

HOUSE FINANCE COMMITTEE  
February 8, 2018  
1:33 p.m.

1:33:05 PM

CALL TO ORDER

Co-Chair Foster called the House Finance Committee meeting to order at 1:33 p.m.

MEMBERS PRESENT

Representative Neal Foster, Co-Chair  
Representative Paul Seaton, Co-Chair  
Representative Les Gara, Vice-Chair  
Representative Jason Grenn  
Representative David Guttenberg  
Representative Scott Kawasaki  
Representative Steve Thompson  
Representative Cathy Tilton  
Representative Tammie Wilson

MEMBERS ABSENT

Representative Dan Ortiz  
Representative Lance Pruitt

ALSO PRESENT

Kendra, Kloster, Staff, Representative Chris Tuck; Patsy Wescott, Chief of Unemployment Insurance, Division of Employment and Training Services, Department of Labor and Workforce Development; Caroline Schultz, Policy Analyst, Office of Management and Budget; Kelly Cunningham, Analyst, Legislative Finance Division; Representative Justin Parish, Sponsor; Mike Barnhill, Deputy Commissioner, Department of Revenue; Alexei Painter, Analyst, Legislative Finance Division.

SUMMARY

HB 142 UNEMPLOYMENT COMPENSATION BENEFITS

CSHB 142 (FIN) was REPORTED out of committee with a "do pass" recommendation and with a new zero

fiscal note by the Department of Labor and Workforce Development and with a new indeterminate fiscal note by the Office of the Governor.

HB 213 PUBLIC SCHOOL TRUST FUND

HB 213 was REPORTED out of committee with three "do pass" recommendations, three "no recommendation" recommendations, and three "amend" recommendations and with one zero fiscal note and with two fiscal impact notes by the Department of Education and Early Development.

Co-Chair Foster reviewed the agenda for the day. He intended to move both bills on the agenda.

#hb142

HOUSE BILL NO. 142

"An Act relating to unemployment insurance benefits; increasing the maximum weekly unemployment insurance benefit rate; and providing for an effective date."

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Co-Chair Foster reported that the bill was last heard on February 2, 2018 at which time the committee took public testimony. There was one amendment that would be offered for the bill. He invited testifiers to the table.

KENDRA, KLOSTER, STAFF, REPRESENTATIVE CHRIS TUCK, relayed Representative Tuck's apologies for not being present. He was chairing another committee currently. She was available for questions.

Representative Wilson understood the amounts were being changed to be closer to the fiftieth percentile. She wondered why the scale stopped at \$59,500.

PATSY WESCOTT, CHIEF OF UNEMPLOYMENT INSURANCE, DIVISION OF EMPLOYMENT AND TRAINING SERVICES, DEPARTMENT OF LABOR AND WORKFORCE DEVELOPMENT, explained that the current scale determined the amount at which the department stopped. The scale increased the benefit in \$2 increments, and it increased the qualifying base period wages in \$250 increments. The department stopped the scale when it

reached \$510, approximately 50 percent of the state's average weekly wage.

Representative Wilson asked about the indeterminate fiscal note. The estimated cost difference, had it been done in 2017, was \$456,600. In order to determine the state's share of increase, she wondered if she would calculate 76 percent of \$456,600. Ms. Wescott responded that the fiscal note was prepared by the Office of Management and Budget (OMB). She thought it would be better to have a representative from OMB speak to the fiscal note.

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CAROLINE SCHULTZ, POLICY ANALYST, OFFICE OF MANAGEMENT AND BUDGET, introduced herself and asked Representative Wilson to repeat her question.

Representative Wilson relayed that the fiscal note was indeterminate because the state did not know what the wages would be or who would qualify. She supposed it was merely an estimate. Again, she referred to the cost difference of \$456,600. She asked for clarification about the calculation.

