

HOUSE FINANCE COMMITTEE

April 13, 2016

8:37 a.m.

8:37:58 AM

CALL TO ORDER

Co-Chair Thompson called the House Finance Committee meeting to order at 8:37 a.m.

MEMBERS PRESENT

Representative Mark Neuman, Co-Chair  
Representative Steve Thompson, Co-Chair  
Representative Dan Saddler, Vice-Chair  
Representative Bryce Edgmon  
Representative Les Gara  
Representative Lynn Gattis  
Representative David Guttenberg  
Representative Scott Kawasaki  
Representative Cathy Munoz  
Representative Lance Pruitt  
Representative Tammie Wilson

MEMBERS ABSENT

None

ALSO PRESENT

Senator Cathy Giessel, Sponsor; Brodie Anderson, Staff, Representative Steve Thompson; Kevin Anselm, Director, Division of Banking and Securities, Department of Commerce, Community and Economic Development; Representative Charisse Millett, Sponsor; Brad Keithly, President, Keithley Consulting, LLC; Senator Bill Stoltze.

PRESENT VIA TELECONFERENCE

Renee Wardlaw, Assistant Attorney General, Department of Law, Anchorage.

SUMMARY

HB 194 AK SECURITIES ACT; PENALTIES; CRT. RULES

HB 194 was HEARD and HELD in committee for further consideration.

HB 311 SUSTAINABLE BUDGET REPORTING

HB 311 was HEARD and HELD in committee for further consideration.

SB 170 DNR FEES FOR GEOLOGICAL SERVICES

CSSB 170(RES) was REPORTED out of committee with a "do pass" recommendation and with one previously published fiscal note: FN2 (DNR).

Co-Chair Thompson discussed the meeting agenda.

#sb170

CS FOR SENATE BILL NO. 170(RES)

"An Act authorizing the Department of Natural Resources, division of geological and geophysical surveys, to collect fees for facilities, equipment, products, and services; relating to accounting for certain program receipts; and providing for an effective date."

[8:38:48 AM](#)

SENATOR CATHY GIESSEL, SPONSOR, relayed that the bill was another revenue generating step for the Department of Natural Resources (DNR). She relayed that the Geologic Materials Center (GMC) functioned as the main repository for geologic materials from all over Alaska and was similar to a library; i.e., companies and agencies went to the GMC to look at the rocks and determine mineral content or other information regarding resource extraction. She elaborated that the materials had been stored in conex boxes and were degenerating. The department purchased a shuttered retail building "a couple years ago" at a reduced price, located in Eagle River and converted it to the GMC. She detailed that Repsol had discovered "promising materials" in the GMC that led to their recent oil discovery in the Colville Delta that could contain 500 million to 3.7 billion barrels of oil. The bill allowed DNR to set and collect fees for entry into the GMC and use of its facilities. She referenced page 2, lines 25 through 26 of the legislation that was modified in the Senate Resources Committee that

allowed student's free admission. She reported that the fiscal note pointed to revenue generation through program receipts.

Co-Chair Neuman stated that he liked the concept. He asked about viewing areas. Senator Giessel replied that there were many shelves of sample cores as well as viewing rooms where cores from certain areas could be examined.

Co-Chair Thompson OPENED public testimony.

Co-Chair Thompson CLOSED public testimony.

Vice-Chair Saddler discussed the fiscal note from DNR. He noted that the fiscal note (FN 2 (DNR)) included revenue estimates.

[8:44:37 AM](#)

Co-Chair Neuman MOVED to REPORT CSSB 170(RES) out of committee with individual recommendations and the accompanying fiscal note.

CSSB 170(RES) was REPORTED out of committee with a "do pass" recommendation and with one previously published fiscal note: FN2 (DNR).

[8:45:04 AM](#)

AT EASE

[8:48:03 AM](#)

RECONVENED

#hb194

HOUSE BILL NO. 194

"An Act repealing and reenacting the Alaska Securities Act, including provisions relating to exempt securities and transactions; relating to registration of securities, firms, and agents that offer or sell securities and investment advice; relating to administrative, civil, and criminal enforcement provisions, including restitution and civil penalties for violations; allowing certain civil penalties to be used for an investor training fund; establishing increased civil penalties for harming older Alaskans; retaining provisions concerning corporations organized

under the Alaska Native Claims Settlement Act; amending Rules 4, 5, 54, 65, and 90, Alaska Rules of Civil Procedure; and providing for an effective date."

8:48:10 AM

Vice-Chair Saddler MOVED to ADOPT the proposed committee substitute for HB 194, Work Draft 29-GH1060\G (Bannister, 4/12/16). There being NO OBJECTION, it was so ordered.

BRODIE ANDERSON, STAFF, REPRESENTATIVE STEVE THOMPSON, explained the changes in the Committee Substitute. He related that the change corrected language from a conceptual amendment adopted in the previous committee to match the intent of the amendment. He delineated that one correction was located on page 101, line 2 and deleted the number 19 that was replaced by the number 18. He explained that the number reflected the age of maturity. In addition, on page 101, line 5, the words "or disappearance" were deleted and the words "dementia or Alzheimer's disease" were inserted.

