

ALASKA STATE LEGISLATURE
SENATE STATE AFFAIRS STANDING COMMITTEE

February 11, 2016
9:02 a.m.

MEMBERS PRESENT

Senator Bill Stoltze, Chair
Senator John Coghill, Vice Chair
Senator Charlie Huggins
Senator Lesil McGuire
Senator Bill Wielechowski

MEMBERS ABSENT

All members present

COMMITTEE CALENDAR

SENATE BILL NO. 127

"An Act relating to actions by insurers based on credit history or insurance score; and providing for an exception to consideration by an insurer of credit history or insurance score."

- HEARD & HELD

SENATE BILL NO. 128

"An Act relating to the Alaska Permanent Fund; relating to appropriations to the dividend fund; relating to income of the Alaska Permanent Fund; relating to the Earnings Reserve Account; relating to the Alaska Permanent Fund dividend; making conforming amendments; and providing for an effective date."

- HEARD & HELD

PREVIOUS COMMITTEE ACTION

BILL: SB 127

SHORT TITLE: INSURER'S USE OF CREDIT HISTORY/SCORES

SPONSOR(S): SENATOR(S) HUGGINS

01/19/16	(S)	READ THE FIRST TIME - REFERRALS
01/19/16	(S)	STA, L&C
02/11/16	(S)	STA AT 9:00 AM BUTROVICH 205

BILL: SB 128

SHORT TITLE: PERM. FUND: DEPOSITS; DIVIDEND; EARNINGS

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

01/19/16	(S)	READ THE FIRST TIME - REFERRALS
01/19/16	(S)	STA, FIN
01/26/16	(S)	STA AT 9:00 AM BUTROVICH 205
01/26/16	(S)	Heard & Held
01/26/16	(S)	MINUTE(STA)
01/28/16	(S)	STA AT 9:00 AM BUTROVICH 205
01/28/16	(S)	Heard & Held
01/28/16	(S)	MINUTE(STA)
02/02/16	(S)	STA AT 9:00 AM BUTROVICH 205
02/02/16	(S)	Heard & Held
02/02/16	(S)	MINUTE(STA)
02/04/16	(S)	STA AT 9:00 AM BUTROVICH 205
02/04/16	(S)	Heard & Held
02/04/16	(S)	MINUTE(STA)
02/04/16	(S)	STA AT 5:30 PM BUTROVICH 205
02/04/16	(S)	Heard & Held
02/04/16	(S)	MINUTE(STA)
02/11/16	(S)	STA AT 9:00 AM BUTROVICH 205

WITNESS REGISTER

LAUREN RASMUSSEN, Staff
Senator Huggins
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Provided an overview of SB 127.

Laurie Wing-Heier, Director
Division of Insurance
Alaska Department of Commerce, Community, and Economic
Development
Juneau, Alaska

POSITION STATEMENT: Explained the reason for presenting SB 127.

TIM MAUDSLEY, President
Alaska USA Insurance Brokers
Anchorage, Alaska

POSITION STATEMENT: Testified in support of SB 127.

KRISTIE BABCOCK, Agent
State Farm Insurance
Kenai, Alaska

POSITION STATEMENT: Testified in support of SB 127.

ARMAND FELICIANO, Vice President-Government Affairs
Property Casualty Insurers Association of America
Sacramento, California

POSITION STATEMENT: Testified in support of SB 127.

CINDA SMITH, Senior Counsel
GEICO Insurance
Washington, D.C.

POSITION STATEMENT: Testified in support of SB 127.

JEFFREY KINSEY, Actuary
State Farm Insurance
Bloomington, Illinois

POSITION STATEMENT: Testified in support of SB 127.

CRAIG RICHARDS, Attorney General
Alaska Department of Law
Juneau, Alaska

POSITION STATEMENT: Addressed legal questions regarding SB 128.

BILL MILKS, Assistant Attorney General
Alaska Department of Law
Juneau, Alaska

POSITION STATEMENT: Addressed legal questions regarding SB 128.

MEGAN WALLACE, Attorney
Legislative Legal Services
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Addressed legal questions regarding SB 128.

ACTION NARRATIVE

[9:02:08 AM](#)

CHAIR BILL STOLTZE called the Senate State Affairs Standing Committee meeting to order at 9:02 a.m. Present at the call to order were Senators Wielechowski, Huggins, and Chair Stoltze.

SB 127-INSURER'S USE OF CREDIT HISTORY/SCORES

[9:02:28 AM](#)

CHAIR STOLTZE announced the consideration of SB 127.

SENATOR CHARLIE HUGGINS, Alaska State Legislature, bill sponsor, explained that SB 127 proposes that the component of credit history be a factor in determining what an individual pays. He revealed that Alaska is the only state that allows credit scoring for initializing a policy, but credit scoring cannot be used for renewal.

