

SENATE FINANCE COMMITTEE
March 26, 2015
9:04 a.m.

[9:04:11 AM](#)

CALL TO ORDER

Co-Chair MacKinnon called the Senate Finance Committee meeting to order at 9:04 a.m.

MEMBERS PRESENT

Senator Anna MacKinnon, Co-Chair
Senator Pete Kelly, Co-Chair
Senator Peter Micciche, Vice-Chair
Senator Click Bishop
Senator Mike Dunleavy
Senator Lyman Hoffman
Senator Donny Olson

MEMBERS ABSENT

None

ALSO PRESENT

Pamela Leary, Director, Treasury Division, Department of Revenue; Gary Bader, Chief Investment Officer, Treasury Division, Department of Revenue; Kristin Pratt, Staff, Senator Anna MacKinnon; Diane Barrans, Executive Director, Alaska Commission on Postsecondary Education, Department of Education and Early Development.

SUMMARY

SB 34 PCE ENDOWMENT FUND INVESTMENT

SB 34 was HEARD and HELD in committee for further consideration.

SJR 2 CONST. AM: G.O. BONDS FOR STUDENT LOANS

SJR 2 was HEARD and HELD in committee for further consideration.

[9:04:39 AM](#)

#sb34

SENATE BILL NO. 34

"An Act relating to investment of the power cost equalization endowment fund; and providing for an effective date."

[9:04:57 AM](#)

PAMELA LEARY, DIRECTOR, TREASURY DIVISION, DEPARTMENT OF REVENUE, began the presentation "State of Alaska, Department of Revenue, SB 34 PCE Endowment Fund Investment," (copy on file). Ms. Leary presented Slide 2:

Fund Purpose:

- To fund the Power Cost Equalization & Rural Electric Capitalization Fund and to reimburse the costs associated with managing the fund.
- 7% of the monthly average market value of the fund for the previous 3 fiscal years may be appropriated.

Fund History:

- 2000-Power Cost Equalization Endowment Fund established from Constitutional Budget Reserve Appropriation of \$100 million
- 2002-PCE receives \$89.6 million from proceeds of the sale of the four dam pool hydroelectric project.
- 2007-Additional appropriation of \$182.7 million
- 2012-Additional appropriation of \$400 million
- February 28, 2015 balance: \$986.27 million

[9:06:50 AM](#)

Ms. Leary addressed Slide 3:

SB34

- Removes the stated nominal return target of at least 7% from the statute.
- Allows the commissioner of revenue to invest the fund in a manner that can meet the objectives of the fund.

- Why? It allows the commissioner of revenue to invest in less risky investments, when appropriate, that will still meet the financial needs of the program.
- Zero Fiscal Note

9:07:30 AM

GARY BADER, CHIEF INVESTMENT OFFICER, TREASURY DIVISION, DEPARTMENT OF REVENUE, commented that it was fundamental to investment management to seek the highest rate of return commiserate with the appropriate amount of risk. He said that current statute directed the commissioner of revenue to attain a 7 percent rate of return, without regard to the amount of risk that would be undertaken. He drew the committee's attention to Slide 4, "2015 Capital Market Expectations - Return and Risk." He stated that most prepared assumptions were similar; the statistics represented Callan Associates' projections of the returns and standard deviations of many of the most popular asset classes for the 10 year period ending 2024. He relayed that the left hand column on the slide reflected various asset classes, with broad domestic equity shown at the top of the page. He elaborated that broad domestic equity represented United States stocks. He moved to the column labeled, "1-year Arithmetic", which represented the average of one-year investment returns Callan might expect the asset class to earn over the next ten years. He spoke to the column labeled, "Projected Risk/Standard Deviation." He shared that standard deviation was a measure of volatility of the investment returns, roughly two-thirds of the time an investment return would be plus or minus one standard deviation of the arithmetic return. He directed committee attention to the column labeled, "10-year Geometric", which represented the compounded annual rate of return that Callan projected an asset class would return over the next 10 years. He pointed out that the greater the standard deviation, the further the 10-year geometric return grew from the arithmetic return; the higher the standard deviation, the more difference in the compounded return.

9:10:21 AM

Mr. Bader gave an example of how the investment return scenario might work. He asserted that volatility and the amount of risk were important factors for achieving a long-term rate of return. He relayed that if the projections held for the Power Cost Equalization (PCE) of a ten year

rate of return, nearly all of the PCE investment would need to be broad equities; approximately 88 percent under statute. He related that domestic equities had been in a bull market for 6 years, interest rates were low and expected to increase mid-year. He added that as interest rates rose, the value of fixed income investments fell. He thought that the 7 percent return would have been a reasonable expectation 15 years ago, when a 10-year Treasury bond was earning 6 percent; now the 10-year Treasury bond was earning 2 percent. He relayed that when interest rates went up, bond values fell, and it was unlikely that the stock market would continue to rise for another six years. He concluded that passage of the legislation would allow the commissioner of revenue to attempt to meet the goals of the PCE program while managing risk.

[9:12:19 AM](#)

Vice-Chair Micciche asked whether any of Alaska's other investment funds had a statutory requirement for return.