KEVIN ANSELM, DIRECTOR, DIVISION OF BANKING AND SECURITIES, DEPARTMENT OF COMMERCE, COMMUNITY AND ECONOMIC DEVELOPMENT, reported that the legislation was a re-write of the Alaska Securities Exchange Act and much of the language remained the same. She provided a brief overview and highlighted the changes. She outlined that the bill separated securities statutes from the Alaska Native Claims Settlement Act (ANCSA) related statutes to reduce confusion and improve the understanding of both acts. The bill removed the securities statutes in AS 45.55 and added a new chapter, 45.56. The legislation "synthesized" the Securities Act with other state's laws by adopting relevant provisions of the Uniform Securities Act (2002) to make it easier for businesses, entrepreneurs, and investors to understand their rights, responsibilities, and opportunities. She furthered that the bill recognized and incorporated current securities industry terms and standards. The legislation opened equity crowd funding opportunities and derailed investment scams by increasing civil penalties. The penalties could be used to provide investor, consumer, and entrepreneurial education via legislative approval. Finally, HB 194 tripled penalties for offences against senior citizens or vulnerable adults. She provided background regarding the securities industry in Alaska. She reported that by the end of 2015 the state had 1,234

registered broker/dealer firms, however only one firm was Alaskan. She remarked that Alaska had 765 investment advisors and only 30 firms were "domiciled" in the state. In 2015, 90,340 financial sales persons were licensed in Alaska and less than 1000 were domiciled here. She observed that the state received 6,600 securities filings each year and most were from out-of-state. In general, the industry was compliant with state laws.

Representative Munoz joined the meeting.

Ms. Anslem continued to address the bill. She relayed that Alaska's security industry paid approximately \$13 million per year in licensing and filing fees and the bill did not affect the fees. The budget for the division was \$3.5 million per year. She informed the committee that the division investigated and took enforcement action against securities firms, agents, and issuers, if necessary. In the last four calendar years the division had taken 54 actions against securities related firms and sales persons. She offered that most actions were settled through consent agreements, and all civil penalties went directly to the General Fund (GF). The division took default orders against the six cases that weren't settled. She discussed three of the unsettled cases to emphasize the importance of the enforcement actions and passage of the bill. She indicated that the current maximum fine was only \$25,000 per respondent no matter how many violations were committed.

[8:55:46 AM](#)

Ms. Anslem read the following from prepared notes:

13-1095-S, Fortune Oil & Gas, Russell Vera and R. Gerald Bailey: On February 3, 2014, the Division issued a Final Cease and Desist Order that included the MAXIMUM civil penalty of \$25,000 against Respondents for selling over \$3.1 million in unregistered limited partnership interests in Texas Oil and Gas ventures, mainly to Alaskan investors.

14-1442-S, Global Arena Capital Corp.: On October 23, 2015, the Division issued a Final Cease and Desist Order that included a civil penalty of \$150,000 against Global Arena and six of its employees for violations of the Alaska Securities Act. Specifically, an employee of Global Arena contacted an

elderly Alaska halibut fisherman in poor health and sold him junk bonds, although the investor believed he was buying something like a CD. The investigation revealed that the agents were instructed to offer and sell the junk bonds as "safe investments." The fisherman invested \$27,000 in the bonds, which rapidly lost value. The firm even attempted to sell the investor other bonds, including one that would not reach maturity until the investor was 119 years old. The investment lost nearly \$16,000. Global Arena was cited for deceptive and misleading representations and offering unsuitable securities. Currently, the Division can only get money back for a defrauded investor with an agreement with a bad actor to pay restitution directly to the investor. In this case, the Division successfully negotiated with one of the respondents to pay restitution to the investor. The Division may be able to recover some of the penalties through a SIPC action since the firm is now out of business.

15-1520-S/15-1520-2-S, Garden State Securities/Garland James: Garland James, previously an agent at Global Arena Capital Corp., went to work for Garden State. He cold-called the same elderly Alaskan fleeced by Global and tried to sell him \$82,000 of a risky biotechnology stock. When he made the call, James was not registered as a broker-dealer agent in Alaska. The Division entered into a consent agreement with Garden State to withdraw its registration in Alaska and pay a \$25,000 civil penalty (maximum) for failing to supervise James. The Division issued a Temporary Cease and Desist Order against James on March 21, 2016 for unregistered activity and for offering an unsuitable security to the investor, seeking a \$25,000 civil penalty.

12-85-S, Troy Stafford and Patrick Williams: Stafford and Williams formed an Alaska LLC, GS Capital and WS Seafood. Stafford offered an Alaska resident an opportunity to invest \$40,000 in WS Seafood and employment. Stafford also stated, falsely, that another corporation had promised a \$10 million loan to assist the endeavors. The investor invested his money. The deal fell through and the investor never received the promised management role. The Division negotiated a settlement with the respondents, requiring them to

offer rescission to the investor, which respondents agreed to do and promised to pay, even filing a notice of rescission with the Division. Respondents never paid the investor as promised. The Division issued a Cease and Desist and received a court order to enforce it.