[9:04:18 AM](#)

LAUREN RASMUSSEN, Staff, Senator Huggins, Alaska State Legislature, Juneau, Alaska, provided an overview of SB 127 follows:

When Alaskan consumers apply for a new auto or homeowner's insurance policy, companies take several variables into consideration to assess risk. A few examples are your motor vehicle record, good student discount, age, marital status, and credit history. Now this is not your FICO credit score, your credit history can look at payment history, credit utilization, and bankruptcies. Insurers do not look at the consumer's income, so it doesn't matter if you are low or high income.

Under current law, credit history is included in underwriting new policies, but must be removed, as Senator Huggins had mentioned, when calculating a rate for policy renewal, which usually happens about every two years. It should be noted that consumers can elect to include their credit history at the time of policy renewal, but as you will hear in later testimony, this is an extremely time consuming process and ultimately confusing for the consumers. The process of removing credit history often results in consumers seeing an increase in their rates and further leads to market disruption known as "churning," where a consumer will go from one company to another looking for lower rates; they in turn would not have the benefits of long term policyholders.

SB 127 will also require insurers to make exceptions to a consumer's rate when the consumer's credit is adversely effected by extraordinary circumstances.

[9:06:33 AM](#)

SENATOR HUGGINS pointed out that requiring exceptions due to extraordinary circumstances was an important consideration for SB 127.

MS. RASMUSSEN explained that the extraordinary circumstances clause would apply to both new insurance policies and renewal policies, acting mostly as a safeguard for consumers. She noted the examples of the extraordinary life circumstances were in Sec. 3 of SB 127 and included: serious illness, injury to the consumer or immediate family member, death of a family member, military deployment overseas, divorce, or involuntary unemployment.

She summarized that SB 127 simply fixes a discrepancy in the law. She noted that Alaska was the only state to require insurers to remove the credit history when rewriting a policy. She added that SB 127 has no fiscal impact on the State of Alaska.

[9:08:36 AM](#)

LAURIE WING-HEIER, Director, Division of Insurance, Alaska Department of Commerce, Community, and Economic Development, Juneau, Alaska, asserted that SB 127 was an emotional bill where its intent would provide a "fix." She said her office receives numerous phone calls from the industry and consumers. She revealed that consumers are most often surprised when they receive their second billing with a rate increase from an insurance company. She noted that some rate increases were up to 100 percent. She explained that the rate increases were not due to anything like having an accident, covering a teenage driver, buying a car, or buying a new home. She specified that the rate increase were due to the way that Alaska's law reads in the application of credit score. She explained that many consumers resort to "churning" by either going to a new insurance company or signing a form to order their credit history and score again. She revealed that business relationships are often destroyed due to the rate increases.

[9:10:35 AM](#)

CHAIR STOLTZE asked if "churning" was a pejorative term for overcharging people for fees.

MS. WING-HEIER explained that the term "churning" is the process of consumers leaving one market for another due to pricing and the pricing being a reflection of the use of credit scoring because it cannot be used on renewal. She specified that "churning" was not because of dissatisfaction with the market or the service being received, but because a consumer cannot use their credit scoring for the preferred rate upon product renewal.

SENATOR HUGGINS remarked that "churning" forces consumers to look at other agencies and the downside from the act does not allow individuals to develop relationships with their insurance company or agent. He specified that developed relationships allow consumers to reap the benefits from their positive lifestyle. He added that a provision in the bill takes unforeseen circumstances for consumers into account too.

[9:12:37 AM](#)

MS. WING-HEIER explained that insurance agents are having their commissions cut due to the added step of renewal because of the law not allowing the automatic use of an individual's credit score. She reiterated that a credit score can be used for new business, but not for renewal.

SENATOR WIELECHOWSKI asked what the thinking was for allowing insurance companies credit score access just for the first time and not for renewal.

MS. WING-HEIER answered that statistics prove that the use of credit scoring correlates to a better claims history that ultimately leads to a lower premium on auto and homeowners insurance.

[9:14:30 AM](#)

SENATOR MCGUIRE joined the committee meeting.

[9:16:29 AM](#)

SENATOR WIELECHOWSKI asked if lower income or wealthy individuals have lower credit ratings.

CHAIR STOLTZE asked Senator Wielechowski to define "wealthy."

SENATOR WIELECHOWSKI replied that he would like the witness to answer.

CHAIR STOLTZE responded that Senator Wielechowski asked the question. He asked how Senator Wielechowski would define "wealthy" in fairness to the witness.

SENATOR WIELECHOWSKI replied that he would use \$100,000 as the annual income that defines "wealthy."

MS. WING-HEIER explained that the credit score does not have anything to do with income.

SENATOR WIELECHOWSKI asked if either low income or wealthy individuals tend to have lower credit ratings.

MS. WING-HEIER answered that the data was not tracked because income was not part of credit scoring.

