

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

March 22, 2007

8:12 a.m.

MEMBERS PRESENT

Representative Bob Lynn, Chair
Representative John Coghill
Representative Craig Johnson
Representative Andrea Doll
Representative Max Gruenberg

MEMBERS ABSENT

Representative Bob Roses, Vice Chair
Representative Kyle Johansen

COMMITTEE CALENDAR

HOUSE BILL NO. 166

"An Act relating to contributions from permanent fund dividends to community foundations, to certain educational organizations, and to certain other charitable organizations that provide a positive youth development program, workforce development, aid to the arts, or aid and services to the elderly, low-income individuals, individuals in emergency situations, disabled individuals, or individuals with mental illness; and providing for an effective date."

- MOVED CSHB 166(STA) OUT OF COMMITTEE

HOUSE BILL NO. 171

"An Act relating to the terms of legislators, the date and time for convening regular legislative sessions, adoption of uniform rules of the legislature and to certain of those rules, the date for organizing the Legislative Budget and Audit Committee, and deadlines for certain matters or reports to be delivered to the legislature or filed; prohibiting bonuses for legislative employees; and providing for an effective date."

- HEARD AND HELD

HOUSE BILL NO. 13

"An Act relating to prepayments of accrued actuarial liabilities of government retirement systems; relating to the Alaska Municipal Bond Bank Authority; permitting the Alaska Municipal

Bond Bank Authority or a subsidiary of the authority to assist state and municipal governmental employers by issuing bonds, notes, commercial paper, or other obligations to enable the governmental employers to prepay all or a portion of the governmental employers' shares of the unfunded accrued actuarial liabilities of retirement systems; authorizing a governmental employer to issue obligations to prepay all or a portion of the governmental employer's shares of the unfunded accrued actuarial liabilities of retirement systems and to enter into a lease or other contractual agreement with a trustee or the Alaska Municipal Bond Bank Authority or a subsidiary of the authority in connection with the issuance of obligations for that purpose, and relating to those obligations; and providing for an effective date."

- MOVED CSHB 13(W&M) OUT OF COMMITTEE

HOUSE BILL NO. 184

"An Act relating to a commemorative troops license plate; and providing for an effective date."

- BILL HEARING CANCELED

PREVIOUS COMMITTEE ACTION

BILL: HB 166

SHORT TITLE: CONTRIBUTIONS FROM PERM. FUND DIVIDENDS

SPONSOR(s): REPRESENTATIVE(s) THOMAS

02/28/07	(H)	READ THE FIRST TIME - REFERRALS
02/28/07	(H)	STA, FIN
03/20/07	(H)	STA AT 8:00 AM CAPITOL 106
03/20/07	(H)	Heard & Held
03/20/07	(H)	MINUTE(STA)
03/22/07	(H)	STA AT 8:00 AM CAPITOL 106

BILL: HB 171

SHORT TITLE: ACCOMMODATE 90-DAY SESSION/LEG PROCEDURES

SPONSOR(s): RULES

03/01/07	(H)	READ THE FIRST TIME - REFERRALS
03/01/07	(H)	STA
03/06/07	(H)	STA AT 8:00 AM CAPITOL 106
03/06/07	(H)	Scheduled But Not Heard
03/15/07	(H)	STA AT 8:00 AM CAPITOL 106
03/15/07	(H)	Heard & Held
03/15/07	(H)	MINUTE(STA)

03/22/07 (H) STA AT 8:00 AM CAPITOL 106

BILL: HB 13

SHORT TITLE: RETIREMENT SYSTEM LIABILITY/BONDS/CORP.

SPONSOR(S): REPRESENTATIVE(S) HAWKER

01/16/07 (H) PREFILE RELEASED 1/5/07
01/16/07 (H) READ THE FIRST TIME - REFERRALS
01/16/07 (H) W&M, STA, FIN
02/14/07 (H) W&M AT 3:30 PM HOUSE FINANCE 519
02/14/07 (H) Heard & Held
02/14/07 (H) MINUTE(W&M)
02/16/07 (H) W&M AT 3:30 PM HOUSE FINANCE 519
02/16/07 (H) Heard & Held
02/16/07 (H) MINUTE(W&M)
03/05/07 (H) W&M AT 3:30 PM HOUSE FINANCE 519
03/05/07 (H) Moved CSHB 13(W&M) Out of Committee
03/05/07 (H) MINUTE(W&M)
03/07/07 (H) W&M RPT CS(W&M) NT 3DP 3AM
03/07/07 (H) DP: FAIRCLOUGH, ROSES, HAWKER
03/07/07 (H) AM: WILSON, SEATON, CISSNA
03/22/07 (H) STA AT 8:00 AM CAPITOL 106

WITNESS REGISTER

KACI HOTCH, Staff

to Representative Bill Thomas, Jr.

Alaska State Legislature

Juneau, Alaska

POSITION STATEMENT: Reviewed the changes made in Version C, on behalf of Representative Thomas, prime sponsor of HB 166.

