the fund, but I can give you a history lesson. I've had the privilege of working with all but four trustees of the Alaska Permanent Fund Corporation. I have worked for, been or known every executive director of the Alaska Permanent Fund Corporation and I have worked for or with every chief investment officer in the history of the Alaska Permanent Fund Corporation.

What I have observed is the corporate culture of the administrators of the fund - they have always used this investment privilege very prudently and very conservatively. We have always spent time trying to ferret out fads from real contemporary issues and we are more than content to watch and learn from others' mistakes. If history is a lesson of this, I would say that we've used our privilege of expanded investment flexibility judiciously, carefully and I think the fund has benefited from that.

How will the board of trustees use this flexibility? That's a key issue that I would ask and one of the main things, as I've noted, is to allow future administrators the flexibility to address contemporary investment management issues. So to some degree I don't know. I can identify some sort of cornucopia of options or the myriad of options that are available. Clearly one use, and the immediate use would be to not have the statutory constraints if the funds assets appreciate and we would hope that they would. We are currently using a bit of the statutory "basket clause" or the outside of the statutory identifications to invest in private equities. [It would be a] small weighting - no more than 3 percent and [we would] probably take several years to implement. We probably won't start investing our first dollars until late spring, early June. That alone, if we're successful - and of course we spent a lot of time studying it - success actually will take that 3 percent over a 5 percent limit because of appreciation right there. We are going to propose to the board something that I think is unique.

The term of art right now is called an absolute return strategy. You see it in the papers a lot - it's called

a hedge fund. Sometimes you see negative press on hedge funds. You always see the headlines in the negative. It's not necessarily bad, but what we're doing in the first time of the permanent fund is we're recommending a pilot program - a program that will be small enough so that if there are problems it will have, we hope, virtually no impact on the performance of the fund. By the same token, if it's successful it will have virtually no impact on the permanent fund.

These are sophisticated investment philosophies and we want to learn from the live experience. The other thing that is unique in this proposal is we're going to have a sunset clause. The contracts will be good for up to 36 months and then that investment strategy will die as a matter of course. We're not saying we want this flexibility in perpetuity. We think it has merit, but we want to learn more from it.

The last one is derivatives. That was a more pejorative word in the '80s and earlier '90s and less so now. What are derivatives? The simplest definition - it is an investment instrument that derives its return from some other investment. An example would be hedging your equity exposure using an equity contract - either a forward or a futures contract. That's not investing in the stock market, but the returns on that contract will be derived by the reality of what happens in the stock market. That's called a derivative - people use derivatives to hedge their exposure. You can use a derivative to gain exposure in a certain market - immediately while you invest then systematically in the stocks you want as an example.

Would there potentially be derivatives? The answer is yes, hopefully in a very deliberate manner.

CHAIR GARY STEVENS asked Mr. Lorensen for his comments.

RON LORENSON, outside counsel for the Alaska Permanent Fund Corporation, walked members through the bill and gave an explanation of the recommended changes.

He suggested focusing on Section 2 first because that contains the "basket clause." The provision begins on page 1, line 14 and continues through line 10 on page 2. He explained that subsection (g) is what Mr. Storer referred to as the legal list.

It describes the investment forms that the Permanent Fund Corporation is authorized to invest in with the exception of the basket clause.

He continued to say that in addition to (g), there are other provisions under [AS] 37.13.120 that provide a restriction on investments under certain circumstances.

That's what has raised the concern or the interest of the Permanent Fund Corporation in terms of making some adjustments in the way the basket clause would operate. Right now, under the basket clause provision, it says, 'Notwithstanding (g)' and that means even though there is this legal list, you don't have to follow the legal list for up to 5 percent of the value of the assets of the fund. You can go outside the legal list as long as the other investments satisfy the prudent investor rule.

With respect to that 5 percent, it's okay to go outside that legal list. There are, however, under (h) and (i), which are the two provisions you'll see at the bottom of page 1 in section 2 that are proposed to be added to the language authorizing the 'basket clause' - there are some additional restrictions in (h) and (i), which by a legal interpretation, if they aren't specifically acknowledged, would continue to operate to restrict the use of the 'basket clause.'

