

CSHB

547

SENATE COMMITTEE REPORT

FURTHER

4/19/88

DATE TURNED INTO OFFICE 5/6/88

Mr. President:

FINANCE Committee considered CSHB 547 (FIN) am  
investment and management of certain state funds; efd

and recommended

replace with SCS CS HB 547 (Fin)  same title  
 or adopt \_\_\_\_\_ CS \_\_\_\_\_  new title

attached amendment(s) and

do pass

do not pass

no recommendation

individual recommendations

further referral to \_\_\_\_\_

letter of intent adopted \_\_\_\_\_

Committee  attached or  adopted fiscal note(s)

new  updated or  previous

zero DOR  fiscal impact

MEMBERS SIGNING DO PASS

OTHER RECOMMENDATIONS

[Signature]  
[Signature]  
[Signature]  
[Signature]  
[Signature]  
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[Signature] NO REC  
Chairman signature and recommendation

Committee Backup attached

FISCAL NOTE

REQUEST:

Revision Date: \_\_\_\_\_  
Title: Investment & Management of  
Certain State Funds  
Sponsor: House Finance  
Requestor: House Finance

Agency Affected: Department of Revenue  
BRU: Treasury  
Components: \_\_\_\_\_

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 88	FY 89	FY 90	FY 91	FY 92	FY 93
OPERATING						
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LANDS & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0	0	0	0	0	0
CAPITAL						
REVENUE						

FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL						

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS: Attach a separate page for analysis.

Prepared By: Milt Barker MB  
Division: Treasury

Phone: 465-2350  
Date: March 30, 1988

Approved by Commissioner: [Signature]  
Agency: Department of Revenue

Date: 3/31/88

Distribution (by preparer):  
Legislative Finance  
Legislative Sponsor  
Requestor  
Office of Management and Budget  
Impacted Agency(ies)



APR 4 1988 page 1 of 1

5-2059X  
Cramer  
5/5/88

Original sponsor: Finance Committee

*Adopted*  
*5/6/88 am*

1 IN THE HOUSE

BY THE FINANCE COMMITTEE

2 SENATE CS FOR CS FOR HOUSE BILL NO. 547 (Finance)

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 FIFTEENTH LEGISLATURE - SECOND SESSION

5 A BILL

6 For an Act entitled: "An Act relating to the investment and management of  
7 certain state funds; and providing for an effective  
8 date."

9 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

10 \* Section 1. AS 14.25.035(c) is repealed and reenacted to read:

11 (c) The board shall confer with the commissioner of adminis-  
12 tration regarding the administration of the system and may make rec-  
13 ommendations that it considers necessary.

14 \* Sec. 2. AS 14.25.035(d) is repealed and reenacted to read:

15 (d) The commissioner of administration shall report to the board  
16 concerning the condition and administration of the system. The re-  
17 ports shall be distributed to the members of the system. The commis-  
18 sioner of revenue shall provide reports to the board on the condition  
19 and investment performance of the teachers' retirement trust fund.

20 \* Sec. 3. AS 14.25.170 is amended to read:

21 Sec. 14.25.170. ADMINISTRATION. The commissioner of adminis-  
22 tration is responsible for the administration of the retirement system  
23 and for making the provisions of this chapter effective. The [AND  
24 THE] powers and duties of the commissioner for this purpose include  
25 [BUT ARE NOT LIMITED TO]

- 26 (1) maintaining the accounts of the system;  
27 (2) making payments for the various purposes specified;  
28 (3) submitting required [SUCH] periodic reports or state-  
29 ments of account [AS MAY BE REQUIRED];

1 (4) establishing [PRESCRIBING] by regulation the rate of  
2 interest that shall be credited to the individual contribution ac-  
3 counts of teachers each year; the rate of interest shall be adopted on  
4 the basis of the probable effective rate of interest on a long-term  
5 basis, and the rate may be changed from time to time by subsequent  
6 regulation;

7 (5) establishing a teachers' retirement trust fund in which  
8 the assets of the system shall be deposited and held; and

9 (6) engaging an independent certified public accountant to  
10 conduct an annual audit of the system's accounts and the annual report  
11 of the system's financial condition and financial activity.

12 \* Sec. 4. AS 14.25.180 is repealed and reenacted to read:

13 Sec. 14.25.180. INVESTMENT AND TREASURY. (a) The commissioner  
14 of revenue is the treasurer of the system and the fiduciary of the  
15 fund. In managing the fund, the commissioner of revenue shall

16 (1) consider the status of the fund's investments and the  
17 system's liabilities on both a current and a probable future basis;

18 (2) determine the appropriate investment objectives for the  
19 fund;

20 (3) establish investment policies aimed at achieving the  
21 objectives; and

22 (4) act only in regard to the best financial interests of  
23 the system's beneficiaries.