REPRESENTATIVE PAUL SEATON

Alaska State Legislature

Juneau, Alaska

POSITION STATEMENT: Presented the idea for a 31-day break mid 90-day session during the hearing on HB 171.

REPRESENTATIVE MIKE HAWKER

Alaska State Legislature

Juneau, Alaska

POSITION STATEMENT: Presented HB 13 as prime sponsor.

BRIAN ANDREWS, Deputy Commissioner

Department of Revenue

Juneau, Alaska

POSITION STATEMENT: Offered an overview regarding pension obligation bonds (POBs) during the hearing on HB 13.

GARY M. BADER, Chief Investment Officer
Treasury Division
Department of Revenue
Juneau, Alaska

POSITION STATEMENT: Assisted with an overview regarding pension obligation bonds during the hearing on HB 13.

GREG SUNDBERG, Managing Director
Merrill Lynch
Seattle, Washington

POSITION STATEMENT: Testified during the hearing on HB 13.

LINDSEY SOVDE, Vice President
Seattle-Northwest Securities Corporation (SNW)
Seattle, Washington

POSITION STATEMENT: Testified during the hearing on HB 13.

MIKE BARNHILL, Assistant Attorney General
Labor and State Affairs Section
Civil Division (Juneau)
Department of Law (DOL)

POSITION STATEMENT: Testified during the hearing on HB 13.

ACTION NARRATIVE

CHAIR BOB LYNN called the House State Affairs Standing Committee meeting to order at [8:12:07 AM](#). Representatives Coghill, Johnson, Doll, and Lynn were present at the call to order. Representative Gruenberg arrived as the meeting was in progress.

HB 166-CONTRIBUTIONS FROM PERM. FUND DIVIDENDS

[8:12:50 AM](#)

CHAIR LYNN announced that the first order of business was HOUSE BILL NO. 166, "An Act relating to contributions from permanent fund dividends to community foundations, to certain educational organizations, and to certain other charitable organizations that provide a positive youth development program, workforce development, aid to the arts, or aid and services to the elderly, low-income individuals, individuals in emergency situations, disabled individuals, or individuals with mental illness; and providing for an effective date."

8:13:07 AM

REPRESENTATIVE JOHNSON moved to adopt the committee substitute (CS) for HB 166, Version 25-LS0678\C, Cook, as a work draft. There being no objection, Version C was before the committee.

8:13:38 AM

KACI HOTCH, Staff to Representative Bill Thomas, Jr., Alaska State Legislature, reviewed the changes made in Version C, on behalf of Representative Thomas, prime sponsor of HB 166. The first change, she noted, opens the program up to all 501(c)(3) entities, with one exception shown on page 2, [lines 15-17], which read as follows:

(c) The department may not include on the contribution list an educational organization, community foundation, or charitable organization that is the affiliate of a group.

MS. HOTCH noted that clarification is made on page 2 that every 501(c)(3) that is eligible must reapply each year. She said that requirement will prevent the necessity of the state searching out a 501(c)(3) that it thinks may no longer be eligible.

MS. HOTCH pointed to another change on page 3, line 24, which states that before a contract with a corporation or organization that will be managing the program is executed, a copy of that entity's policies and procedures must be on file with the Department of Revenue. Another change is found on page 3, line 26, which provides that the department can circumvent the procurement code if it desires to do so.

8:16:15 AM

REPRESENTATIVE JOHNSON moved to report CSHB 166, Version 25-LS0678\C, Cook, out of committee with individual recommendations and the accompanying fiscal notes. There being no objection, CSHB 166(STA) was reported out of the House State Affairs Standing Committee.

HB 171-ACCOMMODATE 90-DAY SESSION/LEG PROCEDURES

8:16:45 AM

CHAIR LYNN announced that the next order of business was HOUSE BILL NO. 171, "An Act relating to the terms of legislators, the date and time for convening regular legislative sessions, adoption of uniform rules of the legislature and to certain of those rules, the date for organizing the Legislative Budget and Audit Committee, and deadlines for certain matters or reports to be delivered to the legislature or filed; prohibiting bonuses for legislative employees; and providing for an effective date."

[8:17:16 AM](#)

REPRESENTATIVE COGHILL requested that Representative Paul Seaton be invited to speak on the matter of a proposed 30-day break within a 90-day session, a concept which Representative Coghill said Representative Seaton initiated. He mentioned that there was also a legal matter to address.

[8:17:47 AM](#)

REPRESENTATIVE PAUL SEATON, Alaska State Legislature, said his focus was to accommodate the 90-day session and meet requirements for timing of incoming and outgoing members of the legislature. He said the big question is how the legislature can eliminate 25 percent of its time in Juneau while not diminish the public's access to debate and notification of legislation as it goes forward. He urged the committee to consider splitting the session into two parts, with a 31-day break between. He stated that although the wording of the initiative calls for a continuous 90 days, there was no campaigning during the initiative process that would require such continuity. He said he has spoken to both sponsors of the initiative that are still in the legislature, and they both think that splitting the session into two parts would comport with the initiative intent.