I was involved in 1999 when the bill was presented to the Legislature and passed, it wasn't the intention of the drafters or ever in discussion with the Legislature that those two provisions operate to act as restrictions on the 'basket clause.'

What (h) does is say that futures contracts can only be used under certain very restricted circumstances. Overall it makes sense in terms of a conservative approach to investment, but in terms of the prudent investor rule and flexibility under the basket clause, applying that limitation on futures has the effect of potentially limiting various kinds - particularly hedge funds - that the permanent fund might otherwise be able to invest in as a result of the basket clause.

(i) says that the permanent fund cannot invest in any fixed income asset bond - essentially - where there

has been a default on the interest payment in the last 5 years. It makes a lot of sense as a general investment guideline, but to the extent that you want to be able to take advantage of the 'basket clause' and use various funds of alternative investments such as some of the high yield bond type products that might be available. It acts as a restriction and limitation that again, wasn't intended when people were visualizing what the basket clause might be used for.

He pointed out the other change on page 2 increases the size of the basket clause from a maximum of 5 percent to a maximum of 15 percent.

Subsection (e) in section 1 says the corporation can't borrow money as part of its investment strategy. The second sentence was then added to permit investments that the corporation was involved in - and at that time the only focus was on real property investments - to permit real property investments of the fund - to borrow money is a way of leverage potentially as part of the investment in a particular piece of real estate.

What (e) does is say the permanent fund corporation can't borrow money as part of its investment strategy. It makes a lot of sense and no one has suggested that the permanent fund should borrow money as part of its strategy. But the second sentence was then added to permit investments that the corporation was involved in - and at that time the only focus was on real property investments - to permit real property investments of the fund - to borrow money is a way of leverage potentially as part of the investment in a particular piece of real estate.

When the permanent fund invested in real estate, it always does it through a holding company - an LLC or a limited partnership. It doesn't do it directly and that's what this language authorizes. The holding company can borrow money as part of its investment strategy with respect to an asset as long as there is no recourse back against the permanent fund corporation. In other words, as long as the only reliable entity is the holding company and there is no ability to go back and sue or pursue a claim for default against the corporation.

That's the way it's set up for real estate. There's no reason not to provide the same flexibility for other forms of holding entities - limited partnerships in the area affirmative investments - private equity for instance. We're just recommending there, that the restriction for real property be taken out, but the limitation remains. That is that the corporation cannot borrow money directly. If money is going to be borrowed, it is part of the investment strategy of the corporation. It has to be through some other legal entity that isolates the corporation from liability if things don't go right.

SENATOR JOHN COWDERY asked how many dollars 15 percent might represent at today's value.

MR. STORER answered 10 percent would represent \$4.2 billion.

SENATOR COWDERY inquired about the type of investments that are considered.

**TAPE 04-9, SIDE B**  
**4:22 pm**

MR. STORER replied there are numerous options most of which he wouldn't support, but an example of investment expansion could be private equity buyouts. Some hedge funds have absolute return strategies and there are a myriad of sophisticated approaches. An obvious approach would be high yield debt, which can be a speculative investment. Another category of high yield debt is a company that has fallen out of investment grade and is restructuring. The latter doesn't offer as much investment opportunity as the more speculative type, but it is a way of increasing fixed income returns beyond investment grade. He suggested that is a standard tool that deserves consideration.

Some funds are looking at timber, agriculture and commodity based investments. He wasn't endorsing those, but they do fall within investment grade.

He noted that many funds are diversifying and some endowments and foundations are becoming more aggressive on the absolute return strategies.

SENATOR COWDERY mused the corporation must support the concept and a number of desirable options must be unavailable currently.

MR. STORER maintained the options are numerous and some are worthy of evaluation. He asked members to remember that it took more than two years of study before they concluded that they wanted to invest in the private equity market. When he identifies the options as worthy of consideration, he assured members that a lengthy and in depth study is part of the process. Certainly, he wouldn't support some of the options he mentioned.