Ms. Schultz responded that the state paid for state employee unemployment insurance (UI) claims by associating a rate with every state employee. The unemployment insurance rate was .4 percent which went into the working reserve account. The state paid out terminal leave cash-ins and UI claims from the terminal leave account. The fund was underwritten by the .4 percent which came from personal services. She explained that about 50 percent of personal services costs were undesignated general funds (UGF), 36 percent were designated general funds (DGF), and the other 14 percent were federal funds. She continued that of \$456,600, about \$228,000 was UGF, \$164,000 was DGF and other, and \$64,000 were federal funds. Representative Wilson asked her to restate her answer. Ms. Schultz repeated the figures. Representative Wilson appreciated the information.

Representative Grenn asked when the weekly benefit had been increased last. Ms. Wescott responded effective January 1, 2009. Representative Grenn asked if there had been automatic adjustments every year. Ms. Wescott responded that the second portion of the bill would allow for

automatic increases moving forward. Representative Grenn referred to a note he had from the previous year that 36 states had automatic adjustments. He wondered if that number had changed. Ms. Wescott responded that the number was still 36.

Vice-Chair Gara understood why the fiscal note was indeterminate and was okay with leaving it that way. However, he thought there might be a problem at the end of the year because of no budget money being allocated for what the state knew would be approximately \$228,000 of UGF. He suggested there would be a \$230,000 cost at the end of the year.

Co-Chair Foster indicated that the one amendment being offered was brought to the committee by the bill sponsor.

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Co-Chair Foster MOVED to ADOPT Amendment 1 (copy on file):

Page 9, line 13:

Delete "2019"

Insert "2020"

Page 9, line 28:

Delete "2018"

Insert "2019"

Co-Chair Foster reviewed the amendment.

There being NO OBJECTION, Amendment 1 was ADOPTED.

Co-Chair Seaton was not comfortable with the indeterminate fiscal note. Fiscal notes were combined into the budget as appropriations. Without an amount, no money would be appropriated for the bill if it were to pass. He was unsure how to handle the matter.

Co-Chair Foster would take an at ease after Vice-Chair Gara reviewed the fiscal note.

Vice-Chair Gara reported that HB 142, version U, had 2 fiscal notes. The first was a zero fiscal note by the Department of Labor and Workforce Development (DLWD). The appropriation was unemployment and training services and the allocation was unemployment insurance. The OMB component number was 2276. The second fiscal note was the indeterminate fiscal note by OMB that had just been discussed. It reached across all of the departments in the state and had an OMB component number of 0.

Co-Chair Foster invited Kelly Cunningham from the Legislative Finance Division (LFD) to the table.

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KELLY CUNNINGHAM, ANALYST, LEGISLATIVE FINANCE DIVISION, responded that because increasing the UI benefits would touch all allocations, she did not believe there was a way to generate a fiscal note that would represent every allocation in the state. The Legislative Finance Division worked with OMB and DLWD on the fiscal note and concluded that it made sense to use "various" and for the note to be indeterminate as long as an amount was included in the analysis.

Vice-Chair Gara asked if the normal course would be to add the funds as a statewide appropriation when the budget was reconciled at the end of the year. Ms. Cunningham replied that there would not be an appropriation in the operating bill. The costs would not be seen, as they would be spread throughout the agencies and rolled in with all of the other benefits that went into salary adjustment increases in the following year.

Vice-Chair Gara was comfortable with the bill and would support it. However, he did not want the state to lose 2 employees because of the lack of a fiscal note. Ms. Cunningham noted that there would not be a loss of 2 employees within DLWD because the cost would be spread throughout the state agencies.

Co-Chair Foster asked Ms. Cunningham to repeat her response, as Co-Chair Seaton did not hear her answer. Ms. Cunningham explained that because the increase in the UI benefits would touch all allocations throughout the state, there would not be an efficient way of generating a fiscal

note. The "various" indeterminate note made sense as long as the estimated amount was in the analysis.

Representative Wilson asked when the bill would take effect. Ms. Cunningham replied it would take effect in January 2019. It would impact half of the FY 19 budget. The estimated amount for FY 19 would be \$115,000, and it would be \$230,000 in the out years starting in FY 20. She noted it would be automatic.