REPRESENTATIVE SEATON mentioned that the committee has received a legal opinion stating that the Alaska State Constitution permits the legislature to modify an initiative to make it a workable document, provided those modifications do not violate the intent or spirit of the initiative.

[8:19:53 AM](#)

REPRESENTATIVE SEATON said a [31-day] break would eliminate the number of excused absences. Furthermore, legislators would have more time to meet with their constituents. Currently, he noted, legislators take time off for the annual Energy Council and

Easter break; if the 31-day break was placed strategically, it could cover that time. He explained the reason for stating that the break would be 31 days rather than 30 is because the legislature would actually be changing from 121 to 90, not 120 to 90.

8:22:06 AM

REPRESENTATIVE SEATON, regarding staff, said a legislative employee currently can earn a step increase related to wages after working 115 days. He said there is dispute over whether or not to allow employees a step increase after 85 days. If the 31-day break was in play, session staff could stay employed during the break, and the step increase would not be an issue. Furthermore, hiring staff through the break would address concerns that have been raised related to the difficulty in getting staff to work in Juneau for only 90 days.

8:23:27 AM

REPRESENTATIVE SEATON turned to the fiscal note and pointed out that "there's hardly any savings." He explained that the difference between session per diem and long-term per diem is minimal; therefore, since most legislators would be "working a good portion of this time on their own anyway and collecting longer-term per diem," if they stayed on session per diem, he said, they could maintain their Juneau lodgings, which would not disrupt the housing market.

REPRESENTATIVE SEATON remarked that the same level of engagement is not achieved when legislators are spread throughout the state participating in meetings via teleconference.

8:24:39 AM

REPRESENTATIVE SEATON directed attention to two of the legal opinions in committee packet, which are from Tamara Cook of Legislative Legal and Research Services. The first, he noted is dated March 16, 2007 [and shows "(Work Order 25-LS0764)" within the subject line]. He cited the first sentence of the first paragraph on the second page, which read as follows "[original punctuation provided]:

If I am correct that the legislature is not bound by the statutory session limit under AS 24.05.150(b), then the legislature is legally free to adopt your proposed schedule as a compromise position designed to

limit the actual number of days the legislature meets to 90 days, while allowing the legislature to wait for better revenue forecasts before it reconvenes and finalizes the budget in the spring.

REPRESENTATIVE SEATON said the second of the two legal opinions, dated March 20, 2007, is in response to the following question:

Could a statute providing for a 31-day recess during each regular session constitute the agreement required under Art. II, sec. 10 of the state constitution for a recess longer than three days?

REPRESENTATIVE SEATON read part of Ms. Cook's response to that question, found in the last sentence of the second paragraph, which read as follows [original punctuation provided]:

However, so long as both houses cooperatively abide by the statute and neither expresses its determination to force the other house back into session, I believe that the statute will serve as acceptable evidence of the concurrence in the recess by each of the houses under art. II, sec. 10.

[8:26:09 AM](#)

CHAIR LYNN recognized Representative Seaton's having addressed the needs of the staff, a consideration that is often times overlooked, he indicated.

[8:26:33 AM](#)

REPRESENTATIVE COGHILL moved to adopt the committee substitute (CS) for HB 171, Version 25-LS0653\E, Cook, 3/16/07, as a work draft.

[8:26:57 AM](#)

REPRESENTATIVE GRUENBERG objected for the purpose of hearing a review of Version E.

[8:27:26 AM](#)

REPRESENTATIVE JOHNSON noted that he will have recommendations to make regarding the bill.

[8:27:41 AM](#)

REPRESENTATIVE COGHILL reviewed the changes made by Version E by referring to the original bill and pointing to the following language that had been deleted: Page 3, Section 5, which gave the opportunity for each house to adopt different rules; Page 4, Section 8, which would have killed any bills not passed by one house within the first session; Page 6, Section 14 - the entire section - regarding timeline issues; and Page 6, Section 15, requiring the administration's budget by January.

[8:29:28 AM](#)

REPRESENTATIVE GRUENBERG removed his objection to Version E. There being no further objection, Version E was before the committee as a work draft.

[HB 171 was heard and held.]

HB 13-RETIREMENT SYSTEM LIABILITY/BONDS/CORP.