SENATOR COWDERY asked if new investment managers would be selected or guidelines changed.

MR. STORER replied nothing like that would change. He noted that the corporation manages quite a lot of money internally and the staff does very well. However, "These, by and large, are more sophisticated investments that require more personnel, more analysis etc. So the answer is we would most clearly seek outside expertise to assist us in managing those assets."

To do that, he said, they establish criteria, which might include expected returns, types of options, and benchmarks and standards. The consultant would be told to review peer groups that have expertise in that area. They look at performance as well as how long they have managed that type of discipline. They look at the depth of the organization and an analysis of whether or not repeated success is likely. After that, three prospects are brought in for interview and the board makes a selection from there.

He advised that any time they make an investment policy it is posted on the web site. There are resolutions for every asset class or discipline that managers must follow broadly and then contracts further tighten the guidelines.

SENATOR COWDERY asked if a manager had ever underperformed and had to be changed.

MR. STORER replied they try to stay with a manager as long as their discipline works because there are transaction costs associated with change. Although there are a number of issues, one is whether the assets are managed as represented and another questions whether they are managing it well. They look at whether the management style is out of favor or whether the job is simply done poorly.

He pointed out that one equity manager they selected in 1983 still has "a substantial relationship with the permanent fund

and the others have not so they have been fired for performance, for personnel turnover or for mergers...or simply we have decided that we need to implement different strategies."

SENATOR HOFFMAN noted he was around in 1999 when the Legislature made the last change. Although he doesn't have any reservations about adding (h) and (i), the request also triples the amount of funds that wouldn't be restricted by the investment rule. To put \$4.2 billion into perspective, he called it \$4,200 million. Although they are the same, the latter sounds like a larger number. "You're asking for a lot more flexibility" and he questioned whether that might not be too much risk.

He reminded members that the POMV (percent of market value) question was also before legislators. Currently the state doesn't use the earnings from the permanent fund, but that could change if POMV passes and a percentage of the earnings is allotted to government and the state comes to rely on that income. When you become dependent upon your earnings, it's natural that you become less willing to assume risk, he reasoned.

MR. STORER agreed with the last statement saying that, "The sooner you need the money, the more conservative you should be."

SENATOR HOFFMAN interjected, "The more you're dependent on it."

MR. STORER agreed adding that stock market investment is for the long term. He confirmed that Senator Hoffman correctly identified the two issues. He called the first issue house cleaning related to the original intent and the other issue is potentially expanding the risk from 5 to 15 percent. However, as he identified earlier,

As a management tool, one of the things that we will be doing right now is restricting ourselves because of the statutory limitations so it actually could work - we wouldn't have to change our asset allocation - and the current statutes would be an inhibitor on our return simply because we would be forced to liquidate assets because of statutory limitations, not what the market and asset allocation tells you.

He also made the point that even at 15 percent, the permanent fund is probably the most restrictive and conservative public funds in the country. It is far more restrictive than the state retirement system, he said.

They are not cavalier when it comes to large numbers, but they are used to managing money and the implications of large numbers. He said, "I'm not prepared to suggest that the future managers of the fund would put all their eggs in a \$4.2 billion basket. I don't know, but I think the opposite would occur." He agreed that Senator Hoffman's concern is valid, but he maintained that the increased investment latitude would be diversified and they would continue to follow the rules of prudent investing.

SENATOR HOFFMAN recalled that in the early '90s, the fund managers asked to invest in foreign stocks and that wasn't a very good decision for the first several years.

He then asked where the sunset clause was referenced.

MR. STORER explained that it related to just the one issue and they intend to impose the sunset clause in their investment policies and not statute. That one investment strategy will be a very small component, he said.

SENATOR HOFFMAN said, "You're not saying that that should be considered in this legislation and the Legislature should look at it in three years and see how the fund is doing."

MR. STORER maintained that a statutory sunset on the investment strategy would not be a good idea, but frequent performance evaluation is always a good idea.

SENATOR BERT STEDMAN said he understood private placements but he needed further clarification on increasing the basket from 5 to 15 percent. He questioned whether future markets might be used and if so, how much and where would they be used.