[9:17:57 AM](#)

SENATOR WIELECHOWSKI explained that he was addressing the bill's impact on his constituents. He noted that he has a lot of lower-income constituents in his district. He asked how much more an individual pays if they have a "poor" or "average" credit history.

MS. WING-HEIER replied that an individual with a poor credit history would be treated as "neutral."

SENATOR WIELECHOWSKI asked Ms. Wing-Heier to verify that an individual with a poor credit history will be paying more than a person with a good credit rating.

MS. WING-HEIER answered yes.

SENATOR WIELECHOWSKI asked what the rate difference was between an individual with a poor credit rating and a good credit rating.

MS. WING-HEIER reiterated that there was a correlation that those with a good credit history, which is estimated to be 80 percent of the population, would receive a preferred rate. She pointed out that the problem occurs when an individual with a good credit history does not receive a preferred rate and pays a higher premium at renewal. She explained that the intent was to focus on the 80 percent that were effected during renewal. She said the 20 percent that were never getting the preferred rate in the first place would not be effected.

SENATOR WIELECHOWSKI asked what the difference was and how much more do the people with the preferred credit rating pay under the way the law was currently written and how much would be saved from the legislation.

MS. WING-HEIER answered that the rates and premiums depend on the underwriting criteria for an individual: age, type of car, home value, and where an individual lives.

[9:20:11 AM](#)

SENATOR HUGGINS asked how long an initial policy was typically written for auto insurance.

MS. WING-HEIER answered six months to a year.

SENATOR HUGGINS asked how long an initial policy was written for home insurance.

MS. WING-HEIER answered a year.

SENATOR HUGGINS explained that his constituents have asked why credit history was used for an initial policy and not for renewal.

[9:21:56 AM](#)

MS. WING-HEIER called attention to a recent article where Alaska's national insurance ranking was marked down due to the state's credit-score policy for underwriting.

[9:23:59 AM](#)

CHAIR STOLTZE commented that how much an individual makes should not be used for underwriting insurance. He remarked that some of the most responsible people he knows make less money.

MS. WING-HEIER reiterated that insurance companies maintain their concern regarding the state's credit-scoring law pertaining to renewals.

[9:25:08 AM](#)

SENATOR MCGUIRE stated that when the law was passed by Senator Cowdery eight or nine years ago, her understanding was that credit history could not be used as a means for deciding auto insurance rates. She stated that she understood the notion of unfairness when people shop insurance companies due to the absurd result when renewing. She set forth that if the law were applied evenly in a way that she believed she had voted on where credit was not taken into account, there wouldn't be the disparity at all. She asked how Ms. Wing-Heier interpreted the law and its implementation.

[9:27:07 AM](#)

MS. WING-HEIER replied that the law as it was written was that credit scores could be used on new business, but not on renewal. She specified that 80 percent of new business policy holders were given a preferred rate because of their credit score and then their rates go up 50 to 60 percent at renewal.

SENATOR MCGUIRE replied that she did not know if allowing the use of a person's credit rating was a political compromise. She asked Ms. Wing-Heier to verify that the use of a credit rating was statutory and not regulations that were interpreted. She said Alaskans were right to be angry when entering a contract with an insurance company and unfairly have an increase in their rates six months to a year later. She set forth that a person with a good driving record being penalized due to a poor credit rating was not fair.

[9:29:36 AM](#)

MS. WING-HEIER replied that the current law applies to new business, not renewal. She added that SB 127 addresses extenuating life circumstances that impacts credit scores as well.

SENATOR MCGUIRE explained that she was trying to get at the point of what the statute said versus the regulations that were promulgated to effectuate the statute.

MS. WING-HEIER replied that she was not aware of regulations, strictly statutes.

CHAIR STOLTZE announced that the bill would not be moved during the meeting and the intent was to hear the public testimony. He said there would be time to explore statutes at the next meeting.

[9:31:07 AM](#)

TIM MAUDSLEY, President, Alaska USA Insurance Brokers, Anchorage, Alaska, stated that Alaska USA has submitted a letter of support for SB 127. He specified that SB 127 would remove the requirement for insurers to eliminate the credit-based insurance score from the rating process after two years. He specified that the change would provide consumers with a fair and accurate rate on insurance renewals and eliminate confusion due to policy cancellation and burden of changing carriers to maintain preferred insurance rate discounts. He summarized that SB 127 would hopefully open the Alaska insurance market to additional carriers, increase competition, and greatly benefit consumers. He disclosed that Alaska is the only state that with a provision that stripped credit out of renewals, a provision that deterred additional insurance companies from entering the Alaska insurance market.

[9:34:09 AM](#)

KRISTIE BABCOCK, Agent, State Farm Insurance, Kenai, Alaska, remarked that SB 127 offers a solution to her customers' difficulty with the current law affecting higher insurance rates during renewal. She asserted that certain credit components were a very accurate and high indicator in assessing the risk a client presents to an insurance company. She detailed that credit components have nothing to do with income, past bankruptcy, or foreclosures. She specified that the credit components pertained to certain characteristics that represented a person's current life situation along with dozens of other characteristics, including one's driving record. She noted that clients have paid higher rates due to inadvertently missing a waiver submission during the time of renewal.