[8:29:55 AM](#)

CHAIR LYNN announced that the last order of business was HOUSE BILL NO. 13, "An Act relating to prepayments of accrued actuarial liabilities of government retirement systems; relating to the Alaska Municipal Bond Bank Authority; permitting the Alaska Municipal Bond Bank Authority or a subsidiary of the authority to assist state and municipal governmental employers by issuing bonds, notes, commercial paper, or other obligations to enable the governmental employers to prepay all or a portion of the governmental employers' shares of the unfunded accrued actuarial liabilities of retirement systems; authorizing a governmental employer to issue obligations to prepay all or a portion of the governmental employer's shares of the unfunded accrued actuarial liabilities of retirement systems and to enter into a lease or other contractual agreement with a trustee or the Alaska Municipal Bond Bank Authority or a subsidiary of the authority in connection with the issuance of obligations for that purpose, and relating to those obligations; and providing for an effective date." [Before the committee was CSHB 13(W&M).]

[8:29:58 AM](#)

REPRESENTATIVE MIKE HAWKER, Alaska State Legislature, presented HB 13 as prime sponsor. He said the bill would provide government employers with a financial tool that could

potentially save tax payers of the state a great deal of money by paying down the retirement system's unfunded liability - a mounting liability estimated at over \$10 billion. He likened the unfunded liability of the pension system to a residential mortgage: the government is the homeowner, and rather than owing money to the bank, it has an obligation to pay off the liability to the pension funds. Legislators, he said, owe it to their constituents to pay off the obligation to the trust with the least possible expenditure from state and public treasuries. Representative Hawker stated, "Our liability to the pension fund is an absolute, constitutional liability. We have no choice but eventually to write that check."

[8:33:45 AM](#)

REPRESENTATIVE HAWKER said HB 13 proposes use of Pension Obligation Bonds (POBs) - a proven financial device - to lower the interest cost of the unfunded liability. He said the director of the Department of Revenue will offer a detailed description of POBs and how they could be a substantial benefit to the treasury of the state.

REPRESENTATIVE HAWKER, in response to a question from Chair Lynn, confirmed that there was a similar bill introduced in a previous legislature, but it stopped its movement in the Senate Finance Committee. Representative Hawker said that end to that particular legislation was appropriate, because it had served the purpose of getting everyone to start thinking about the concept. Now, he opined, "we're blessed with an administration that has a very contemporary view on public finance and [has] embraced this idea as part of [its] own budgeting process." In response to a follow-up question from Chair Lynn, he said it could be argued that because the state did not pass the bill last year, it lost 3 percent of the \$2-\$3 billion it might have used in a bonding transaction.

CHAIR LYNN commented that that is not "chump change."

[8:36:21 AM](#)

BRIAN ANDREWS, Deputy Commissioner, Department of Revenue, offered an overview [based on a PowerPoint presentation included in the committee packet] regarding pension obligation bonds (POBs). He stated that the goal of POBs is to reduce the cost of the pension plans' outstanding liability. He said a simple analogy would be "paying off your credit card debt with a cheaper line of credit against your house." Over the past

decade, he noted, there have been over 300 POBs issued by state and local governments in 26 different states. He said POBs are not new to Alaska - they were issued successfully by the City of Anchorage in 1980.

[8:38:46 AM](#)

MR. ANDREWS listed three primary reasons the state should consider POBs: the interest rate savings on the reduction in cost, the possibility of a positive earnings arbitrage, and the general view that POBs do not add to the debt burden of the state. Regarding the latter, he explained, "We already have the debt; we're just simply replacing it with a lower cost of debt." He said when he mentions "state" he is also including local governments. He relayed that the pension system is giving the state a bill which, in the reevaluation of 2006, totals \$8.6 billion. Of that, \$5.5 billion is the responsibility of the Public Employees' Retirement System (PERS), while \$3.1 billion belongs to the Teachers' Retirement System (TRS). He said the evaluation of 2007 has not yet been seen, but the prediction is that the bill will have increased.

MR. ANDREWS said there are two ways to pay off the bill: the state can pay it off with cash, or the pension plan - knowing the state's credit is good - can give the state a loan to pay off the bill over a 25-year period of time at a cost of 8.25 percent. He continued:

[8:40:44 AM](#)

So, we talk about interest rate savings; let me give you a simple example: The difference between 8.25 and 5.75 percent is 2.5 percent. On a billion dollars, we take a look at the principle and interest payment at 8.25 percent, and we will see that that annual payment is \$96 million a year.

If we can lower the cost down to 5.75 percent, we'll save 2.5 percent, or an annual savings of \$19 million a year. Now, we take that \$19, we times it times 25, and then we discount it back to 5 percent to bring it in today's dollars, and that's a savings of \$272 million for the system.

MR. ANDREWS stated that today's interest rate environment is a favorable one as related to using pension obligation bonds. He said last week the yield on the 10-year treasury was

approximately 4.5 percent. He said POBs can be issued in the market with a premium of approximately 100 basis points or 1 percent; therefore, he said last week's cost of issuing POBs would have been between 5.6-5.7 percent. More importantly, he related, today's interest rates are at the lowest level they have been since the late '60s.