Ms. Anslem stressed that in regards to the last case; no statute mandated payment by the perpetrators to the investor. The current version of the legislation authorized enforcement. She continued to read the following:

This bill would change the maximum civil penalty per violation to \$100,000. You can see that with the kinds of cases we are talking about, there would be a wider range of potential civil penalties. The fines imposed for the six cases that I mentioned were \$525,000. Under the provisions in HB 194, the potential fines could have reached over \$7,000,000. Of course, one never knows what can actually be collected. Accordingly, we can't promise revenues with any certainty, thus the indeterminate fiscal note.

[9:01:02 AM](#)

Co-Chair Thompson asked about the importance of the legislature adopting HB 194 during the current session. Ms. Anslem considered the bill critical. She explained that the division had worked for a number of years to update the securities law. She believed the legislation helped with revenue generation by increasing the civil penalties for businesses that harm Alaskans.

Vice-Chair Saddler asked what specific sections or elements of the bill were the most critical. Ms. Anslem replied that most of the Alaska specific provisions dealt with exemptions from registration and carried over from the original act. She pointed out that the state had special exemptions for certain fishing cooperatives, the Commercial Fishing and Agricultural Bank (CFAB), and some mining exemptions. Vice-Chair Saddler asked whether there were sections or elements of the bill that were "more critical than the others." Ms. Anslem answered that the enforcement and crowd funding provisions were critical. She thought that the provisions that were the least critical were the exempt security sections: Article 1, 2, and 4, which

remained very similar to the original. She deduced that another important element allowed the legislature to allocate up to one third of the funds collected from civil penalties for consumer and investor education. She revealed that consumer and investor education was part of the division's mission but currently was not funded.

[9:04:51 AM](#)

Vice-Chair Saddler asked whether there were elements of the bill that required conformity with federal requirements. Ms. Anslem replied that there were a number of federal requirements that had evolved over time but were already referenced in the law. She elaborated that securities law was comprised of two components: a federal overlay, and a "blue sky law" that all states administered. One layer, the national securities law governed individual investors, dealers, and financial markets operations. She furthered that localized securities laws were handled by individual states. Alaska's laws written in alignment with other states aided business and investors, which allowed them to cross state lines and maintain compliance with federal and state laws.

Vice-Chair Saddler noted that the National Conference of State Legislatures (NCSL) and the Council of State Governments issued uniform laws and recommendations. He asked who produced and administered the Uniform Securities Act.

RENEE WARDLAW, ASSISTANT ATTORNEY GENERAL, DEPARTMENT OF LAW, ANCHORAGE (via teleconference), answered that the National Conference of Commissioners on Uniform State Laws [also known as the Uniform Law Commission (ULC)] drafted the legislation.

Representative Wilson stated that she had not vetted the bill. She referred to the provisions on criminal enforcement that changed "willful" violation to "knowing" violation and asked for an explanation. Ms. Anslem responded that the Uniform Securities Act had included the term "willfully" that meant "intentionally." The Legislative Legal Services Agency attorney's requested the change to "knowingly." She clarified that the legal determination regarding state of mind and culpability in criminal law (Mens Rea) was hierarchically categorized as intentionally, knowingly, recklessly, and negligently.

Knowingly was a lesser standard. Representative Wilson asked for verification that the standard for criminality was being lowered. Ms. Anslem replied in the affirmative. She cited AS 11.81.900 as the statute that contained the language.

9:09:40 AM

Representative Wilson asked whether the division or court proceedings determined whether violations occurred and dispensed penalties. Ms. Anslem responded that there were three different types of actions that could be taken. She detailed that the first action was administrative taken by the Department of Commerce Community and Economic Development (DCCED). The second action was civil taken by either DCCED or "a private cause of action." The third action was criminal, taken by DCCED or the state. She clarified that the department had not taken on a criminal case to date and the Department of Law (DOL) could take criminal action if a case arose in a context outside of DCCED. Representative Wilson surmised that the department could find someone guilty through an administrative action and the new provisions could enact penalties up to \$100,000 in restitution. She asked whether the department could add additional fines. Ms. Anslem replied that the civil penalty would be up to \$100,000 per violation although the amount was typically negotiated on a consent basis. She stated that restitution was different. She explained that restitution was usually a repayment of lost money and that imposing both was possible. Representative Wilson wondered about the administrative appeal process. Ms. Anslem answered that an appeal was heard in the Office of Administrative Hearings and that decisions could be appealed to Superior Court. Representative Wilson contended that she had issues with the administrative hearing process.

Co-Chair Thompson noted that Representative Edgmon had joined the meeting.

Representative Pruitt wondered what the state could have done differently for the elderly gentlemen in the case against Garden State Securities if the new provision in HB 194 had been enacted at the time. Ms. Anslem answered that the state would have been able to order restitution and fine the firm for failure to supervise employees. The state would have been able to take action against every manager

in the firm involved in instructing brokers to mislead investors. The findings would have led to the amount of culpability and the fines would have been adjusted accordingly. Representative Pruitt asked whether Garden State Securities was registered outside of Alaska. Ms. Anslem replied that Garden State was a New York firm. Representative Pruitt asked how the division enforced the law outside of Alaska and whether enforcement was part of the uniform law. He asked whether the laws assisted Alaska to pursue enforcement outside of the state. Ms. Anslem answered in the affirmative. She detailed the North American Securities Administrators Association facilitated states working together via very strong agreements among each other. She observed that often violations were not occurring in just one state and joint investigations were common.