24 (b) The commissioner of revenue may invest the fund on the basis  
25 of probable total rate of return without regard to the distinction  
26 between principal and income or to the generation of income.

27 (c) In carrying out investment duties under this chapter, the  
28 commissioner of revenue has the same powers and duties in regard to  
29 the teachers' retirement trust fund as are provided in AS 37.10.071,

1 except that the standard of prudence that the commissioner must obey  
2 under AS 37.10.071(c) shall be in regard to the management of large  
3 trust investments rather than large investments.

4 \* Sec. 5. AS 14.40.255 is amended to read:

5 Sec. 14.40.255. INVESTMENT OF SURPLUS MONEY. If the Board of  
6 Regents determines that there is a surplus of money, received in the  
7 form of state and federal appropriations, above the amount sufficient  
8 to meet current and projected cash expenditure needs of the univers-  
9 ity, the surplus must be invested as [IN THE SAME INSTRUMENTS] set out  
10 in AS 37.10.071. Income [AS 37.10.070 APPROVED FOR INVESTMENT OF  
11 STATE TREASURY SURPLUS. INTEREST INCOME] earned on investments made  
12 under this section may be retained by the university and expended in  
13 accordance with the Executive Budget Act (AS 37.07).

14 \* Sec. 6. AS 14.40.400(a) is amended to read:

15 (a) The Department of Revenue shall establish a separate endow-  
16 ment trust fund in which all net income [MONEY] derived from the sale  
17 or lease of the land granted under the Act of Congress approved  
18 January 21, 1929, and in which all monetary gifts, bequests or endow-  
19 ments made to the University of Alaska for the purpose of the fund,  
20 shall be held in trust.

21 \* Sec. 7. AS 14.40.400(b) is repealed and reenacted to read:

22 (b) The commissioner of revenue is the fiduciary of the trust  
23 fund and shall account for and invest the fund as set out in AS 37.-  
24 14.110(c), 37.14.160, and 37.14.170, except that the commissioner  
25 shall report the condition and investment performance of the fund to  
26 the Board of Regents.

27 \* Sec. 8. AS 14.40.400(c) is amended to read:

28 (c) The net income from the trust fund shall be used exclusively  
29 for the Agricultural College and School of Mines.

1 \* Sec. 9. AS 14.40.400(e) is amended to read:

2 (e) The Department of Administration shall disburse the net  
3 income from the trust fund upon vouchers approved by the president and  
4 treasurer of the University of Alaska specifying the purpose for which  
5 the money is to be used and showing it is to be used in conformity  
6 with this section.

7 \* Sec. 10. AS 14.42.200(8) is amended to read:

8 (8) invest or reinvest, subject to its contracts with  
9 noteholders and bondholders, money held by the corporation as set out  
10 in AS 37.10.071 [OBLIGATIONS OR OTHER SECURITIES AUTHORIZED FOR IN-  
11 VESTMENTS OF THE COMMISSIONER OF REVENUE UNDER AS 37.10.070(a)];

12 \* Sec. 11. AS 14.42.210(b) is amended to read:

13 (b) Money and other assets of the student loan fund may be used  
14 to secure bonds of the corporation, invested in student loans and  
15 investments under AS 37.10.071 [DESCRIBED IN AS 37.10.070(a)] and used  
16 to purchase loans approved under AS 14.43.090 - 14.43.325, 14.43.600 -  
17 14.43.700, or 14.43.710 - 14.43.790.

18 \* Sec. 12. AS 18.26.170 is amended to read:

19 Sec. 18.26.170. INVESTMENTS BY AUTHORITY. Except as otherwise  
20 provided by this chapter, the authority may invest any funds, not  
21 needed to meet current cash expenditure needs, as set out in AS 37.-  
22 10.071 [SECURITIES, OBLIGATIONS OR CERTIFICATES OF DEPOSIT APPROVED  
23 FOR INVESTMENT OF THE STATE TREASURY SURPLUS UNDER AS 37.10.-  
24 070(a)(1) - (4). THESE INVESTMENTS SHALL BE PURCHASED AT NO HIGHER  
25 PRICE THAN THE OFFERING OR MARKET PRICE OF THEM AT THE TIME OF THE  
26 PURCHASE].