[8:42:21 AM](#)

MR. ANDREWS addressed the issue of a positive earnings arbitrage, which he defined as "the difference between what we can achieve as an investment return on the proceeds of the bond issuance." He directed attention to the historical investment returns of PERS over the past 15 years [on page 7 of the PowerPoint], which show an average return of 9.09 percent. That takes into effect the bare market of 2000, which was the worst bare market since the 1929 Depression, he noted. Standard deviation, he explained, is a measurement of volatility, and shows at 7.25 percent. What that really means, he said, is that two-thirds of the time, a return of between 16.3 percent down to 1.8 percent can be expected. The next page of the PowerPoint, he noted, shows the returns for TRS, and they vary slightly from PERS, at 9.14 percent. He explained that the reason for the difference is timing of funds. He added, "But the portfolios are identical."

MR. ANDREWS reported that the pension plans exceeded a return north of 15 percent for the 2006 calendar year.

[8:44:11 AM](#)

GARY M. BADER, Chief Investment Officer, Treasury Division, Department of Revenue, reviewed the information on page 9 of the handout, titled, "Long Term Target Asset Allocation." He said there is an anticipated median return of 8.05 percent and plus or minus 12.27 percent. He explained, "Two-thirds of the time, you might expect the range of earnings to be as high as 20 percent, or it could be as low as a negative 4 percent." He said it is not his intention to suggest that there is no possibility to have negative earnings; however, the history of the pension fund is that they have earned north of 9 percent, and "that's the basis upon which we suggest going forward."

[8:45:53 AM](#)

MR. ANDREWS turned to the subject of credit rating consideration [on page 10 of the PowerPoint] and read the two quotes as follows:

Moody's believes the issuance of POBs is an effective way of addressing the unfunded liability.

Standard & Poor's has viewed POBs as a strategy for savings on carrying charges as long as the transactions are structured ... conservatively and the assumptions are reasonable and attainable.

[8:46:47 AM](#)

MR. ANDREWS addressed the subject of risks, directing attention to page 11 of the PowerPoint, entitled, "Investment Risk (PERS)." On the page are columns indicating rate of return, cost of borrowing, and cumulative net return for fiscal years 1992 through 2006. Some of the cumulative net returns for certain years show in the negative; however, he said if the bonds had been issued in those years at today's rate, the return would have been positive. He emphasized the importance of timing in issuing bonds. Twelve of the fifteen years shown on the chart showed positive returns, and Mr. Andrews reminded the committee that there are ten years yet to be shown, because the length of the bonds is 25 years.

[8:48:50 AM](#)

REPRESENTATIVE COGHILL remarked that he would be interested to compare the chart with the earnings of the permanent fund.

MR. ANDREWS said it would be possible to make that side-by-side comparison.

[8:49:21 AM](#)

REPRESENTATIVE GRUENBERG requested a list of any problems that have occurred for the 26 states currently using POBs.

MR. ANDREWS said he would provide that list for the committee.

REPRESENTATIVE GRUENBERG asked if [page 13 of the PowerPoint], "Investment Return Forecast," pertains to a risk, as well.

MR. ANDREWS answered no.

[8:50:44 AM](#)

MR. ANDREWS said page 13 shows the results of using a tool called "Monte Carlo Simulation." He explained that the past 25 years' returns of the S&P 500 and the government credit bond index are scrambled up "over 10,000 different reiterations," and out of that comes an idea of "what the confidence level is of achieving the cost of the bonds," which he said in today's environment is 5.75 percent. With all the various combinations of returns, based on a 70/30 portfolio, "you can see that we were able to achieve that cost of debt 91.45 percent of the time," he said, and from "the average annual return of all the samples in the Monte Carlo, we came up with 9 percent." He said that is similar to the investment that is currently coming from the pension plans.

[8:52:12 AM](#)

REPRESENTATIVE GRUENBERG said he wants the public to know that the legislature has "fully considered both sides of the issue" and has acted conservatively. He continued:

Looking at the other 8.5 percent, ... that says the probability of not outperforming. But in some of those 8.5 percent, have there been drastically bad results?

MR. ANDREWS responded:

Well, you can see what the results have been, but typically the results on average below 5.7 have been in the neighborhood of 4 percent.

REPRESENTATIVE GRUENBERG asked if there is any way to cut down that risk.

MR. ANDREWS said that issue can be discussed.

[8:53:32 AM](#)

MR. ANDREWS returned to the PowerPoint presentation, [to page 14, regarding "Security"]. He named the three categories under security: general obligation bonds, obligations imposed [by law], and annual appropriation bonds. He said POBs fall under the latter category. He explained that state and local governments have to annually budget and appropriate for the debt

service of the bonds so that they do not carry the full credit backing of the state.

[8:55:12 AM](#)

MR. ANDREWS turned to the issue of potential savings through proceeds from POBs and using cash to pay down the unfunded liability. He said "by doing that" there is an immediate reduction in the unfunded liability, an increase in the funding ratio related to the pension plans, and a reduction in the employers' contributions. He directed attention to a series of matrixes [for PERS and TRS, on pages 18 and 19, respectively], which show cash balances and proceeds that would come from a POB. He illustrated how the state could start paying down the unfunded liability rate to a normal contribution rate level. He highlighted some examples of savings for PERS and TRS.