[9:16:42 AM](#)

Co-Chair Neuman asked whether the bill created a board or a committee. Ms. Anslem replied in the negative. Co-Chair Neuman asked whether any businesses were currently working in Alaska that would be impacted by the bill. Ms. Anslem responded that any of the changes in the bill did not apply to transactions that took place before the effective date of July 1, 2016. Co-Chair Neuman thought that businesses were not required to have an Alaska business license to practice in Alaska. Ms. Anslem replied that the question was related to the Division of Boards and Professional Licensing (CBPL) regarding whether a specific business was required to have a license. She commented that most of the firms in Alaska did have a business license in the state. Co-Chair Neuman referred to a "snow bird" carve out. Ms. Anslem answered that the snow bird carve out applied to firms that had clients from another state that travelled to Alaska and permitted the firms to carry out three transactions without being separately licensed. Co-Chair Neuman noted that via statute, money received from court judgements went into the General Fund. Ms. Anslem replied that HB 194 would not change the statute.

Representative Guttenberg spoke about a letter from Samuels Yoelin Kantor LLP - Robert Banks dated February 1, 2016 (copy on file) that reported an issue with variable annuities for customers and brokers. He wondered why variable annuities were allowed to be sold in the state. He stated that he could not find the statute AS 45.56.605 (f)

as cited in Mr. Banks letter in the bill or summary of changes (copy on file). He wondered whether the provision was deleted. Ms. Anslem replied in the affirmative - it had been removed from the current version of the bill. She explained that the Division of Insurance was the primary regulator of variable annuities, which were federally considered a security. However, states could regulate variable annuities depending on what provisions of the Uniform Securities Act a state adopted. Upon request by the insurance industry, the division chose not to adopt federal provisions relating to variable annuities.

[9:21:25 AM](#)

Representative Guttenberg noted the importance Mr. Banks placed on the adopting the provisions. He asked how the regulations were "being covered" under the Division of Insurance. Ms. Anslem responded that the Division of Insurance was and always had been the sole regulator of variable annuities. Representative Guttenberg asked whether additional rules should be placed in the bill no matter who the regulator was. Ms. Anslem replied in the negative. She thought that the issue required more review and that the division might revisit the issue. Representative Guttenberg asked whether there was a history of problems with variable annuities in Alaska and wondered why the provisions were being left out of a bill dealing with conforming to national standards. He remarked that the letter reported issues related to lack of conformity to national standards. Ms. Anslem responded that issues around variable annuities were different in other states depending on the strength of its regulations. She offered that variable annuities were regulated on a national level by the Securities Exchange Commission (SEC) the successor [Financial Industry Regulatory Authority, Inc. (FINRA)] to the National Association of Securities Dealers who required licensing. The department licensed variable annuities brokers through both the Division of Banking and Securities and the Division of Insurance. She informed the committee that the insurance division had the sole authority to regulate variable annuities under Chapter 21 and provisions under 45.56 would be additional to the insurance division's regulations. She revealed that the decision had been made between the Division of Insurance and the insurance industry to do further study to determine how well the state was regulating the annuities. Representative Guttenberg asked whether there was a problem with the sale

of variable annuities in Alaska. Ms. Anslem answered that there had been complaints, but she did not characterize them as a problem.

Representative Gattis asked whether there were provisions in the legislation that were imperative to pass in the current session. She felt the bill was immense and wanted to be sure the committee did its due diligence but realized there were essential "clean-up" provisions that were necessary.

[9:25:43 AM](#)

Ms. Anslem replied that the bill had a number of hearings through prior committees: House Labor and Commerce and the House Judiciary Committee. She deemed that the most important issues were enforcement, civil penalties and restitution, and consumer education. She expounded that the issues were about the protection of Alaskans and educating the public to protect them from "getting ripped off" and made aware of the resources available. Representative Gattis acknowledged that there was a lot of cleanup in the bill that could be done and wondered where emphasis could be placed. She wanted to know why passage of the bill "was pressing" in the current session. Ms. Anslem replied that the bill had been in process for the past 6 years in order to bring the state in compliance with the most recent act from 2002 and enable alignment with other states. She felt that passage of the bill was important for economic development in the state. In addition, the crowd funding provisions represented a new opportunity for Alaskans that authorized investing up to \$5000 per year on Alaskan businesses and start-ups. She noted that SB 126 (Small Security Offerings) sponsored by Senator Mia Costello dealt with the issue and was moving through the legislature. She remarked that the crowd funding provisions were regulated solely by the state.

[9:29:45 AM](#)

Representative Munoz asked about the 90,000 registered agents. She asked whether the number was unusually large compared to other states. Ms. Anslem answered that the number was a larger per capita number than in other states but not the largest. She indicated that one of the largest draws was Alaska's higher per capita income and higher per capita net worth. She believed that without solid

enforcement opportunities the state would continue to be a target for offences. Representative Munoz asked whether crowd funding statutes existed in current state law. Ms. Anslem answered in the negative. She remarked that the only crowd funding allowed was through internet option like Kick Starter and the investor did not expect to get a return on investment. However, with equity crowd funding, returns on investment or other remunerations were possible. Representative Munoz asked whether the \$5000 was a cumulative cap. Ms. Anslem answered that the limit was \$5,000 per investment. Representative Munoz asked how violations were discovered. Ms. Anslem responded that cases were often referred to the division through federal or state law enforcement, complaints, the Securities Exchange Commission, and from a number of other sources such as the National Association of Securities administrators.