Representative Guttenberg wanted reassurance that the indeterminate fiscal note would not end up as a negative in the budget. Ms. Cunningham understood that the costs would get rolled in after the fact. Representative Guttenberg clarified that the cost would be added rather than subtracted after the fact. Ms. Cunningham responded, "That is correct."

Co-Chair Seaton confirmed that the legislature had the ability to do a fiscal note in conference committee if necessary. He was comfortable moving the bill.

Co-Chair Seaton MOVED to report CSHB 142 (FIN) out of Committee with individual recommendations and the accompanying fiscal notes.

There being NO OBJECTION, it was so ordered.

CSHB 142 (FIN) was REPORTED out of committee with a "do pass" recommendation and with a new zero fiscal note by DLWD and with a new indeterminate fiscal note by the Office of the Governor.

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AT EASE

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RECONVENED

#hb213

HOUSE BILL NO. 213

"An Act relating to the investment, appropriation, and administration of the public school trust fund."

[1:56:33 PM](#)

Co-Chair Foster indicated that the committee last heard HB 213 on January 30, 2018 at which time a committee substitute, version R, was adopted, and public testimony was taken. His office had received one amendment for the bill. He asked the bill sponsor and his staff to come to the table.

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REPRESENTATIVE JUSTIN PARISH, SPONSOR, spoke to the benefit of the bill. The bill was a way of bringing additional revenue to the State of Alaska through better management of one of the state's large investment funds. The state would be able to continue to achieve the mission of the trust - to maintain its inflation-adjusted value and do better at spinning off money to support public education. He had no fundamental objections to the amendment being offered.

Representative Wilson wanted to better understand how much money the state was making on the account based on the way it was currently being managed, versus the amount the state would make if it was managed in the way it was proposed in the bill.

Representative Parish referred to a Department of Revenue (DOR) spreadsheet "DOR 10-Year 'What if' Payout" (copy on file). He pointed to the 3rd and 4th lines below the table under "Notes." The status quo endowment returned a little under 6 percent (the projection). He deferred to Mr. Barnhill to explain further.

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MIKE BARNHILL, DEPUTY COMMISSIONER, DEPARTMENT OF REVENUE, sent a letter to the committee, dated February 3, 2018 (copy on file). Attached to the letter were the rates of return for the Public School Trust as of December 31, 2017. The 1-year return was 13.79 percent; the 3-year return was 6.74 percent; the 5-year return was 7.36 percent; and the 10-year return was 6.23 percent. He would be happy to review them to give members the historical sense of the performance of the fund.

Mr. Barnhill continued that the primary intent of the bill, from the department's perspective, was not to generate more income for public schools. It was to convert the trust fund from an old-style principle-and-income trust fund to a

modern style endowment fund. In making the change, the purpose would evolve from protecting the principle to protecting the inflation-adjusted value of the fund over time. The old principle and income fund did a fine job of protecting the inflation-adjusted value. However, he thought the endowment approach did it more precisely. Once the fund was converted to an endowment style trust fund, DOR would feel comfortable changing the asset allocation.

Mr. Barnhill reported that currently DOR had roughly 55 percent invested in equities and 45 percent invested in fixed income. He explained that because it was under the principle and income style of accounting, the department weighted it more heavily to fixed income in order to generate more cash. Under the statute for the trust fund, only cash could be expended. Once the fund was converted to an endowment fund, the department would weight it more heavily to equities - approximately 70 percent equities, 30 percent fixed income. The fund could be invested more aggressively, and over time, the fund was expected to generate more income. The reason for changing to an endowment fund was two-fold. First, the department wanted to protect the inflation-adjusted value of the fund over time so that the real value of the fund would not change. Secondly, the department wanted to prudently maximize income to current beneficiaries. It would maintain the fairness of the trust by providing the same benefit over various periods of time. He referred to the concept as "intergenerational equity."