Ms. Leary replied that this was the only separately managed investment that had a target return.

[9:12:51 AM](#)

Vice-Chair Micciche thought that the situation was "laced with unintended consequences."

Co-Chair MacKinnon clarified that the bill proposed to remove the 7 percent expected return to a nominal rate in order to have a more conservative investment strategy on the PCE fund. She said that the 7 percent had been established because people wanted to grow the fund as quickly as possible in order for rural communities to receive greater dividends. She opined that the recent volatility displayed by the stock market had prompted the desire to secure the risk alternatively.

[9:14:26 AM](#)

Ms. Leary shared that the presentation could be found on the Treasury Division website:

<http://treasury.dor.alaska.gov/>

[9:14:52 AM](#)

Senator Hoffman recalled that the same topic had been discussed in committee the previous year and he had requested that the target be reduced from 7 to 5 percent. He understood as markets rose and fell there could be times when the fund earned in excess of the payout, which had been the case for several years, but that did not mean that in the future there would be draws from the fund that would be larger than the rate of return, and overtime they would level out, which was why he supported the lower interest rate. He felt that there had been substantial increases in the fund and that during those times there was always a temptation to draw from and utilize those funds for other purposes, but to remember that there would be times when the earnings would be less than the draw.

[9:16:55 AM](#)

Co-Chair MacKinnon extrapolated that the 7 percent rate of return was tied to what could be drawn from the fund. She noted that as the administration was trying to create a more conservative approach by limiting the amount that could be withdrawn from the fund. She felt that this could create unintended consequence for the legislature because it would limit the amount that could be withdrawn.

Mr. Bader believed that the statute allowed the average of 7 percent monthly return over a three year period. He said that there would be times when a commissioner could set an asset allocation that would target an earnings rate of less than 7 percent. He added that there could also be times when the commissioner might try to have a rate of return that was greater than 7 percent.

Co-Chair MacKinnon understood that with the passage of the bill, up to 7 percent could still be withdrawn from the fund.

Ms. Leary added that over the life of the fund the rate of return that it had earned was 6 percent.

[9:19:00 AM](#)

Vice-Chair Micciche asked where the language was in the bill that changed the amount that could be drawn.

Co-Chair MacKinnon clarified that the amount that could be drawn would not be affected by the legislation.

[9:19:40 AM](#)

Co-Chair MacKinnon expressed concern that the administration was proposing no percentage rate. She wondered why the nominal return had been considered rather than a reduction in the percentage rate.

Mr. Bader expected that a recommendation would be taken to the commissioner that would be based upon achieving a real rate of return, one earned before consideration of inflation, which would be in the 4 to 5 percent range.

[9:21:20 AM](#)

Senator Hoffman commented that a minimum rate of return should be set, with flexibility for the department to make the ultimate decision.

[9:22:08 AM](#)

Vice-Chair Micciche believed that requiring a rate of return would be micromanaging and was out of the legislatures per view. He said he would rather define an acceptable level of risk and not an acceptable level of return.

[9:23:05 AM](#)

Senator Bishop asked whether it would be prudent to have the ability to manage the fund so it met the outcome at the end of the year with the corpus of the fund intact.

Ms. Leary stated that the question was considered during the asset allocation process.

[9:24:11 AM](#)

Co-Chair MacKinnon opened public testimony.

[9:24:39 AM](#)

Co-Chair MacKinnon closed public testimony.

SB 34 was HEARD and HELD in committee for further consideration.

[9:24:57 AM](#)

#sjr2

SENATE JOINT RESOLUTION NO. 2

Proposing an amendment to the Constitution of the State of Alaska relating to contracting state debt for postsecondary student loans.

9:25:28 AM

KRISTIN PRATT, STAFF, SENATOR ANNA MACKINNON, explained that the resolution would amend Article 9, Section 8, of the Alaska State Constitution to allow for the contracting of state debt for postsecondary student loans. She furthered that student loan debts amounted to over a trillion dollars; the resolution considered lowering interest rates for Alaskans. She concluded that the resolution would be a no-cost way to reduce the debt that burdened Alaskans.

DIANE BARRANS, EXECUTIVE DIRECTOR, ALASKA COMMISSION ON POSTSECONDARY EDUCATION, DEPARTMENT OF EDUCATION AND EARLY DEVELOPMENT, expressed appreciation to the sponsor for bringing forth the legislation. She stated that the bill was a meaningful way to support Alaskan students in financing their own postsecondary education. She suggested that modest adjustments could be made to the credit requirements currently applied to applicants, which would allow more students to qualify for the loans. She relayed that the resolution would create a refinancing opportunity for students already in the workforce currently facing outstanding higher rate debt.

9:28:06 AM

Co-Chair MacKinnon opened public testimony.

9:28:37 AM

Co-Chair MacKinnon closed public testimony.

SJR 2 was HEARD and HELD in committee for further consideration.

Co-Chair MacKinnon discussed housekeeping.

9:29:25 AM

Co-Chair Kelly stated that the operating budget would be discussed in the committee the following week.

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ADJOURNMENT

9:30:20 AM

The meeting was adjourned at 9:30 a.m.