[9:42:09 AM](#)

CHAIR STOLTZE pointed out that the committee had received numerous written testimony from State Farm Insurance. He asked if Ms. Babcock served the purpose of consolidating the testimony of State Farm Insurance.

MS. BABCOCK answered that her comments were a good reflection of the frustrations faced by State Farm agents and customers.

[9:43:22 AM](#)

ARMAND FELICIANO, Vice President-Government Affairs, Property Casualty Insurers Association of America, Sacramento, California, testified in support of SB 127.

[9:44:11 AM](#)

SENATOR HUGGINS stated that he was proud to hear Alaskans stepping forward to address the state's insurance renewal issue.

[9:44:53 AM](#)

CINDA SMITH, Senior Counsel, GEICO Insurance, Washington, D.C., testified in support of SB 127.

[9:46:12 AM](#)

JEFFREY KINSEY, Actuary, State Farm Insurance, Bloomington, Illinois, testified in support of SB 127.

[9:47:06 AM](#)

CHAIR STOLTZE closed public testimony.

SENATOR MCGUIRE asked that a question be answered at a future committee meeting regarding the use of credit scores to assess individual health insurance policies.

CHAIR STOLTZE commented that any discussion about the Affordable Care Act should be on the record as well.

SENATOR MCGUIRE replied that her question does not pertain to the Affordable Care Act and specified as follows:

The point is that each individual line of insurance is a cost to a family unit, they are not discriminatory in their budgeting. If credit is taken into account in a certain couple of lines, I want to know which lines and which lines it isn't, so just kind of a comprehensive overview.

[9:48:38 AM](#)

SENATOR WIELECHOWSKI referenced a 2007 report by the Federal Reserve that blacks and Hispanics have lower credit scores on average. He said his intent was to try and figure out the impact of SB 127 on his constituents. He noted that East Anchorage and Bartlett are the top two most diverse high schools in the U.S.

[9:49:33 AM](#)

CHAIR STOLTZE held SB 127 in committee.

SB 128-PERM. FUND: DEPOSITS; DIVIDEND; EARNINGS

[9:50:21 AM](#)

CHAIR STOLTZE announced the consideration of SB 128.

[9:51:00 AM](#)

CRAIG RICHARDS, Attorney General, Alaska Department of Law, Juneau, Alaska, stated that the legal opinions regarding SB 128 were not considered to be a critical driver issue for the administration. He specified that the issue with SB 128 would only arise if a Constitutional Budget Reserve (CBR) reverse-sweep did not occur. He said even though he has not gone back every year, there has never been a situation where there was not a reverse sweep.

CHAIR STOLTZE asked Attorney General Richards to define a "sweep."

ATTORNEY GENERAL RICHARDS explained as follows:

If you have funds in the general fund that are not fully used at the end of the year, the constitution provides that those funds are subject to being swept

into the CBR as a mechanism to sort of require savings into the CBR, and as a mechanism to have that not happen when the CBR sweep would occur, the Legislature has periodically or routinely done what is called a "reverse CBR sweep" every year where they, by three-quarters vote. Say that funds that would be subject to the constitutional sweep, we go ahead and appropriate that all back to the original place. So even if funds are subject to the sweep, the reverse sweep would undo it effectively.

CHAIR STOLTZE observed that the sweeps were done in conjunction with the Office of Management and Budget (OMB). He detailed that a sweep is not just a legislative initiative, but rather a joint understanding and effort with a lot of involvement from the administration.

ATTORNEY GENERAL RICHARDS emphasized that the sweeps have historically occurred with a generic statement with a couple lines without a detailed fund itemization. He pointed out that the number of accounts that were uncontroversially subject to sweeps were in the neighborhood of a couple of hundred, including: the Mental Health Trust, bond reserve accounts, oil and gas tax credit account, and the School Trust Account.

[9:54:03 AM](#)

CHAIR STOLTZE noted that the Power Cost Equalization (PCE) fund was subject to the sweep.

ATTORNEY GENERAL RICHARDS continued as follows:

Power Cost Equalization is a little different, so I'll get to that one next. So these are things that are subject to the reverse sweep every year and there's never been a problem, it's never been an issue and it's just sort of occurred as a matter of course. Now we can't predict a hundred percent that is always going to happen, but we just think particularly when you look at the history of the legislature respecting rules based and customary framework around the Permanent Fund, we have a high degree of confidence that the legislature will continue to respect the Earnings Reserve Account, even if it were subject to a sweep, not saying it is, and that just like they have with Mental Health Trust funds that it is highly probable that a reverse-sweep would always occur in such a manner as to protect the ERA.