[9:33:01 AM](#)

Vice-Chair Saddler noted that the fiscal note did not include or mention funding for consumer education. He asked for further information. Ms. Anslem replied that consumer protection was part of the department's mission. She provided the example of a \$25,000 securities penalty collected, which allowed for approximately \$8,000 to be deposited into an account under the control of the legislature who could appropriate the funds for consumer education and outreach events. Vice-Chair Saddler wondered how much money could possibly become available. Ms. Anslem answered that the penalties would have totaled approximately \$7,000,000 and up to one third of the funds could have been appropriated for consumer education based on the cases she exemplified, under the maximum fines established in the bill.

Representative Pruitt asked how long the division had been working on the bill. Ms. Anslem replied that work on the bill had been in progress since 2008.

Co-Chair Thompson recalled hearing a version of the bill in the House Judiciary Committee six years earlier.

Representative Pruitt asked about restitution and how the issue was addressed in the legislation. Ms. Anslem responded that restitution needed to be paid before an action was cleared.

9:37:33 AM

Representative Pruitt asked about the crowd funding component of the bill. He asked whether the bill mirrored other states regulation or whether it was adjusted for Alaska. Ms. Anslem answered that the crowd funding provisions in the bill were simpler when compared to other states. The crowd funding was a simple process that helped get entrepreneurs off the ground. The bill did not require escrow but required compiling information about the business but excluded a business prospectus requirement due to the small population of the state and resulting transparency. She noted that the cost to require use of a broker dealer was very high and not included in the legislation. Her goal was to ensure that the information about the business provided to the investor was accurate. The state was considered a "full disclosure" state but not a "merit" state. Representative Pruitt asked if the bill ensured crowd funding consumers that "if something went sideways they would potentially be made whole." Ms. Anslem replied that it was related to the same provisions she had already discussed. Representative Pruitt asked about the mechanism to safeguard that the new business was legitimate. He asked what elements were in place to ensure oversight. Ms. Anslem answered that the elements included; a filing requirement that was scrutinized by securities examiners, background checks, and Alaska residency. She characterized equity crowd funding as "Alaskans for Alaska." Representative Pruitt asked how the division executed consumer education. Ms. Anslem replied that the division worked closely with the SEC who provided presentations and seminars as well as the American Association of Retired Persons (AARP) and acquired joint grants through the Investor Protection Trust to produce a series of 30 minute programs that were broadcast through KTOO TV on the 360 degree North Channel and reached 250,000 viewers per year. The division participated in all kinds of community events; small and large.

9:44:00 AM

Representative Wilson wondered what had been the sticking point on the bill over the past six years to stall adoption. Ms. Anslem answered that the bill was complex and the rewrite made the issue appear "bigger" than it was. She noted that the ANCSA issue was intermixed with securities and had been a real impediment to updating the securities

act because most of the securities act did not apply to ANCSA. She believed that separating the statutes would be beneficial to all parties. Representative Wilson surmised that the bill sounded good, but she did not know enough about it. Her biggest concern was related to administrative hearings versus court hearings. She was concerned about lowering the threshold for guilt. She asked whether the industry received notification and had a chance to weigh in on the bill. Ms. Anslem answered in the affirmative and pointed to the issue involving variable annuities.

Co-Chair Thompson OPENED public testimony.

Co-Chair Thompson CLOSED public testimony.

Co-Chair Thompson understood the concerns of the committee based on the bill's large size. He noted that the bill had been well vetted by two other committees. He spoke to the fiscal notes and reported that two were zero and the other for the Department of Revenue was indeterminate but had a minimal impact. He communicated that the legislation protected consumers, vulnerable individuals, and provided for restitution among other benefits. He asked for discussion regarding reporting the bill out of committee due to the facts that only several days of session remained and CCED thought that the bill would be adopted by the Senate.

[9:48:34 AM](#)

Representative Wilson appreciated the Co-Chair's comments and the consumer protection afforded in the bill. She understood that the bill had been vetted and she acknowledged that there was a companion bill in the other body. However, she wanted more time to answer her concerns regarding lowering the criminal threshold and to familiarize herself with all of the provisions in the bill.

Representative Gattis requested more time to look at the bill in order to gain more clarity.

Vice-Chair Saddler echoed the comments by the previous speakers and asked for more time to review the legislation.

HB 194 was HEARD and HELD in committee for further consideration.

#hb311

HOUSE BILL NO. 311

"An Act requiring the governor's fiscal plan to include certain information."

9:52:22 AM

9:52:50 AM

AT EASE

9:56:04 AM

RECONVENED

9:56:15 AM

REPRESENTATIVE CHARISSE MILLETT, SPONSOR, introduced herself.

