

**ALASKA STATE LEGISLATURE**  
**HOUSE SPECIAL COMMITTEE ON WAYS AND MEANS**

April 22, 2005

8:38 a.m.

**MEMBERS PRESENT**

Representative Bruce Weyhrauch, Chair  
Representative Norman Rokeberg  
Representative Ralph Samuels  
Representative Peggy Wilson  
Representative Max Gruenberg  
Representative Carl Moses

**MEMBERS ABSENT**

Representative Paul Seaton

**COMMITTEE CALENDAR**

HOUSE JOINT RESOLUTION NO. 19

Proposing amendments to the Constitution of the State of Alaska relating to and limiting appropriations from the Alaska permanent fund based on an averaged percent of the fund market value.

- MOVED HJR 19 OUT OF COMMITTEE

**PREVIOUS COMMITTEE ACTION**

BILL: HJR 19

SHORT TITLE: CONST. AM: PERMANENT FUND P.O.M.V.

SPONSOR(S): WAYS & MEANS

04/19/05	(H)	READ THE FIRST TIME - REFERRALS
04/19/05	(H)	W&M, JUD, FIN
04/22/05	(H)	W&M AT 8:30 AM CAPITOL 106

**WITNESS REGISTER**

MICHAEL BURNS, Executive Director  
Alaska Permanent Fund Corporation  
Department of Revenue  
Juneau, Alaska

POSITION STATEMENT: Testified in support of HJR 19.

ED MARTIN SR

Cooper Landing, Alaska

POSITION STATEMENT: Testified in opposition to HJR 19.

LAURA ACHEE, Research and Communications Liaison

Alaska Permanent Fund Corporation

Juneau, Alaska

POSITION STATEMENT: Offered information regarding the percent of market value (POMV).

#### **ACTION NARRATIVE**

**CHAIR BRUCE WEYHRAUCH** called the House Special Committee on Ways and Means meeting to order at [8:38:28 AM](#). Representatives Weyhrauch, Samuels, Wilson, and Moses were present at the call to order. Representatives Rokeberg and Gruenberg arrived as the meeting was in progress.

HJR 19-CONST. AM: PERMANENT FUND P.O.M.V.

[8:38:41 AM](#)

CHAIR WEYHRAUCH announced that the only order of business would be HOUSE JOINT RESOLUTION NO. 19, Proposing amendments to the Constitution of the State of Alaska relating to and limiting appropriations from the Alaska permanent fund based on an averaged percent of the fund market value.

MICHAEL BURNS, Executive Director, Alaska Permanent Fund Corporation (APFC), Department of Revenue, related that this resolution is important to the APFC Board of Trustees because they believe that a percent of market value (POMV) is the best way to manage the fund. He emphasized that the trustees do not see POMV as a fiscal plan, nor would POMV allow the legislature greater access to the earnings in the fund. In fact, in most years POMV would lower the amount available for appropriations compared to the current system. The trustees believe that implementation of POMV and the use of permanent fund earnings for state government are two entirely separate issues. The POMV is predictable and understandable by the people of Alaska versus the current confusing and "archaic" distribution formula.

MR. BURNS turned to the real return formula, which is the total return minus inflation. He related that the real return formula is used by private and public foundations, pensions funds, and endowments, and it's how the trustees, directors, and managers of those organizations view their fiduciary duty and assignment.

As opposed to the real return formula, Alaska uses its own version of return and income, which adds or subtracts any unrealized gains or losses to the [total return] and from that operating expenses and any appropriations are subtracted. The aforementioned is what's called the "accounting net income." From the accounting net income unrealized net income is subtracted, which is the realized net income. From the realized net income the Amerada Hess income is subtracted, and thus it arrives at the statutory net income. The statutory net income is the amount used in the distribution formula. He characterized the aforementioned formula as confusing, out of date, and unworkable.