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Representative Wilson was concerned with spending the principle. She understood that rules disallowing dipping into the fund were no longer in place. She wondered why 4.75 for a Percent of Market Value (POMV) was chosen rather than 4 percent or 4.25 which would lessen the chance of eating into the principle. Mr. Barnhill thought a review of Amendment 1 might help answer the representative's question. He referred to page 2 of the amendment.

Representative Guttenberg suggested that the amendment be moved. Representative Wilson preferred to hear Mr. Barnhill's explanation first.

Mr. Barnhill continued with his explanation. He referred to page 2 of Amendment 1, lines 7-8. He highlighted that words

"not more than" were inserted before 4.75. Currently, the bill read: "4.75 can be appropriated of the 5-year average market value of the fund." He explained that by inserting the words "not more than" it would give the department the ability to correct its course. He suggested there might be investment environments in which, in an effort to maintain the inflation-adjusted value and to maximize income to current beneficiaries, the department would want to appropriate less than 4.75 percent. For example, the department might recommend 4.5 percent for one year and the wording would allow for the adjustment. From an investment management perspective, the department was trying to maintain the inflation-adjusted value over successive periods of time.

Mr. Barnhill pointed to Amendment 1, page 2, lines 10-12 which eliminated the distinction between principle and income. He acknowledged Representative Wilson's concern was fair. In every transition from a principle and income trust to an endowment trust, the question was always raised about being able to protect the principle of a fund. The concern was the principle being invaded and spent in a down market when the trust was under water. He explained that what modern trust law permitted trustees of endowments to do was spend the endowment when it was under water. The notion was about trying to balance competing concerns - protecting the inflation-adjusted value and meeting the needs of current beneficiaries. He reiterated that in substantial down markets modern trust law permitted expenditures from an underwater trust. However, the expectation was that management would do everything possible to return the value to the inflation-adjusted value. He clarified that the department included the course correction language of "not more than 4.75 percent" so that the trust administrators could make the recommendation to appropriate something less than 4.75 percent when the trust was underwater. He added that the benefit to having the "not more" language was the analysis would be made annually and would allow for course correction.

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Representative Wilson appreciated Mr. Barnhill's comments. She asked for further clarification regarding the 4.75 number, which she thought was a number used in general practice. She queried the use of language that stipulated

not using any of the principle. She wanted to ensure the health of the fund.

Mr. Barnhill thought her concern was fair. The department called her concern, "The blow through concern." The question was whether the department would make a recommendation or whether the legislature would blow through the principle. He could not offer a guarantee that the principle would not be spent. He spoke about the "Prudent Expenditure Rule." He explained that the experts in trust law married a prudent expenditure rule with the prudent investment rule. The idea was that the department would be subjecting an expenditure to a prudency evaluation and the fiduciary standard of care, the highest standard under law. The department's hope was that if the legislature embraced the endowment approach, when the department made a recommendation to spend less than 4.75 percent and provided justifying analysis, the legislature would respect its recommendations. He relayed that the department would provide the factors used in its evaluation to support spending less. He noted that if an analysis was done pursuant to a fiduciary standard of care, the department would be rigorous in its analysis and give the legislature its best guess as to the prudent way to spend from the trust.

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Vice-Chair Gara MOVED to ADOPT Amendment 1 (copy on file):

Page 1, lines 4 - 10:

Delete all material and insert:

"\* Section 1. AS 3 7.10.07 1(d) is amended to read:

(d) In exercising investment, custodial, or depository powers or duties under this section, the fiduciary or the fiduciary's designee is liable for a breach of a duty that is assigned or delegated under this section, or under AS 14.40.255, 14.40.280(c), 14.40.400(b), AS 37.10.070, AS37.14.160 [AS 37.14.1 10(c), 37.14.160], or 37.14.170. However, the fiduciary or the designee is not liable for a breach of a duty that has been delegated to another person if the delegation is prudent under the applicable

standard of prudence set out in statute or if the duty is assigned by law to another person, except to the extent that the fiduciary or designee

(1) knowingly participates in, or knowingly undertakes to conceal, an act or omission of another person knowing that the act or omission is a breach of that person's duties under this chapter;

(2) by failure to comply with this section in the administration of specific responsibilities, enables another person to commit a breach of duty; or

(3) has knowledge of a breach of duty by another person, unless the fiduciary or designee makes reasonable efforts under the circumstances to remedy the breach."