9:56:25 AM

REPRESENTATIVE CHARISSE MILLETT, SPONSOR, explained that the bill was an additional tool to help the budgeting process by calculating a sustainable amount that the state can reasonably spend on funding government each year. The bill would accentuate a sustainable budget plan and not compete against one. The legislation took into consideration all of the budgetary mechanisms the state already employed to calculate a "sustainable spend." She believed that the bill was a "fiscal planning tool" and was "relevant" to the budget crisis. She shared that she had worked extensively with Dr. Scott Goldsmith, Institute of Social and Economic Research, University of Alaska Anchorage, (ISER) who currently retired. During the process of crafting the bill the amount of \$4.5 billion was calculated as the sustainable budget amount. She felt that by determining the state's capacity for spending each year the bill was "generational". She believed the bill complemented any fiscal plan implemented by the legislature.

9:59:32 AM

Representative Gattis asked whether the bill would hold the legislature accountable. She noted her frustration with other fiscal plans was that they did not hold the

legislature or future legislatures accountable to a spending limit and she would judge the legislation based on accountability.

Representative Guttenberg voiced that he had seen similar legislation over the years. He believed that it was very difficult in the end to develop a "one page snapshot" so that everyone could understand and base policy around the information. He thought that the approach was important and beneficial and should happen every year regardless of passage of the bill.

Representative Gara appreciated the bill. He spoke to the requirements mandating the governor to issue a report regarding incoming revenue excluding the net present value of oil reserves and wondered why. Representative Millett replied that the answer would be forthcoming through the slide presentation on how ISER set up the calculation.

Vice-Chair Saddler voiced that he did not see anything that precluded including future oil reserves and did not find the word sustainable in the legislation.

BRAD KEITHLY, PRESIDENT, KEITHLEY CONSULTING, LLC, provided a PowerPoint presentation titled "HB 311: Sustainable Budget Reporting" dated April 13, 2016 (copy on file). He relayed that he would discuss the background, objective, and implementation of the legislation. He moved to slide 3:

#### Background

- HB 136 (28th Legislature)
- Hearings on HB 136:  
Apr. 5, 2013 (full Committee)  
Jan. 9, 2014 (Fiscal Policy Subcommittee)
- HB 311 is the same bill

In preparation for the 2013 testimony Dr. Goldsmith and I prepared a work draft that improved some provisions.

We have included that work draft here as part of this testimony.

Mr. Keithley relayed that the bill had originally been introduced as HB 136 during the 28th legislature. The work draft was included in the bill's backup file and could be adopted as a Committee Substitute. He turned to slide 4 which contained a quote from Dr. Scott Goldsmith:

#### Objectives

- Requires the Administration to calculate and submit each year as part of the December budget process a long term sustainable budget number

"A spending level based on current financial assets and the projected future petroleum revenue stream which, if adopted now, could be maintained consistently long into the future, adjusted for inflation and population growth"

Mr. Keithley thought that the bill's objective to annually calculate a long-term sustainable budget number was simple. He noted that the methodology was considered the "Goldsmith approach." He discussed the historical volatility of the price of oil and the resulting revenue ups and downs as well as spending highs and lows. He moved to slide 4 and referred to the table depicting different sources of revenue to the state in various colors. He listed the income sources considered in the Goldsmith model; Constitutional Budget Reserve (CBR), other taxes, current oil sources, incremental oil revenues from new oil, revenues from the AKLNG Project, divert earnings from the Permanent Fund deposit, and Permanent Fund Dividend (PFD) Earnings Reserve funds. He explained that the black line was calculated by the model and depicted a steady budget through periods of time when revenues were higher and lower. He delineated that if the state saved money when revenues were above the line sufficient funding would be available when revenue dipped below the line. The goal of the process was to treat all generations of Alaskans fairly through a reliable spending stream.

[10:10:56 AM](#)

Mr. Keithley addressed the goal of the bill on slide 5:

#### Objectives

- Goal is to provide a number that "looks through" the ups and downs of the commodity cycle and identifies a stable, long term (i.e., "sustainable") budget number
- Not a spending cap, although it could be used for that (as I and others have advocated)
- Not a fiscal plan, although it could be used for that as well (as I and others have advocated)
- But in the form of HB 311 a guide to the spending levels that help ride through the ups and downs of commodity cycles

Mr. Keithley communicated that the bill was not a spending cap or a fiscal plan. The bill merely provided information and would "institutionalize" getting a number before the legislature.

[10:12:58 AM](#)

AT EASE

[10:13:07 AM](#)

RECONVENED

Mr. Keithley presented slide 6:

Origin of the model

- A response to wide swings in spending levels (and economy) based on revenue levels

"How much do we need to save during a high revenue period in order to be prepared to offset the effect during a low revenue period"

Mr. Keithley revealed that the plans inception came as a question to Dr. Goldsmith from bankers at Northrim Bank who asked him to develop a methodology to determine what the state would have to save today in order to have income for tomorrow in light of the revenue volatility the state experiences. He noted the chart on the slide developed by the Legislative Finance Division that depicted the high and low revenue periods through the years. He turned to slide 7:

Creates focus on long-term outlook

If you assume future is always like the present:

- At high prices, too optimistic and current spending overshoots the mark
- But pessimism is an equal problem - at low prices, too pessimistic and policy makers pull tax/PFD levers that unnecessarily penalize the current economy

HB311 creates a tool to help focus fiscal policy on the long-term outlook to look through high and low cycles, which is critical in a commodity based economy

[10:16:36 AM](#)

Mr. Keithley remarked that the following slides were directly from ISER. He highlighted slide 9:

RECOGNIZE AND MANAGE OUR PETROLEUM WEALTH (ENDOWMENT) LIKE A DEPLETABLE ASSET

1. How much is it worth?
2. How can we invest it for maximum return?
3. How much of it can we spend annually without depleting it?