27 \* Sec. 13. AS 18.56.095(b) is amended to read:

28 (b) In addition to any other fees and charges that the corpo-  
29 ration may charge on mortgage loans, it may collect or cause to be

1 collected on all mortgage loans made or purchased with the proceeds of  
2 the sale of mortgage insurance bonds, either or both a special mort-  
3 gage loan insurance commitment fee or a mortgage loan insurance premi-  
4 um. The special mortgage loan insurance commitment fees and special  
5 mortgage loan insurance premiums when received shall be deposited in  
6 the mortgage insurance fund by the corporation, or by any mortgage  
7 loan servicer, trustee, or agent designated by the corporation to  
8 receive them, and shall be held, invested and, together with all  
9 investment income derived from them, reinvested by the commissioner of  
10 revenue as set out in AS 37.10.071 [INVESTMENTS AUTHORIZED UNDER  
11 AS 37.10.070(a)], subject to any agreement with the corporation under  
12 (a) of this section.

13 \* Sec. 14. AS 22.25.048(a) is amended to read:

14 (a) The commissioner of administration shall establish a judi-  
15 cial retirement trust fund for the judicial retirement system in which  
16 the assets of the system are deposited and held. The commissioner  
17 [AND] shall maintain accounts and records for the [JUDICIAL RETIRE-  
18 MENT] system.

19 \* Sec. 15. AS 22.25.048(c) is repealed and reenacted to read:

20 (c) The commissioner of revenue is the treasurer of the system  
21 and the fiduciary of the fund and has the same powers and duties under  
22 this section in regard to the judicial retirement trust fund as are  
23 provided in AS 14.25.180.

24 \* Sec. 16. AS 26.05.228(a) is amended to read:

25 (a) The commissioner of administration shall establish a mili-  
26 tary retirement trust fund for the system in which the assets of the  
27 system are deposited and held. The commissioner shall [AND] maintain  
28 accounts and records for the system.

29 \* Sec. 17. AS 26.05.228(c) is repealed and reenacted to read:

1 (c) The commissioner of revenue is the treasurer of the system  
2 and the fiduciary of the fund and has the same powers and duties under  
3 this section in regard to the fund as are provided under AS 14.25.180.

4 \* Sec. 18. AS 36.30.850(b) is amended to read:

5 (b) This chapter applies to every expenditure of state funds,  
6 irrespective of their sources, including federal assistance except as  
7 otherwise specified in AS 36.30.890, by the state, acting through an  
8 agency, under a contract, except that this chapter does not apply to

9 (1) grants;

10 (2) contracts for professional witnesses to provide for  
11 professional services or testimony relating to existing or probable  
12 lawsuits in which the state is or may become a party;

13 (3) contracts of the University of Alaska where the work is  
14 to be performed substantially by students enrolled in the university;

15 (4) contracts for medical doctors and dentists;

16 (5) acquisitions or disposals of real property or interest  
17 in real property, except as provided in AS 36.30.080;

18 (6) disposals under AS 38.05;

19 (7) contracts for the preparation of ballots under AS 15.-  
20 15.030;

21 (8) acquisitions or disposals of property and other con-  
22 tracts relating to airports under AS 02.15.070, 02.15.090, and 02.15.-  
23 091;

24 (9) disposals of obsolete property under AS 19.05.060;

25 (10) disposals of obsolete material or equipment under  
26 AS 35.20.060;

27 (11) agreements with providers of services under AS 47.07;  
28 AS 47.08; AS 47.10; AS 47.17; AS 47.24; AS 47.25.195, and 47.25.310;

29 (12) contracts of the Department of Fish and Game for

1 flights that involve specialized flying and piloting skills and are  
2 not point-to-point;

3 (13) purchases of income-producing assets for the state  
4 treasury or a public corporation of the state;

5 (14) a contract that is a delegation, in whole or in part,  
6 of investment powers held by the commissioner of revenue under AS 14.-  
7 25.180, AS 14.40.400, AS 14.42.200, 14.42.210, AS 18.56.095, AS 22.-  
8 25.048, AS 26.05.228, AS 37.10.070, 37.10.071, AS 37.14, or AS 39.-  
9 35.080; or

10 (15) a contract that is a delegation, in whole or in part,  
11 of investment powers of the Board of Trustees of the Alaska Permanent  
12 Fund Corporation under AS 37.13.