MR. BURNS recalled that when the fund was created it was prudent to restrict investment authority to a bond-only strategy in its early stages. He explained that bond portfolios only generate income in two ways which include, the interest or coupon income that is actually received and capital gains from bonds sold at appreciated prices. The distribution formula based upon the aforementioned income types made sense for calculating traditional realized net income, however, the fund's asset allocation now incorporates investments that generate significant unrealized gains as well as realized income. He related that the current payout methodology and method used to protect the principal no longer serve the fund as well as they once did. The trustees believe that only a POMV payout limited by the sustainable yield from the fund can provide the necessary protection for the future, while allowing current generations their equitable share of fund earnings, he added. Furthermore, the trustees believe the only way to fully ensure protection of the fund is to place this limitation in the state's constitution. He offered that the POMV is simple because no more than 5 percent of the average market value of the fund averaged over the previous five-years may be appropriated from the fund, which leaves a minimum of 95 percent of the fund protected from spending in any given year. The POMV is not a fiscal plan and with \$50 oil the interest in and focus on a fiscal plan may well be elsewhere. He indicated that this is the opportune time to modernize and increase the transparency of the fund so that it cannot only be managed in harmony with its distribution formula but also understood by Alaskans when difficult decisions must be made in the future. He urged the committee to support this proposal because [the POMV] modernizes, clarifies, and offers better protection.

[8:44:19 AM](#)

CHAIR WEYHRAUCH related that the legislature has had many discussions regarding the POMV methodology so its workings are fairly well understood.

[8:44:47 AM](#)

REPRESENTATIVE SAMUELS requested the aforementioned formulas, and noted his agreement with Chair Weyhrauch regarding the [legislature's] knowledge of the POMV.

[8:45:07 AM](#)

REPRESENTATIVE WILSON opined that the POMV seems like "the way to go" and she requested a copy of all the testimony.

[8:45:35 AM](#)

REPRESENTATIVE GRUENBERG provided copies of a statutory POMV proposal from a previous legislative session, which he recalled was drafted during a special session. This statutory amendment couldn't authorize getting into the principal of the fund, he noted.

CHAIR WEYHRAUCH said that a statutory POMV has been discussed as an alternative to a constitutional amendment.

REPRESENTATIVE GRUENBERG informed the committee that he has several memos from David Teal, Legislative Fiscal Analyst, Legislative Finance Division, on the subject.

[8:48:27 AM](#)

ED MARTIN SR. related his belief that there's absolutely no compelling reason to change the present arrangement of earnings payout. He urged the committee to leave the permanent fund [earnings] alone unless it's put into the constitution as it is currently managed. He indicated that many other Alaskan's share his perspective. He related his understanding that approximately 99 percent of the fund is invested outside of the state, of which a portion is realized through the dividend. He noted his desire for more in-state investment and urged the legislature and permanent fund investors to analyze the direct good it offers to citizens and the state. He concluded by acknowledging that the [permanent fund] needs to be revamped, although he urged the committee not to pass HJR 19.

[8:54:07 AM](#)

CHAIR WEYHRAUCH highlighted that the proposal in HJR 19 would have go to a vote of the people, and therefore there is the opportunity for public debate.

MR. MARTIN SR. said, "As it is written, I can almost guarantee you that the people are not going to buy it." He suggested that this resolution sends the wrong message to the citizens of Alaska and violates their trust in the legislature.

[8:55:28 AM](#)

REPRESENTATIVE SAMUELS related that the POMV stabilizes the cash flow no matter the daily market fluctuations. He then pointed out that this resolution doesn't address how the earnings are used, and therefore it could all be paid out in dividends. He opined that the POMV keeps politicians' hands off the money.

[8:56:44 AM](#)

LAURA ACHEE, Research and Communications Liaison, Alaska Permanent Fund Corporation, in response to Representative Samuels, clarified that close to \$2 billion is in the earnings reserve.