Mr. Keithley moved to slide 10 titled "Petroleum Wealth of the "Owner State." He reported that the chart showed ISER's calculation of the state's wealth (Total: FY 2017 \$125 billion) in the bank (\$64 billion) and oil in the ground (\$61 billion). He explained that oil in the ground was defined as the estimated net present value of future petroleum revenue based on a three year moving average to account for volatility in the price of oil. He addressed slide 11 titled: "How Much Can We Spend Today: GF Maximum Sustainable Yield." He indicated that Mr. Goldsmith's approach considered the state's fiscal assets and the net present value of the oil assets equally and took 5 percent of the total and subtracted 0.8 percent adjusted for inflation and population growth, which kept the revenue level per Alaskan the same in the future which equaled 4.2 percent. He calculated that 4.2 percent of \$125 billion was \$5.2 billion minus the PFD maintained at the full amount (\$1.3 billion) and added in non-petroleum revenue (\$.5 billion) and came up with the GF maximum sustainable yield in FY 17 totaling \$4.4 billion. He observed that the

maximum sustainable yield was the number the state could spend today from revenue and savings without adversely impacting the future. When revenues were high the number adjusted for inflation and population growth should remain the same and the surplus deposited into savings. He detailed that the savings needed to be replenished to repay the withdrawal from savings when revenues were low and to maintain spending through future periods of low revenues. He reiterated that the number was not a spending cap.

[10:22:33 AM](#)

Mr. Keithley briefly examined slide 12 titled "What Should We Sustain?" which contained a chart that portrayed the results of maintaining a sustainable budget approach. He summarized that overtime more money would be taken out of earnings to supplement low oil reserves but the savings would grow and be available for spending. He highlighted slide 13: "Maximum Sustainable Yield: Implementation."

- Manage financial assets for maximum long term return
- Proactively participate in management of petroleum in the ground for maximum return
- Establish monitoring system to track Nest Egg value, set MSY target, and track progress towards sustainability
- Gradually transition to GF Maximum Sustainable Yield level

Mr. Keithley pointed out that the third bullet point was the only one on the slide relevant to HB 311. He moved to slide 14:

Other perspectives

"The State is spending money at an unsustainable rate. If this is not checked, extreme measures such as diverting all Permanent Fund Dividends and and/or instituting state taxes could become necessary to sustain spending on State programs ...

The State has an urgent need to develop the practice of creating successive long-term strategic plans with

annual budgets based on maximum sustainable yield of the State's primary assets."

-Commonwealth North (Feb. 2013)

Mr. Keithley informed the committee that The Alaska Chamber had recommended Dr. Goldsmith's approach to the legislature. In addition, Commonwealth North had looked at the approach in detail in February, 2013. He read the two quotes from the slide. He underlined slide 15:

HB 311 was a tool to help keep Alaska fiscal policy focused on the long-term...

10:26:08 AM

Representative Gattis agreed that the state needed a sustainable budget. She stated there were others who may disagree and planned to "play devil's advocate" through her questions. She wondered why the state would assume \$125 billion and then exclude the major saving account from the maximum sustainable yield formula. Mr. Keithley answered that it had been a deficiency in the original bill. He explained that when drafting the bill a long debate ensued between Legislative Legal Services and the sponsor regarding the language in the bill that did not capture Dr. Goldsmith's intention. He related that the work draft for HB 136 (Sustainable Budget) [introduced February 22, 2013] more accurately reflected the approach he described. Representative Gattis read the following: "the changes the bill made to statute seemed to nullify the basis of a maximum sustainable yield principal. Your maximum sustainable yield calculation for FY 2017 was \$4.4 billion not including the dividend. She asked where the state would "get the cash" if the approach excluded savings accounts. Mr. Keithley replied that the language deficiency in the current version was incorrect and the methodology did not exclude anything. He recapped that the approach drew from savings when in a low revenue cycle and adds to saving in a high revenue cycle. Representative Gattis asked why the state would be broke in FY 2022 if the maximum sustainable yield plan worked. Mr. Keithley answered that if the plan was used the state would not be broke in FY 22; application would lead the state to be solvent in FY 22.

Representative Millett interjected that the bill could be used with any of the fiscal plans that had been proposed. She reiterated that the approach was a tool and was a

mechanism for determining a sustainable spend. She declared that the legislation was not a panacea. The bill provided the legislature with a guide. She maintained that the sustainable yield was merely "an indicator of what the state could spend based on assumptions that we use."

[10:32:29 AM](#)

Representative Wilson asked whether the \$4.4 billion number included capital and operating expenses. Mr. Keithley answered in the affirmative. He elaborated that the formula did not care what category the spending was. Representative Wilson asked how the plan reconciled the accounting when general fund spending was moved to "other funds." Mr. Keithley responded that the tool did not delve into the undesignated general fund versus designated general fund monies; it offered a number that represented a "pot of money" available for spending.