Now the only way we think we find ourselves in a situation where there can even really be a legitimate challenge is if in fact that reverse sweep didn't happen. So let's talk about this very low probability event, let's say that occurs. Now that is the only situation where there is going to be a legal challenge, we'd have to change what we are currently doing pretty dramatically. Now if that happens, we believe, and we'll let the "brainiacs" go at it here in a minute here on their different reasons why, we believe that the Supreme Court has basically said that even if there wasn't a reverse sweep, it was brought in inclusive across a plethora of all of the hundreds of state accounts that would be subject to it, that the ERA would not be subject to it for the same reason that, well the Supreme Court has said it isn't and it's the same reason that the Power Cost Equalization account has not been viewed as subject to the reverse sweep and for some reason our pension funds aren't subject to the reverse sweep.

Now the theory that the Supreme Court might change their mind and change the status and classification of the ERA, as I understand it is basically that the governor's plan would change the character of the account by having a situation where we are having production taxes going in, so we have a new insource and we are now going to take money out of the ERA under the plan for something other than dividends and somehow these two events occurring either individually or in conjunction would change the character of the account in a way that the Supreme Court might view it differently. Well, we don't think that's likely because look at history, under that logic that means that when the Legislature appropriated \$3 billion into the pension funds, under that logic then suddenly our pension accounts would be subject to the CBR sweep, suddenly the Power Cost Equalization, which has funds flowing both ways through it, would now be subject to the CBR sweep and we just think that is a legally mandated or a practical outcome.

The final thing is if we have two really low probability events occur, one is the Legislature changes the way it does the reverse sweep as would impact the ERA, so that you then have the genesis for

a legal challenge, and the Supreme Court changes its point of view and now says the ERA is subject to the sweep, if these two low probability events occurred in sequence in such as we had to change, we would change at that time, because we would have a decision, the decision would have clarity and we would design the system around whatever the Supreme Court said. So that's a long way of saying that we think it is highly unlikely that the Earnings Reserve Account will ever be in a situation where it is subject to a sweep and if it does, then at that time, just like that decision will make the Power Cost Equalization fund subject to it, it would make our retirement assets potentially subject to it, we'll deal with it if that really low probability event occurs.

[9:57:42 AM](#)

CHAIR STOLTZE pointed at that Attorney General Richards can create law based on his opinion whereas the Legislature has to go through three constitutional readings, a majority vote, and a signature by the governor. He asked that Attorney General Richards clarify that the PCE and the pension funds were not subject to sweep.

ATTORNEY GENERAL RICHARDS replied that the Department of Law's position has always been that the PCE fund and pension funds were not subject to sweep and subjecting them to a sweep would only occur if the court doctrine changed.

CHAIR STOLTZE pointed out that Attorney General Richards' positions and opinions become law.

ATTORNEY GENERAL RICHARDS replied that his opinions do under rare circumstances, but not on the subject that he was currently addressing.

[9:59:19 AM](#)

BILL MILKS, Assistant Attorney General, Alaska Department of Law, Juneau, Alaska, explained that the Power Cost Equalization (PCE) fund sort of fits exactly with the Department of Law's view regarding an ERA sweep. He specified that Section 17(d) [Article 9 of the Alaska Constitution] regarding the CBR specifically identifies funds that were subject to sweep as funds in the general fund. He set forth that the Alaska Supreme Court decision in Hickel v. Cowper specifically says there are funds which are general fund or other funds available for appropriation. He asserted that the court specifically said the

17(d) sweep or payback provision was for general fund accounts, not other funds. He said the ERA was a specific example of an account available for appropriation, but not subject to a sweep. He pointed out that the PCE fund was a fund within the Alaska Energy Authority that the Legislature decided statutorily for the fund not to be in the General fund. He noted that the Supreme Court ruling in *Hickel v. Cowper* commented that its position or role was not to change words in the constitution or suggest other ways the constitutional provisions could be written. He said the Supreme Court specifically addressed general fund accounts subject to sweep and non-general funds not subject to sweep. He set forth that the ERA was not subject to the sweep based on the decision from the Supreme Court saying it was not.

MR. MILKS said a concern was raised that the court would change its mind because SB 128 would change the ERA where the account would be used for general government appropriations. He remarked that that the posed issue could be raised on any bill that started to use the ERA for general appropriations. He said the Department of Law does not think the court would change its mind because the statute had not been changed and the ERA was not a general fund account. He summarized that the Supreme Court knew exactly in *Hickel v. Cowper* when it said that the ERA was fully available for legislative appropriation and not subject to sweep.