[8:56:52 AM](#)

REPRESENTATIVE SAMUELS pointed out that currently the legislature could appropriate that \$2 billion tomorrow. However, the POMV proposal [encompassed in HJR 19] actually limits the amount the legislature can appropriate and stabilizes the cash flow, which in turn benefits the dividend. He acknowledged the political realities of the statutory POMV, however, it doesn't address the market fluctuation problem or erase the line between the corpus and the earnings. In fact, if the market completely tanked, there would be no earnings to pay out. Representative Samuels concluded by noting his support of HJR 19.

CHAIR WEYHRAUCH closed public testimony.

[8:57:44 AM](#)

REPRESENTATIVE GRUENBERG acknowledged that under current law there is the possibility of receiving no dividend in the event the stock market tanks. He opined that most Alaskans understand the aforementioned circumstances and further understand that

under the current system the principal is guaranteed, which they appreciate.

[8:59:24 AM](#)

REPRESENTATIVE ROKEBERG moved and asked the consent of the committee that the entire deliberations of the House Special Committee on Ways and Means on the POMV concept of House Joint Resolution 26 of the Twenty-Third Legislature be made part of the record of this resolution. He characterized House Joint Resolution 26 of the Twenty-Third Legislature as an important historical document on this subject.

[9:00:00 AM](#)

REPRESENTATIVE GRUENBERG objected for discussion purposes, and asked if the motion could be amended to include "all committees."

CHAIR WEYHRAUCH proposed that the motion focus only on the House Special Committee on Ways and Means.

REPRESENTATIVE GRUENBERG withdrew his objection.

CHAIR WEYHRAUCH, upon determining there was no further objection, announced that the motion was adopted.

[9:00:41 AM](#)

MR. BURNS, in response to Representative Rokeberg, said that the [Alaska Permanent Fund Corporation] uses a well-defined formula albeit a confusing and arcane method.

REPRESENTATIVE ROKEBERG clarified his understanding that the formula [makes assumptions about] the unrealized and realized gains, values, and timing.

[9:02:17 AM](#)

MS. ACHEE added that the calculation is "well laid out," although the amount of realized earnings available could vary. The amount of realized earnings could be artificially changed by the action of the trustees or by direction from the legislature, she specified.

[9:02:51 AM](#)

MR. BURNS, in response to Representative Rokeberg, related his belief that a distribution formula based on realized income was logical when the portfolio was 100 percent bonds. However, it doesn't "fit" with the current management of the fund. The fund is managed for the total return minus inflation, which gives the real rate of return. The aforementioned is the type of accounting upon which the distribution formula should be based rather than the removal of "unrealized gains and losses, and the Amerada Hess" funds because it leads to confusion from the public, he said. He highlighted that the only two pieces of the permanent fund in the constitution are the 25 percent that "goes in" and the protection of the principal.

[9:04:23 AM](#)

REPRESENTATIVE ROKEBERG requested a memorandum on the formula used to calculate the dividend.

MR. BURNS explained that there is a two-step process which includes the dividend calculation formula and accounting calculation used to determine what is available for the dividend formula.

[9:05:11 AM](#)

REPRESENTATIVE ROKEBERG related he would like both the aforementioned formulas. He related his belief that there is a "problem" with memorializing the current statute in the constitution. He highlighted that the statutory POMV has merit in the sense that if the constitutional authority couldn't be reached, it may provide a way in which the legislature can educate the public. However, the statutory POMV is almost valueless because it doesn't protect the downside market situation in which there may be no funds for dividends or the earnings reserve. He concluded by characterizing the POMV as a simple mechanism process that's a central mechanism for a long-range fiscal plan. The legislature has the opportunity to place the POMV on the next general election ballot as a mechanism concept, he added.

[9:07:30 AM](#)

REPRESENTATIVE WILSON moved to report HJR 19 out of committee with individual recommendations and the accompanying fiscal note. There being no objection, HJR 19 was reported from the House Special Committee on Ways and Means.

**ADJOURNMENT**

9:08:19 AM

There being no further business before the committee, the House Special Committee on Ways and Means meeting was adjourned at 9:08 a.m.