MR. STORER replied they would be used. Future markets are currently used to a small degree and he could see a day when they would be used more. Although they have never done so, they can use futures to hedge a long position. Fund managers use the futures market on currency on international investments because they tend to have longer settlement dates. When you make an international investment, you invest in the company and in the currency. Managers use futures to lock in the currency rate at the time.

He said more and more often, managers are employed to use futures in more sophisticated ways. There is danger in that though because a residual futures contract is potential leverage. They aren't suggesting such use and are very mindful of that issue.

However, using futures as a management tool to mitigate transaction costs can be worthwhile. For example,

We have a significant payout annually to - for the dividend payout and one could take their cash flow and instead of investing in - and it would be a small component - the stock market and incurring a transaction cost and then selling it later and incurring another transaction cost. One could use either future or forward contract that expires - that takes the cash and commits that to a future so that it expires right on that date to reduce transaction costs. My guess is that the dividend costs right about 2 to \$5 million in transaction costs. So that's one type of tool, but there are a myriad of ways one could use them. I would assume they would be used not now, not next year, but maybe five years down the road. I would expect to see more use of futures contracts - forward contracts, but I can't tell you the magnitude.

SENATOR STEDMAN said they would use short-term futures to bridge a settlement timeframe versus hedging the currency on the portfolio.

MR. STORER replied that would be one way and another would be to mitigate transaction costs for funding the dividend.

SENATOR STEDMAN viewed it differently. He said, "If you're going to access the futures market for short timeframes to mitigate your calendar on your settlement versus using futures to hedge currency in your international portfolio - particularly your international bond portfolio. So there's no intent to do that?"

MR. STORER replied, "No, not right now."

SENATOR STEDMAN said, "So there's no intent to use the basket move from 5 to 15 [percent] - where you can actually start getting a fairly good chunk of leverage on your portfolio - to go in and speculate or leverage up your equities portfolio. It would always be used as a hedge?"

MR. STORER replied they weren't discussing that use right now and although he couldn't say it would never happen, he couldn't envision that the board would leverage their equity portfolio in the foreseeable future.

With regard to increasing the flexibility now and the reference to the ability to invest in the international equity markets, he said, "There seems to be a classic event that occurs when the permanent fund is trying to increase their investment capabilities. What happened during that period [1999] is that it was only through the success of the international equity markets - and specifically in Japan - that we were able to get legislative ability to make international investments."

The point Senator Hoffman made was correct, he said; their initial investment in the international equities market went down. Fortunately they didn't invest a great deal of money, but since that time the international market returns have been significant. In fact, international equity markets have outperformed the domestic equity market in the last several years.

He concluded, "You have to justify your ability by showing how these high returns occur and it's like all things, you overshoot in both directions. That is the point of getting flexibility now."

**4:50 pm**

CHAIR GARY STEVENS noted that it was getting late and the members had a number of questions on the issue. Furthermore, 35 people were waiting to speak on the next bill. He stated he would like to return to this at a later date.

MR. STORER replied, "We would be delighted Mr. Chair. It's an important issue and we want to make everybody comfortable."

CHAIR GARY STEVENS held SB 326 in committee.

**SB 352-MANAGERS NOT EMPLOYEES UNDER P.E.R.A.**

CHAIR GARY STEVENS announced SB 352 to be up for consideration. He read the title and asked Kevin Jardell to come forward and introduce the bill.

KEVIN JARDELL, assistant commissioner for the Department of Administration, explained that the intention is to modernize the Public Employee Relations Act (PERA). The changes would conform to most states that allow public employees to bargain and would also conform to federal law, which applies to private industry unions throughout the U.S. Department of Education.

The impetus for the change stems from confusion and frustration associated with trying to implement the new administration's policies, he said. In working through the policies, they were trying to understand the management they have in the state and how to utilize that management to implement the administration's policies.