[10:02:40 AM](#)

He said a second issue was raised that SB 128 would change the ERA into a general fund account because oil and gas production taxes and additional royalties would be put into the account. He set forth that SB 128 does not change the statute that the ERA is a non-general fund account. He specified that the expressed language in the constitution says "general fund" and without a statute change, the ERA was not in the general fund. He remarked that the *Hickel* case reaffirmed that the courts are going to analyze the CBR language in the constitutional provisions. He said the Department of Law does not think the court would change its mind based on the theory that additional monies put into a non-general account can be captured and brought back in a sweep. He concurred with Attorney General Richards that sweeping the ERA would mean the PCE fund and pensions could be swept as well. He said the ERA was a statutory state savings account that the legislature has the full constitutional power to appropriate from, to the general fund and other accounts. He summarized that making the ERA a de facto general fund account for legal reasons was very problematic.

[10:06:39 AM](#)

CHAIR STOLTZE responded that he would go the opposite way than Mr. Milk did. He remarked that having both the attorney general and judiciary declaring that the legislature had broad power to create de facto dedicated funds was unusual.

ATTORNEY GENERAL RICHARDS replied that an important distinction exists between a dedicated fund and one that was subject to the CBR fund.

CHAIR STOLTZE specified that he said de facto dedicated fund.

ATTORNEY GENERAL RICHARDS explained that a dedicated fund was essentially one that does not go to the general fund and was not subject to regular appropriation by the legislature. He pointed out that the dedicated fund prohibition long predated the CBR rule in the constitution and was separate and distinct.

[10:08:12 AM](#)

CHAIR STOLTZE stated that the Permanent Fund's premise was predicated on making an exception to the dedicated fund rule for making appropriations. He remarked that he had not seen the Attorney General's office and the Department of Law get together and want to expand legislative power as was asserted.

MR. MILKS specified that the Permanent Fund's principal was the exception to the dedicated fund and could not be appropriated from; however, voters approved a constitutional provision that provided the legislature with wide flexibility to appropriate from the Permanent Fund's income, resulting in the legislature establishing a separate statutory account, the ERA.

[10:10:55 AM](#)

MEGAN WALLACE, Attorney, Legislative Legal Services, Alaska State Legislature, Juneau, Alaska, stated that the ERA is composed solely of income generated from the Permanent Fund. She said SB 128, along with the governor's proposed operating budget, seeks to add additional revenue to the ERA by transferring the balance of the CBR fund to the Statutory Budget Reserve (SBR) fund and then appropriate \$3 billion to the ERA. She said Legislative Legal Services' opinion is that the proposed change in composition of the ERA creates potential issues pertaining to the sweep under Article 9, Section 17(d). She set forth that the question was whether the legislature can purposely put general fund money into the Permanent Fund temporarily to avoid a separate constitutional mandate and by

doing that whether they can retrieve that money that is supposed to be held temporarily in the Permanent Fund. She said the ERA is a statutory account in the Permanent Fund. She pointed out that Article 9, Section 15, relating to the Permanent Fund provision, only mentions two things: principal and income of the Permanent Fund. She asserted that the constitution and the amendment that established the Permanent Fund did not expressly take into the adding of additional funds to the Permanent Fund and the Supreme Court did not address the issue in the Hickel v. Cowper case. She added that the Office of the Attorney General had previously issued opinions that the placement of additional monies into the Permanent Fund was not retrievable. She summarized that an issue may arise if additional revenue and general fund monies were eventually transferred into the ERA.

10:14:28 AM

CHAIR STOLTZE stated that there was a discussion by the assistant attorney general about a dissection of the intent of the voters. He said he did not recall if there was specific debate amongst voters regarding earnings and sub-accounts, the focus was on saving money. He asked if the Supreme Court actually dissects what voters said and meant or just the verbiage.

MS. WALLACE replied that she was not sure that the Supreme Court reached the level of discussion that addressed what voters said or meant. She surmised that the Supreme Court may consider legislative history and voting record.

CHAIR STOLTZE asked Ms. Wallace to verify that based on Ms. Wallace's legal research that the courts have not dissected and analyzed specific public intent.

MS. WALLACE answered not that she was aware of. She said she would have to reread the beginning of the Hickel v. Cowper case to see if the Supreme Court went as far as public intent.

CHAIR STOLTZE conceded that sometimes the public has a different opinion than what they say and think when testifying in committee.

MS. WALLACE noted that part of the reason that Legislative Legal Services raised an issue as to whether or not the placement of additional funds into the Permanent Fund through the ERA were retrievable goes back to the Permanent Fund section of the constitution that states the principal should be used only for income-producing investments. She said when more money is placed

into the Permanent Fund's principal, more income would be generated and the issue pertains to not having an expressed provision that allows for the temporary placement of money in the Permanent Fund to then be used for general funds expenditures or financing operation costs. She specified that appropriations out of the ERA and what the appropriations were used was not an issue. She reiterated that the larger issue pertained to the temporary placement of funds into the Permanent Fund itself.