[8:58:16 AM](#)

MR. ANDREWS directed attention to [pages 20-21 of the PowerPoint], relating to tax issues. He stated:

The reason that POBs are taxable bonds is that the IRS [Internal Revenue Service] takes a very dim view of using tax exempt privilege, as given to states and local entities for capital projects ..., for an earnings arbitrage play. And that very simply is why we look at issuing taxable bonds for pension obligations.

Now, having said that, the Department of Revenue is currently evaluating various tax exempt strategies that we ... could use. But at this point, those strategies ... have to be coincidental to the infusion of those proceeds back into the PERS and TRS programs; there cannot be a direct link, otherwise we will run afoul of the Internal Revenue Service, and we don't particularly want an audit at this time.

[8:59:36 AM](#)

MR. ANDREWS turned to the topic of "Take Aways," [shown on page 22 of the PowerPoint]. He paraphrased the four points on the page, which read as follows [original punctuation provided]:

POB issuance is a financial transaction which will lower the cost of funding the UAAL [unfunded actuarial

accrued liability] by the state and local governments
- POBs issued in the near future will be at a cost
lower than 8.25% charged by the pension system.

We are in a very favorable interest rate environment -
take advantage of it!

Risks associated with POB issuance are quantifiable
and statistically justified by the rewards.

Doing nothing is not a viable option.

MR. ANDREWS clarified the Department of Revenue's position on
POBs:

Over the long run, we believe that the POB program ...
that is prudently implemented has a high probability
of success.

[9:00:39 AM](#)

CHAIR LYNN expressed appreciation for Mr. Andrew's lucid
explanation of what could be a complicated subject.

[9:01:08 AM](#)

REPRESENTATIVE GRUENBERG asked what role POBs are playing in the
governor's overall strategy to pay off the unfunded liability of
PERS and TRS.

MR. ANDREWS responded that it is just one tool. In response to
a follow-up question from Representative Gruenberg, he said the
other options are to pay down the unfunded liability with cash
or to do nothing and continue to pay the exorbitant contribution
rates.

[9:02:31 AM](#)

CHAIR LYNN noted that there is a bill in the works that
addresses changing contributions rates.

[9:02:38 AM](#)

REPRESENTATIVE COGHILL, regarding credit rating, asked if there
is an industry standard.

[9:03:16 AM](#)

MR. ANDREWS said typically a rating agent would look for a funding that was no more than 80 percent of the unfunded liability. Exceeding that level may result in over funding in the future. The funds would be used for additional benefits to the pension plan, which would not call for the paying down of the debt. He clarified that it is possible to get into a situation where the proceeds from a bond issuance are overdone.

REPRESENTATIVE COGHILL, regarding case studies, asked what Mr. Andrews anticipates would be the bonding level. He said, "It seemed to me it must be over half a billion dollars."

[9:04:45 AM](#)

MR. ANDREWS said the example on page 18 uses a combination of \$500 million in cash and \$2 billion of POBs, which he said brings the funding level up to 92 percent.

[9:05:21 AM](#)

MR. ANDREWS, in response to a question from Representative Doll, said the combined total assets currently in PERS and TRS equal \$15 billion.

[9:05:34 AM](#)

REPRESENTATIVE COGHILL offered his understanding that "that \$15 billion represents somewhere just north of 60 percent ... of the actual, expected value of the payout."

[9:05:49 AM](#)

MR. ANDREWS confirmed Representative Coghill's statement is correct. He stated that the funding ratios of the pension plan versus the unfunded liability is between 60-65 percent.

[9:06:02 AM](#)

REPRESENTATIVE COGHILL concluded that the obligation bonds would help in managing the 25-30 percent unfunded liability. He said he wonders if the state would have to go beyond 90 percent.

MR. ANDREWS reiterated that an 80 percent funding level is considered reasonable.

[9:06:56 AM](#)

REPRESENTATIVE JOHNSON asked if local municipalities will also be able to issue POBs.

[9:07:24 AM](#)

MR. ANDREWS replied:

That's kind of moving target from the standpoint that the administration has also ... submitted a level-pay bill. If that level-pay bill goes through for the Public Employees' Retirement System, there's going to be some sort of ratio - taking the PERS program and making it look like TRS. What that funding ratio will be ... is the ratio that would be shared as a cost on the pension obligation bonds.

[9:08:01 AM](#)

MR. ANDREWS, in response to a follow-up question from Representative Johnson, said the simple answer is that the state will be issuing bonds.

[9:09:24 AM](#)

GREG SUNDBERG, Managing Director, Merrill Lynch, echoing Mr. Andrews' previous remark, said that POBs are but one tool in addressing the unfunded liability. He stated, "We think the state's approach to this, to date, has been extremely responsible."