The first thing they noticed is that there was excessive micromanagement on the commissioner level. They determined that lower-level managers should be implementing many of the policies, but found there were no lower-level managers. Under current state law, the organization is such that everyone below the commissioner, including assistant commissioners and deputy commissioners, is labor under PERA. Upon further investigation, they found that although assistant and deputy commissioners have the right to bargain, they haven't exercised that option. That isn't the pressing problem, he said.

ASSISTANT COMMISSIONER JARDELL continued to say that the problem is that there is no line drawn to define managers, management and labor. They were certain that drawing the line at the commissioner level was not appropriate, but weren't sure where it would be appropriate. The focus was to identify the management team and train them as professionals that would become a part of policy implementation at the division level.

They looked at state history and learned that this isn't a new concept. The Cooper, Hammond and Hickel administrations all took some action on this issue. In 1977 and 1980, the Blue Ribbon Commission reviewed PERA. In particular they reviewed confidential employees and the managerial class of employees. That task force determined that those employees should be management rather than in organized labor.

A number of previous administrations concluded that they could solve the problem by removing these people from classified service and placing them in partially exempt service. This doesn't solve the problem, he asserted. First, placing employees in the partially exempt service, doesn't remove their right to bargain. The other reason it doesn't work is that this

administration doesn't believe that it is in the best interest of the state to make career-service employees who have risen to the management level in a division into political appointees. This administration doesn't want more political appointees at this level, he insisted.

What this administration wants to do is to develop a career-service path for management level employees that would be under the political appointees. That line is at the deputy director level and it would "provide a lot of continuity between administrations and a professionalism and a management class that we currently don't spend the resources to train and put in because we can't identify them as management."

He pointed to the Division of Retirement and Benefits to provide example of another problem. One director oversees over 100 employees and when he or she is gone, for any reason, there is no management representative in the division during the entire absence. In those instances, organized labor is running the division. To address that issue, they are trying to identify the managerial, deputy director level that is acting with independence in implementing the governor's policies.

He said appointees create and develop policy then the next level of management implements the policy with discretion. That level of independent judgment is the root of the definition they propose to adopt. The employee must have that to be defined as a management level. Employees that exercise independent judgment to implement policy are defined as managerial level.

SB 352 adopts the federal standard for confidential employees.

CHAIR GARY STEVENS told Assistant Commissioner Jardell that he wanted to give him every opportunity to fully present the administration's point of view, but it might have to be at a future time. Many people were waiting to testify and it was getting late in the day.

ASSISTANT COMMISSIONER JARDELL concluded that the principle of the bill is "to build a better management scheme for the state of Alaska, not make new political appointees, but generally professionalize and train a management class of employee."

CHAIR GARY STEVENS thanked him for working within the committee's time constraints. He said he would begin to take testimony in Juneau then move to the various communities to allow the 35 some people to speak.

SENATOR GRETCHEN GUESS asked the Chair if he wanted members to hold their questions until the end of the public testimony period.

CHAIR GARY STEVENS replied Assistant Commissioner Jardell would return to complete his testimony and answer questions at a future hearing.

JEFFERY PRATHER, staff manager with children services in Juneau said he listened to the previous testimony and he was unclear "who all they're envisioning being a part of this." As someone who might potentially be management, he cautioned the members to take care in determining the level that is appropriate to draw the line. In his office, managers make many sensitive decisions and "politics can play a role in decisions that are made by supervisors throughout the state." He maintained there is a level of comfort having a union to act as a buffer when they must make decisions that align with state regulation and law, but are troubling due to other issues.

KEVIN BRENNAN from Kodiak testified via teleconference on his own behalf. He works for the Alaska Department of Fish and Game (ADF&G). He thought Assistant Commissioner Jardell's explanation very interesting when compared to the vague language contained in the bill. In fact, the description of a manager could conceivably include anyone in the supervisory unit.

"Politicizing public employee positions would diminish our effectiveness in the state." He asked that the bill be tabled because it is an attack on PERA and collective bargaining.

LESLIE SIMMONS testified via teleconference from Anchorage in opposition to SB 352. She said she is a front line supervisor for the solid waste program in the Department of Environmental Conservation. She implements policy developed by her commissioner, division director, and program manager. She provides information to help them in policy development.