[10:17:33 AM](#)

SENATOR WIELECHOWSKI said he appreciated and trusted Ms. Wallace's opinion. He conceded that no one knows what a court would decide, which creates a huge amount of instability. He asked Ms. Wallace to verify that the legislature has tried in the past to put money into the Permanent Fund and an attorney general had been very clear that money could not be placed into the Permanent Fund. He cited an opinion on the Permanent Fund from Attorney General Avrum Gross, dated August 31, 1977. He asked Ms. Wallace to provide additional historical information.

MS. WALLACE noted that she had written a memo to Senator Wielechowski regarding Attorney General Gross's opinion in 1977 [addresses an extra appropriation to the Permanent Fund] in addition to other attorney general opinions that affirmed the 1977 opinion. She pointed out that the legislature in the past had loaned some money to the Permanent Fund where the initial intent was to get the money back, but after some issues arose the legislature ultimately forgave the loan and the money stayed in the Permanent Fund and became a part of the principal.

[10:19:34 AM](#)

ATTORNEY GENERAL RICHARDS pointed out that the attorney general opinion in 1977 predated the existence of the ERA and specifically addressed how to handle the Permanent Fund corpus. He confirmed that his office has the same opinion as in 1977 that funds going into the Permanent Fund principal are not subject to be pulled out by general appropriation. He specified that the ERA was created after the 1977 opinion and was a creature of statute subject to appropriations.

SENATOR WIELECHOWSKI asserted that there was obvious concern in Attorney General Richards' office about the transfer of money from the CBR to the Permanent Fund because the bill proposes that the money be transferred from the CBR to the SBR and then to the Permanent Fund. He asked why the money was to be transferred in the proposed circuitous manner.

ATTORNEY GENERAL RICHARDS replied that until the issue came up, he was unaware of the proposed transfer. He disclosed that the transfer process was a budgetary decision and was not one that had legal significance. He remarked that the proposed transfer was an artifice of how the budget was put together. He said a direct transfer from the CBR to the ERA as an appropriation would be fine.

[10:20:56 AM](#)

CHAIR STOLTZE noted previous testimony by Attorney General Richards and Mr. Milks that voters had discerned and parsed their opinion on sub-accounts, but their next testimony was that the whole discussion predated [the ERA].

SENATOR MCGUIRE remarked that based on both the opinion predating the ERA and sound law, the testimony had narrowed down exactly right where the issue was not the corpus. She opined that the issue was the ERA, the definition of income, and what goes into the ERA.

She explained that when looking at solutions, she did not have a goal to entirely solve a gap of \$5.2 billion because she questioned the size and cost of government. She remarked that SB 128 was good, but a little bit risky. She asserted that her plan [SB 114] kept all of the elements in place that have had long running opinions, CBR, and ERA exactly where they are. She said the ERA can be both shared in dividends and shared in the amount going to the government itself. She stated that the risk in SB 128 was not inappropriate, but the income going into the ERA was a novel issue that would probably have to be decided in court. She said the committee, Legislature, and executive branch has to decide if the state wants to take on the risk proposed in SB 128.

[10:23:37 AM](#)

ATTORNEY GENERAL RICHARDS conceded that he was a good enough lawyer to know that he "can't fence a phantom" and he "can't prove a negative."

SENATOR MCGUIRE answered right.

ATTORNEY GENERAL RICHARDS remarked that someone can always come up with a legal theory that calls into question what you are trying to do and the response is always, "I don't think that's how the court would rule." He said he obviously could not affirmably say how the court would rule. He specified that what

he was trying to do was put context around the decision process and why the administration was not concerned about the risk. He set forth that the same risk theoretically applied across a whole series of state accounts, like the PCE fund and other pension funds where the funds were dealt with through the reverse sweep. He asserted that the custom around the Permanent Fund makes it more likely that the reverse sweep would be used as a mechanism to protect the ERA. He said in the very low probability event that the ERA was not subject to a reverse sweep, than a court decision would provide guidance. He summarized that the risk from such low probability events strung together should not be a driver in the decision making process because the Legislature has shown a demonstration and history that they are very likely to follow.

[10:25:22 AM](#)

SENATOR WIELECHOWSKI noted that David Teal, Legislative Finance Director, has also expressed concern. He said the combination of Mr. Teal, Legislative Legal Services, and the old attorney general opinions made it very clear that there was concern.

ATTORNEY GENERAL RICHARDS replied that he was not dismissing or diminishing Mr. Teal's or Legislative Legal's opinion. He specified that the same expressed concern exists through a whole series of state accounts that were dealt with by using the reverse-sweep mechanism. He set forth that the administration has a high confidence level that the reverse-sweep mechanism as a threshold matter would protect the plan for the decades going forward.

[10:27:14 AM](#)

CHAIR STOLTZE pointed out that the issue regarding SB 128 was non-partisan and noted that both Legislative Legal Services and Legislative Finance have spoken out against the bill.