Co-Chair Neuman remarked on the \$800 million in tax credits that the state issued to incentivize production in Cook Inlet. He asked whether the credits were included "in the budget." Mr. Keithley answered that they were included in the \$4.4 billion; tax credits were taking money out of the treasury and depleted the state's revenues like all other spending. Co-Chair Neuman discussed the benefits of the oil credits especially in the area of increased throughput. He indicated that when the credits were offered there was more oil in the pipeline and the price of oil was much higher. He wondered whether the state had to spend extra dollars now on tax credits above the \$4.4 billion in order to ensure that in the future there was more revenue coming in through increased input in order to maintain the \$4.4 billion. He wondered how the plan would "level that out." Mr. Keithley answered that the methodology did "a very good job of that" by projecting future oil production and factored in the tax credits. The model included the calculation of the value of what the tax incentives had produced in the future. However, the model informed that even with the additional future value from the tax credits the spending level should still be maintained at \$4.4 billion. He reiterated that the bill did not cap the spending amount at \$4.4 billion. Co-Chair Neuman stated that in the last 3 years throughput in the pipeline had increased 5 percent. He asked whether there was a mechanism that averaged out investing now for increased future throughput. He stated there were \$800 million in credits

that were unexpected and he did not want to "touch" Prudhoe Bay credits in order to maintain the viability of Alaska's oil and gas industry. He reported that the budget was roughly \$4.3 billion or \$4.4 billion in FY 17, which was close to the sustainable number but the oil and gas credits were currently "dogging" the state's budget. He wondered whether there was a mechanism to average the spending on credits now to maintain the \$4.5 billion spend.

[10:39:41 AM](#)

Mr. Keithley returned to a graph on slide 7 that showed a calculation of a long-term sustainable revenue number. The green on the graph related to new oil created from credits and incentives and depicted an estimate of the resulting volume. He reiterated that even by taking the new oil into account the calculation still brought the number to \$4.4 billion. He deduced that spending any more than that amount impaired the dollars available in the future. He suggested that decisions about what to spend the money on was not involved in the calculation. He remarked that the number took into account the consequences of oil and gas tax credits and projected out the future production levels. Co-Chair Neuman noted that several years ago the legislature used \$3 billion from the Constitutional Budget Reserve (CBR) to pay down Public Employees' Retirement System (PERS) and Teachers' Retirement System (TRS) resulting in over \$1 billion less in actuarial payments. Mr. Keithley responded that it had been a bit different scenario than oil tax credits because the payment was used to lower the operating costs going forward. He stressed that the number that was calculated each year out of the methodology was what the number should be. He related that in any given year if the legislature determined that by spending more it would lower future operating costs; the PERS/TRS payment was an example, the judgement to spend more could be made. He believed that the sustainable number would provoke deep examination to understand the long-term impact in a scenario where spending was above the sustainable number. The bill would provide a long-term perspective.

[10:43:30 AM](#)

Co-Chair Neuman characterized the oil tax credits as "somewhat out of the budgeting cycle" that were investments for the future and not really part of the state's "day to day" operating expenses. Mr. Keithley agreed, but felt that

oil tax credits were different than the PERS and TRS one-time payment. He qualified that the oil and gas tax credits were continuing and the sustainable number was the "baseline" measured against what the legislature should consider spending on credits.

Vice-Chair Saddler understood the maximum sustainable yield concept and the "caution" it provided the legislature. He wondered what tool was actually created by the bill. He thought the legislation "did what the governor should do anyway" and was puzzled that the bill language did not address sustainability. Representative Millett reiterated that the language in the current version was inadequate and she recognized the flaw but introduced the legislation in expediency. She shared that she had a fix and formula that explained how the calculation worked and remarked that the bill did a poor job and a new Committee Substitute (CS) would be introduced. She directed an additional remark to Co-Chair Neuman. She agreed that the decisions regarding PERS and TRS were beneficial, carefully weighed, with known fiscal impacts. She offered that the bill did not prohibit any future spending above the sustainable number and it informed the outcome of the spending above the number. She felt that the calculation was "just a number in time and how it would affect" the state's budget and was merely a "mechanism" so that legislatures and the administration would be aware of spending consequences in future years. She thought that a transitional fund for the oil and gas credits could work in concert with the maximum sustainable yield.

[10:48:13 AM](#)

Co-Chair Thompson noted that the bill would be heard again in committee with a new Committee Substitute.

Representative Munoz felt that the calculation was a very important tool. She asked about the intangible aspects of the net operating losses that were difficult to include in a sustainable draw calculation and wondered how they were accounted for. Mr. Keithley replied that the bill represented a big picture tool. He mentioned that future revenue was a prediction of revenue under the current tax regime and the net operating losses factored into the calculation of the net present value of the future oil stream.

Co-Chair Thompson OPENED public testimony.

Co-Chair Thompson CLOSED public testimony.

HB 311 was HEARD and HELD in committee for further consideration.

Co-Chair Thompson addressed the following meeting schedule.

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ADJOURNMENT

[10:51:03 AM](#)

The meeting was adjourned at 10:51 a.m.