[9:10:00 AM](#)

LINDSEY SOVDE, Vice President, Seattle-Northwest Securities Corporation (SNW), concurred with the remarks of Mr. Andrews.

[9:10:22 AM](#)

CHAIR LYNN closed public testimony.

[9:10:31 AM](#)

REPRESENTATIVE DOLL said she wants to get a sense of the risks involved related to increasing medical costs.

[9:11:08 AM](#)

REPRESENTATIVE HAWKER said:

Our unfunded pension liability exists because we have less financial resources - less money - in the pension trust than what we estimate the liabilities to be today. Where today ... - ... as Mr. Andrews pointed out - the most recent valuation was the \$8.6 billion shortfall, most of us are anticipating the new calculation to be in excess of \$10 billion.

As your question goes to what would ... a greater escalation in medical costs be to the future: It would actually widen that gap. ... With that larger unfunded liability clearly accumulating an even greater rate of interest, it makes it even ... more paramount that we take advantage of the ability to mitigate some of that (indisc. - coughing) cost.

The risk of future medical growth is not part of the market risk associated with a transaction like this at all.

[9:12:40 AM](#)

REPRESENTATIVE DOLL stated her understanding that some municipalities have paid into their pension funds and do not have any unfunded liability. She asked whether all cities or municipalities, whether paid up or not, would be expected to participate in the issuance of the proposed bonds.

[9:13:39 AM](#)

REPRESENTATIVE HAWKER said many of the questions that Representative Doll is raising are addressed by other bills currently in the legislature. He offered further details.

[9:14:55 AM](#)

REPRESENTATIVE GRUENBERG said he would support the movement of HB 13 at the earliest opportunity; however, he said he would like Mr. Andrews to answer his questions pertaining to risks.

[9:15:32 AM](#)

REPRESENTATIVE HAWKER noted that in the committee packet is a primer regarding pension bonds published by the Orrick Organization. He said the primer offers a background on risk

analysis, including specific case histories where entities have unadvisedly "entered into transaction."

[9:16:18 AM](#)

MR. ANDREWS said there are two factors that seem to have a high correlation with an "unsuccessful issuance." The first, he said, is related to the timing into the market. He explained that he is talking about the interest rate cost that is paid on the POBs. Typically, he said, the entities that issued bonds from the late '90s through the early 2000s did so at a high interest rate, and that high interest rate worked against them. He relayed that HB 13 includes language that controls that by requiring a positive interest rate arbitrage of 1.5 percent before the bonds can be issued.

REPRESENTATIVE GRUENBERG said he would like the record to reflect where in bill this problem is addressed.

[9:19:06 AM](#)

REPRESENTATIVE HAWKER said that language appears on page 14, [lines 25-30], which read as follows:

Sec. 37.16.080. Purposes and sufficiency of revenue. The proceeds of bonds may be used for the purposes described in AS 37.16.030(a), as appropriate. Bonds may not be issued unless the corporation first finds that the actuarially assumed rate of return on the funds managed by the Alaska Retirement Management Board is projected to exceed the true interest cost to be paid on the bonds by at least 1.5 percent annually.

REPRESENTATIVE HAWKER said that 1.5 percent shows up anywhere in the bill where there is an authority for any state or public agency to conduct transactions.

[9:19:55 AM](#)

MR. ANDREWS said the second factor that has weighed against the issuance of POBs is when an issuing entity has taken the proceeds from the sale of bonds and used them to fix "other budgetary purposes or problems" rather than using them to lower the unfunded liability.

REPRESENTATIVE GRUENBERG asked, "Is that prohibited in the bill?"

REPRESENTATIVE HAWKER replied, "I do not know that we have a specific prohibition there, but the authority is specifically for the purpose of addressing unfunded pension liabilities."

REPRESENTATIVE GRUENBERG asked, "To be absolutely sure, shouldn't we add a provision that does that?"

REPRESENTATIVE HAWKER deferred the question to a representative of the Department of Law, remarking that he is not qualified to answer legal questions.

[9:21:26 AM](#)

MIKE BARNHILL, Assistant Attorney General, Labor and State Affairs Section, Civil Division (Juneau), Department of Law (DOL), said he believes the bill requires proceeds of the bond issuance to be paid to the commissioner of the Department of Administration into the pension fund; therefore, he said he does not believe any additional language would be required to ensure that action. He added, "The Bond Council will require that in the bond documents - that the money be used for that purpose - so, I don't think there's any conceivable way the money could be diverted to some other purpose."

[9:22:12 AM](#)

REPRESENTATIVE GRUENBERG said he knows bond council members are among the most careful and cautious members of the legal profession. He asked Mr. Andrews if there are any other risks that he would like to state for the record.

MR. ANDREWS stated that there is no guarantee of a positive earnings arbitrage; however, records have proven that over the long haul the cost of the POBs are typically covered by the investment results.