Because of her technical expertise, schooling and experience, she is instrumental in helping the department develop environmental regulations. "I do my job with the understanding of the political, social and economic implications. I make decisions based on sound science, laws and regulations and best management practices. Not based on shifting political elections." She urged the committee to table the bill.

CHAIR GARY STEVENS thanked Ms. Simmons and announced that it was 5:00 pm and even though the hearing would continue for a while longer, his intention was to hear the bill again the following Tuesday. Everyone that wanted to speak would have an opportunity.

DEAN WILLIAMS testified via teleconference to say that Assistant Commissioner Jardell's comments are well understood by supervisory members. However, he respectfully disagreed with his analysis of the situation and what he believes to be the problem. He reasoned that as "you move down into the state management team, you understand that when a director leaves of course we're carrying out the governor's and the administration's programs and plans. We are the career employees...."

This legislation makes jobs that are not and should not be political very political indeed. "We respectfully disagree with the analysis of Assistant Commissioner Jardell and ask the committee to look very carefully at what is in the legislation and the severe ramifications that we believe it's going to have on the supervisory employees and the state as a whole."

STEVE HOFFMAN from Ketchikan testified via teleconference. He questioned whether the bill was an attempt to better state government or a first step toward union busting.

OLE LARSON testified via teleconference from the Mat-Su LIO and said where he works, the commissioner, deputy commissioner, directors, and special assistants are all political appointees. He didn't hear about the bill until the previous Friday, he didn't read about it until yesterday and he couldn't understand the urgency. "The state employment system isn't broken or out of control." He said he was opposed to the legislation because it wouldn't provide any protection to supervisory employees from the political whims of changing administrations.

He stated that there is just one supervisory layer under him. "There isn't a long career ladder to begin with and this would eliminate what career ladder is left." A staff member asked what "undivided loyalty" means and he believes this is a scary issue.

**TAPE 04-10, SIDE A**  
**5:12 pm**

CHAIR GARY STEVENS announced that he wanted the entire committee hear all the testimony on this important issue and he intended to take additional public testimony the following Tuesday.

BRUCE SENKOW testified via teleconference from Fairbanks and advised that he is the president of the Alaska Public Employees Association. When he reviewed the bill, he found it to be "wrong on so many levels." With regard to loyalty, he has never heard of a supervisor disobeying a direct request from a director or commissioner if he or she was given clear direction. Next, he couldn't figure out where the governor's concern about confidentiality was coming from because "we probably hear more from commissioners and political appointees than we ever hear from labor relations staff."

The issue of cost is noteworthy even though the fiscal note doesn't reflect that. Under collective bargaining, there is arbitration if you must terminate someone. That is costly. With this bill, he thought a predetermination hearing would be necessary followed by a personnel board hearing. After that lawyers would get involved. "That's going to cost you ten times more than what an arbitration will cost to find out whether or not you did what you should have done."

Drawing on years of experience, he asserted that most supervisors are more fiscally responsible than most political appointees. "On so many levels, this is the wrong time and the wrong thing to address. The system isn't broken it doesn't need to be fixed. I think this needs to be tabled."

SHANNON FLEMING testified that she is the investigation supervisor for the office of children's services in Juneau. Many of her sentiments were stated already, but she wanted to comment on conflicting loyalties.

She professed to no conflicting loyalties now, but suggested that she very well might if she didn't have union representation because she helps six social workers make difficult family related decisions on a daily basis.

GEORGE PAPPAS, an area management biologist for the Department of Fish and Game, testified via teleconference from Kodiak in opposition to SB 352.

As a manager of a fully allocated fishery, nearly every decision that he makes serves some user group and takes away from another, he said. He questioned whether the next generation of

biologists would be able to base their decisions on sound biological principles rather than the politically and economically based process seen in the early 1900s. Without protection of a union, he was concerned that he could lose his job for making a publicly unpopular, but biologically sound decision.