Page 2, lines 3 - 4:

Delete "in separate principal and income accounts for"

Insert "into [IN SEPARATE PRINCIPAL AND INCOME ACCOUNTS FOR]"

Page 2, lines 5 - 6:

Delete "that distinguish between the principal and income of the fund"

Insert "[THAT DISTINGUISH BETWEEN THE PRINCIPAL AND INCOME OF THE FUND]1"

Page 2, line 13, following "appropriate":

Delete "AS 37.14.140 is"

Insert "11AS 37.14.110(c) and 37.14.140 are"

Representative Wilson OBJECTED for discussion.

Vice-Chair Gara spoke to the amendment. He mentioned that he and Representative Pruitt had expressed concerns and thought an amendment was needed for the bill. He explained that without the amendment, if the stock market performed poorly the fund would not generate revenue. The current trust would spin off \$25 million. The legislature would

have to come up with \$25 million from another source. He furthered that if the next year was another bad year, there would be no money again. The prudent expenditure rule stated that trusts were managed for the long-term. In other words, the principle would be fully maintained over the long-term. The point of the Public School Trust was to spin off a consistent amount of money in a careful way.

Vice-Chair Gara spoke to the flexibility of a modern endowment model. He also noted that the bill in its current form tried to balance generating income while protecting the principle. Based on a 5-year look-back and after about 10 years 2.5 percent of the principle would disappear. The sponsor of the bill originally had a 10-year look-back which limited revenue too much. The changes in the amendment would facilitate spinning off roughly \$8 million in revenue and allowed the department to invest more prudently to generate better returns over the long-term. He thought it was a safe way of producing more revenue from the trust fund which was the sponsor's intent along with protecting the principle over the long-term. He invited Mr. Barnhill to comment.

Mr. Barnhill responded that the amendment was fine. He noted that in looking at the chart containing the various adding methodologies ["What if Payouts] that with the 5-year average POMV, the inflation-adjusted value at the end of the 10-year period was less than 100 percent. At the end of a 20-year period it remained less than 100 percent but was incrementally better. He explained that by inserting the "not more than" language, the department would be required to do better by course correcting periodically in order to stay closer to 100 percent. He added that over long periods of time hitting 97 percent to 100 percent would mean managers were doing a good job.

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Representative Wilson asked someone to explain Section 1 of the amendment. Mr. Barnhill asked whether Representative Wilson was referring to the first part of the Amendment. Representative Wilson responded affirmatively.

Mr. Barnhill replied that the first part of the amendment, lines 1-19, simply had conforming changes. The deleted language included reference to AS 37.14.110(c) and AS 37.14.160. All that was being done was conforming the

language to the amendment. The last section of the amendment deleted AS 37.14.110(c) which was what created the distinction between principle and income in the trust. The bill was deleting the distinction between principle and income or the requirement to account for it. The amendment simply removed AS 37.14 110(c) from statute.

Representative Wilson asked for further clarification. She thought the person that made the determination, the commissioner, was being removed. She asked who would make the determination. Representative Parish directed attention to page 2, lines 9-10. The duties of the commissioner included determining the monthly average market value of the fund for the 5 fiscal years preceding the previous year on July 1st of each year. There was a calculation in place.

Mr. Barnhill explained that the repeal of Section 1, lines 1-10 took place in 2 parts of the amendment: the deletion of all material (lines 4-10) and the last part of the amendment, the repealer. In lieu of Section 1, there was a new conforming Section 1. Representative Wilson asked, "Conforming to what?" Mr. Barnhill responded that it deleted reference to AS 37.14.110(c) which was being repealed. Representative Wilson did not understand the amendment. She relayed her understanding of the amendment.