REPRESENTATIVE GRUENBERG asked for discussion regarding Section 1 of the bill. He asked about a single system, whether or not TRS would be changed, and how the school district would be affected according to size and financial ability.

[9:24:19 AM](#)

REPRESENTATIVE HAWKER noted that as chair of the House Special Committee on Ways and Means, he had promised to Representative Seaton to "address that specifically on the record in this committee." He said:

The short answer is ... no, as contemplated in the bill, it would not affect the single rate structure of TRS

MR. ANDREWS concurred with Representative Hawker's statement. He continued:

What Representative Hawker's trying to do in HB 13 is provide a lot of optionality out there. And because the TRS is a single-pay system, typically, this is a call on the state's general fund. So, through [those] mechanisms, all the Teacher's Retirement Systems will be participating in this indebtedness in an equal fashion.

[9:25:48 AM](#)

REPRESENTATIVE COGHILL said it always pains him to create another government corporation, but this one would be singularly focused. He directed attention to page 10, Section 8, of the bill, and he asked, "Is there a need to transcend a particular administration, and do we need to put something in here that gives us that kind of continuity between administrations?"

REPRESENTATIVE HAWKER responded that continuity already exists within the state. He said:

The real cohesiveness that transcends the temporal nature of any individual administration ... is that we're dealing with very contractual obligations ... that are very specific, legal documents, very carefully scripted And so, the combination of the bond indenture agreements ... that any debt issuance entails, and the continuity of bond council ..., really, in our case, I believe, compensates for the inherently temporal nature of folks that serve at the will of the people of the state.

[9:29:22 AM](#)

REPRESENTATIVE HAWKER, in response to Representative Coghill, said the legislature's responsibility is to come up with \$10 billion to pay off the unfunded liability. The proposed legislation proposes one tool to meet the challenge.

[9:30:09 AM](#)

MR. ANDREWS added that in the bill there is a cap of \$5 billion for the issuance of POBs. In response to Representative Coghill, he confirmed that relates to half the obligation.

REPRESENTATIVE HAWKER said it would be imprudent to fund 100 percent of the obligation, because market prices will go up and down in the future. There is nothing in the HB 13 that would prohibit future administrations or legislatures from changing direction.

[9:32:31 AM](#)

REPRESENTATIVE COGHILL said Alaska can be low on funds one day and "awash" the next. He said it could be possible for the state, through a windfall, to pay off the top 50 percent and still retain a bonding rate that "then we put in tension what that bonding rate could be." He said that is a discussion he hopes the legislature gets to.

REPRESENTATIVE HAWKER said Representative Coghill is absolutely correct. He stated that he is willing to put more of today's surplus into the pension plans than many legislators are, because he thinks that is one of the best investments that the state has. He indicated that money put into the constitutional budget reserve (CBR) only earns about 3.7 percent. The bill provides the authority for the state to defease obligations in the chance that a windfall occurs.

[9:34:28 AM](#)

REPRESENTATIVE GRUENBERG directed attention to page 10, lines 18-22, AS 37.16.020. He noted that the three directors would all be commissioners who are subject to removal at the pleasure of the governor. He stated that that makes the board vulnerable to changes within the administration. He asked if other boards are set up in such a manner that they are subject to a strong executive, or if there is any broader control. He explained:

The reason I'm saying this is because there is quite a difference between the last administration's view of this concept and this. ... It's not just a question to me of whether we might have a problem ... once the bonds are set up, but whether we would be ... wisely or unwisely prevented from issuing new bonds when we should. How much independence is there? How would

that affect the bond rating? How have other jurisdictions dealt with that particular issue?

[9:36:16 AM](#)

REPRESENTATIVE HAWKER said he thinks what is most relevant is the constitution under which Alaskans live. Alaska has one of the strongest executive branches. Commissioners of the various state departments enjoy much greater powers than they do in other states. Is said it is most important to consider "how this issue functions in Alaska" and what the "appropriate mitigating controls over political volatility" would be. He said the financial market provides the greatest consistency and control over both a renegade commissioner and board of directors; the market itself is the single, greatest mitigating control. That market is comprised of the people purchasing bonds, the underwriters, and the legal community who structures the transactions.

[9:38:12 AM](#)

REPRESENTATIVE GRUENBERG moved to report CSHB 13(W&M) out of committee with individual recommendations and the indeterminate fiscal note.

REPRESENTATIVE HAWKER explained that the fiscal note is indeterminate because the bill does not authorize or empower any individual transaction; it gives the state the authority "to pursue them and bring them back to us."

CHAIR LYNN announced that without objection, CSHB 13(W&M) was reported out of the House State Affairs Standing Committee.

The committee took an at-ease from [9:39:07 AM](#) to [9:40:43 AM](#).

[9:40:56 AM](#)

CHAIR LYNN discussed the upcoming committee calendar.

ADJOURNMENT

There being no further business before the committee, the House State Affairs Standing Committee meeting was adjourned at [9:41:28 AM](#).