GERRY GUAY testified via teleconference from Anchorage in opposition to the bill. He works for the Department of Environmental Conservation and is also the chair of the Southcentral supervisory unit. SB 352 implies the 500 plus members of the state supervisory workforce need to be controlled because they aren't supportive of the current political direction. "The implication that we could be better controlled is not only a dangerous conclusion, but severely undermines the fabric of state government and being a public servant."

Our role as supervisors is not to be controlled but to serve the residents of the state of Alaska irrespective of the controlling party. We are here to provide informed advice, technical expertise and to serve as check and balance when decisions don't make sense. This is not to suggest that we work against the political pundit, but instead we make sure that the desired results are based on informed decisions. I believe the mere suggestion of political control at my mid-managerial level should send fear to the hearts of most Alaskans.

He observed that he interpreted the bill differently than Assistant Commissioner Jardell and asked how the bill would:

- Improve the loss in productivity in the state system caused by political turnover every 4 years
- Handle the loss in informed experienced leadership in the 3 to 6 months following each election
- Address the brain-drain as older staff leave or are forced out
- Counter the loss of staff leaving for bigger money in the private sector because state employment no longer offers security
- Counter the loss of dedicated state workers and managers
- Address fewer experienced state workers wanting to become managers

- Protect supervisory members that are already afraid to testify at legislative hearings because they are afraid of political retribution

DORIS TANNER testified via teleconference from the Mat-Su LIO to represent supervisory members of the Election Board. She opposed any effort to open the Public Employment Relations Act. She advised that she had a written statement to read and she would send the committee a copy for the file. She read:

PERA isn't broken; if anything it isn't strong enough. This is evident in the continual upheaval and damage done to vital state programs and service of each and every administrative change in subjective replacement

Raiding PERA will increase the number of long-term employees - and these are employees with experience and history necessary to operate efficient programs and services - arbitrarily replaced by political influence. I am here today to tell you about personal experiences with political appointments in state government. As you know, each and every administration brings with it political appointees into key state positions. We have pretty much learned to live with that. Those positions, however, bring their own key people in. These political pawns are generally inexperienced in the department they are charged to represent. They bring varying levels of education and experience and a complete misunderstanding for how the department, the division, or the program functions. They lack the history or memory to quickly get up to speed in the mission of the department they represent. In short, they bring chaos into a perfectly oiled machine.

If PERA is raided, this political process will become the norm occurring daily rather than every four years that we currently experience.

MS. TANNER noted that one of her employees wrote, "This is the first time in my life that I have felt afraid to say what I think in a workplace. This is not like me." That paranoia is widespread and is holding the state hostage, Ms. Tanner charged.

Finally she asked, "Why is this issue only receiving the notice of one hearing held one day after its introduction?" She urged the committee to kill SB 352.

CHAIR GARY STEVENS thanked her for her comments then explained, for the record, "that we did send this out on Thursday - that it was posted on Friday. It was not given a bill number until Monday when it went across the Senate floor." He continued to say that there would be another hearing to give everyone a chance to speak to the issue.

He announced he would like to hear from one more person from Fairbanks so that each community had two people speak to the issue.

JUNE PENNELL-STEPHENS, APEA member and manager at the Fairbanks North Star Borough, stated that she was the next on the list. She made the point, "You make good managers by hiring qualified people and training them properly, not merely by prohibiting them from carrying a union card." It is short sighted and offensive to say that someone can't be a good manager and a good union member. Her contract gives her the explicit right to express political opinions, which is not included in the general personnel policy that covers non-union employees. Without that guarantee, many public employees would be directly or indirectly deprived of their right of free speech. She charged that prohibiting all managers from belonging to any union whatsoever might well be an infringement on their first amendment right to the freedom of association. She urged the committee to defeat the bill.

CHAIR GARY STEVENS announced that the committee schedule was full for the coming Thursday meeting, but they would continue hearing the bill again on Tuesday of the next week. He noted he hadn't given Assistant Commissioner Jardell an opportunity to complete his testimony and asked him if he had anything to add.

ASSISSTANT COMMISSIONER JARDELL replied he would return and answer questions at a later time.

CHAIR GARY STEVENS held SB 352 in committee and adjourned the meeting at 5:30 pm.