Vice-Chair Gara explained the lines in section 1. He thought the amendment could have been written with more clarity. Representative Wilson read from the amendment. She wondered if the amendment was referring to a person. Vice-Chair Gara responded from line 4-19 was already in statute. The only change was the deletion of AS 37.14.110(c) which addressed the issue of whether the principle could be tapped. The only change had to do with the one statutory reference. Representative Wilson asked, if the statute was kept in the bill, whether the principle would remain untouched. Vice-Chair Gara replied that if AS 37.14.110(c) the system would remain a principle trust instead of a prudent expenditure rule trust.

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Representative Wilson relayed she did not want to keep the trust as a principle trust. She wanted to protect the principle. She was fine with the changes and was glad the "up to" language was included. She did not trust the legislature not to use the entire 4.75 percent, as times

were unpredictable. She indicated she had seen similar decisions made by the legislature about other funds such as the Power Cost Equalization (PCE) fund. She wanted to make sure that the money was protected for students. She did not like that there was the possibility that, even after a recommendation from the department for a smaller draw, the legislature would take a higher amount.

Representative Wilson WITHDREW her OBJECTION.

There being NO OBJECTION, Amendment 1 was ADOPTED.

Co-Chair Foster asked Vice-Chair Gara to review the fiscal notes.

Vice-Chair Gara indicated there were 3 fiscal notes for the bill. The first fiscal note with an OMB component number of 2804 by DEED listed the department and the appropriation as fund capitalization. The allocation was the public education fund. The second fiscal note by DEED, OMB component number 1060, listed the allocation and appropriation as Mt. Edgecumbe Boarding School. There was a fiscal impact of \$4.6 million for operating expenditures which was included in the governor's budget request. He continued that the third DEED fiscal note, OMB component number 141, had an appropriation of K-12 aid to school districts and an allocation of foundation program. The bill had a fiscal impact listing the governor's FY 19 request for operating expenditures.

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Representative Wilson was truly concerned with the possibility of going into the principle. Although she liked the possibility of the fund earning more money, she was very concerned about touching the principle. She thought that someone from the Legislative Finance Division should respond.

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ALEXEI PAINTER, ANALYST, LEGISLATIVE FINANCE DIVISION, explained that by removing the distinction between

principle and income, it was possible to dip into what was considered the principle. It was his understanding that the addition of the words "up to" in the amendment would allow the legislature to choose not to do so. He reconfirmed that the legislature could dip into the current value of the principle.

Representative Parish thought that, while the management structure was designed to maintain the inflation-adjusted value of the fund, having separate accounts for principle and income did not achieve the objective. He thought, over the long-term, the most real representation of the value of the fund was not principle income but rather inflation-adjusted value and being able to maximize the amount available to public education in the current year and years to come.

Vice-Chair Gara asked Mr. Barnhill about moving to the Prudent Expenditure Rule. He asked, by allowing the department to manage the fund for long-term returns, whether the bill would have any impact on investment returns possibly leading to better returns.

Mr. Barnhill replied that if the legislature switched to an endowment methodology (the prudent expenditure rule) the department would change the asset allocation from a 55/45 equity fixed income allocation to a 70/30 allocation. He commented that over periods of time the change should generate enhanced growth over a portfolio weighted more heavily towards fixed income. Over specific periods of time the equity markets were more volatile. He could not guarantee that it would produce more income in any particular year but thought that over longer periods it should.

Co-Chair Seaton MOVED to report CSHB 213 (FIN) out of Committee with individual recommendations and the accompanying fiscal notes.

There being NO OBJECTION, it was so ordered

HB 213 was REPORTED out of committee with three "do pass" recommendations, three "no recommendation" recommendations, and three "amend" recommendations and with one zero fiscal note and with two fiscal impact notes by the Department of Education and Early Development.

Co-Chair Foster reviewed the agenda for the following day.

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ADJOURNMENT

2:29:30 PM

The meeting was adjourned at 2:29 p.m.