ATTORNEY GENERAL RICHARDS agreed that there might be a difference of opinion of how the law might be applied. He revealed that he has not heard any difference of opinion as to the robustness of the historical practice of the reverse sweep.

CHAIR STOLTZE asserted that what was done in the past is not always right.

[10:29:29 AM](#)

SENATOR MCGUIRE reiterated that Attorney General Richards' argument was sound and the risk was not inappropriate. She noted

a higher level of scrutiny would be applied and explained as follows:

This issue is going to raise up to a higher level than maybe we've seen in a couple of decades and that's where I am concerned about the potential challenge that comes. I think you are already seeing posts about starting a citizens' referendum on whatever it is we do, whether it's your plan or mine, or a combination, so you're going to have that factor. You're going to have an extreme political microscopic focus on this because historically the Earnings Reserve Account has only statutorily been dedicated to paying out dividends, that's frankly the point, and people when it concerns their money that's going into their pocket they get, rightly, they become alert and aware. So I think there will be an unprecedented focus on whatever it is that we do and I think every element of it will be critiqued and challenged and I think that, particularly when it comes to the sweep and the CBR, because historically those are places where minority interests are protected. So it's almost like a layering of constitutional issues, in my opinion. But I also don't want to say too much on the record because I will say this that if it's the plan we go with, I want to defend it fully because I want the state to be in a good economic position. I do think that you have made sound arguments on the reverse sweep and you are right, there's nothing that we've said here on the record that challenges that mechanism that has been, if not articulated in custom and practice, it's survived the test of time and it has even survived in arguably dedicated funds that could also be somewhat controversial when you think about the impact of the PCE, when you think about the impact of the pension fund, those also have very significant financial impacts on Alaskans. So I can see it, I mean I can see it surviving and I will leave it at that and again say continue to put more and more on the record because I think it will be challenged if it is what survives.

[10:31:59 AM](#)

SENATOR COGHILL stated that the retirement system was probably more constitutionally protected than the PCE, something that probably was not good based on Article 12, Section 7. He conceded that the state was probably living in danger with the

PCE fund knowing that it was a dedicated fund. He said the only thing he was struggling with was whether the ERA was in the Permanent Fund's corpus. He explained that his understanding was that the ERA has been outside of the Permanent Fund corpus, therefore the ERA was sweepable. He opined that the state may have stood in danger for many years in which case the state has a larger problem of violating the constitution.

MR. MILKS replied that the PCE fund was not a general fund. He explained that the constitutional-sweep provision identifies general funds and the administration does not have concern about the ERA being subject to the sweep because the fund is not in the general fund.

SENATOR MCGUIRE agreed that the ERA was clearly not part of the Permanent Fund corpus. She concurred that the ERA was statutory and not a constitutional creation. She said the Hickel opinion has been unchallenged and establishes that the ERA earnings are not sweepable. She set forth that the question regarding the ERA pertained to comingling and asked if the administration agreed.

10:34:42 AM

ATTORNEY GENERAL RICHARDS answered that he agreed and specified that he did not agree that the comingling changes the nature of the ERA.

SENATOR MCGUIRE replied that she understood that Attorney General Richards did not believe that the comingling changes the nature of the ERA. She pointed out that the law was very sound with respect to the distinction between the constitutionally created corpus, the ERA, and the earnings that have come into the ERA as not being sweepable. She set forth that the next level pertained to the comingling of assets and specified as follows:

The next level is this new creation, this sovereign wealth fund, not a percentage of market value using existing structures or some of the other proposals, the new idea where you are comingling assets together in an earnings structure. The question that we've been trying to get at is whether or not that would be a challenge, the sweep-ability of those additional assets that you comeingle.

ATTORNEY GENERAL RICHARDS replied as follows:

As my final word, I'm just going to come back to what I've said now several times which is this issue is a matter of relevance for legal challenge, only even arises if we don't do the reverse sweep.

SENATOR MCGUIRE responded right.

ATTORNEY GENERAL RICHARDS summarized as follows:

It's a pretty low probability that we even ever can get to the legal issue based upon the practices of this body, in my view.

[10:36:09 AM](#)

MS. WALLACE summarized Legislative Legal Services' concerns as follows:

I think that I would just want to rearticulate that it's our office's opinion that the risk is twofold: it's not only that there's a risk that some of the money that is transferred or placed in the ERA might be deemed sweepable by the Supreme Court, but also that the placement of that additional revenue and transfer of money of the CBR and SBR when it's placed into the Permanent Fund whether or not that is retrievable and it's our office's opinion that that risk is more significant than whether you have to pay back a sweepable amount or a sweep that didn't occur.

[10:37:02 AM](#)

CHAIR STOLTZE commented that the committee did not get to a decisive conclusion on SB 128, but good information was put on the table.

[SB 128 was held in committee.]

[10:39:47 AM](#)

There being no further business to come before the committee, Chair Stoltze adjourned the Senate State Affairs Committee at 10:39 a.m.