13 \* Sec. 19. AS 37.10.070 is repealed and reenacted to read:

14 Sec. 37.10.070. INVESTMENT OF RESIDUAL MONEY. (a) The commis-  
15 sioner shall invest, as set out in AS 37.10.071, the money in the  
16 state treasury above an amount sufficient to meet immediate expendi-  
17 ture needs. In managing the invested assets, the commissioner shall

18 (1) consider the status of the assets and liabilities on  
19 both a current and a probable future basis;

20 (2) determine the appropriate investment objectives;

21 (3) establish investment policies to achieve the objec-  
22 tives; and

23 (4) act only in regard to the best financial interests of  
24 the state.

25 (b) The commissioner may invest on the basis of probable total  
26 rate of return without regard to the distinction between principal and  
27 income and without regard to the generation of income.

28 (c) In this section, "commissioner" means the commissioner of  
29 revenue.

1 \* Sec. 20. AS 37.10 is amended by adding a new section to read:

2 Sec. 37.10.071. INVESTMENT POWERS AND DUTIES. (a) In making  
3 investments under this section, the commissioner of revenue shall

4 (1) act as official custodian of cash and investments by  
5 securing adequate and safe custodial facilities for them;

6 (2) receive all items of cash and investments;

7 (3) collect and deposit the principal of and income from  
8 owned or acquired investments;

9 (4) invest and reinvest the assets in accordance with this  
10 section;

11 (5) receive and spend appropriations to cover the cost of  
12 the exercise of duties under this section;

13 (6) exercise the powers of an owner with respect to the  
14 assets;

15 (7) perform all acts, not prohibited by this section,  
16 whether or not expressly authorized, that the commissioner considers  
17 necessary or proper in administering the assets;

18 (8) maintain accounting records in accordance with invest-  
19 ment accounting principles;

20 (9) engage an independent certified public accountant to  
21 conduct an annual audit of the financial condition and investment  
22 transactions;

23 (10) enter into and enforce contracts or agreements con-  
24 sidered necessary, convenient, or desirable for the investment pur-  
25 poses of this section; and

26 (11) when choosing to acquire or dispose of investments,  
27 secure competitive national or international market rates or prices,  
28 or the equivalence of those rates or prices in the judgment of the  
29 commissioner.

1 (b) Under this section, the commissioner or the commissioner's  
2 designee may

3 (1) delegate investment, custodial, or depository authority  
4 on a discretionary or nondiscretionary basis to officers or employees  
5 of the state or to independent firms, banks, or trust companies, by  
6 designation through appointments, contracts, or letters of authority;

7 (2) acquire or dispose of investments either directly,  
8 indirectly, or through investment pools or trusts, by competitive or  
9 negotiated agreements, contracts, or auctions, in public or private  
10 markets;

11 (3) concentrate or diversify investments as the commis-  
12 sioner considers appropriate to increase the probable total rate of  
13 return or to decrease the overall exposure to potentially adverse  
14 market value risks;

15 (4) protect the market value or the rate of return of the  
16 investments by entering into forward agreements to buy or sell assets  
17 at a future date as a hedge against existing held assets or as a  
18 precommitment of future cash flows;

19 (5) lend assets, under an agreement and for a fee, against  
20 deposited collateral of equivalent market value;

21 (6) borrow assets on a short-term basis, under an agreement  
22 and for a fee, against the deposit of collateral consisting of other  
23 assets in order to accommodate temporary cash or investment needs;

24 (7) hold investments in bearer or registered form in the  
25 name of the state, a fund, or nominees authorized by the commissioner;

26 (8) utilize consultants, advisors, custodians, investment  
27 services, and legal counsel for assistance in investment matters on  
28 either a continuing or a limited-term basis and with or without com-  
29 pensation;

1 (9) declare records to be confidential and exempt from  
2 AS 09.25.110 and 09.25.120 if the records contain information that  
3 discloses the particulars of the business or the affairs of a private  
4 enterprise, investor, borrower, advisor, consultant, counsel, or  
5 manager.

6 (c) In exercising investment, custodial, or depository powers or  
7 duties under this section, the commissioner shall exercise the judg-  
8 ment and care under the circumstances then prevailing that an institu-  
9 tional investor of ordinary professional prudence, discretion, and  
10 intelligence exercises in managing large investments with considera-  
11 tion for the purpose of the fund, the investment objectives, the  
12 continuing disposition of the fund's investments, and the probable  
13 safety of the capital as well as the probable investment returns.

14 (d) In exercising investment, custodial, or depository powers or  
15 duties under this section, the commissioner or a designee of the  
16 commissioner is liable for a breach of a duty that is assigned or  
17 delegated under this section, or under AS 14.25.180, AS 14.40.400(b),  
18 AS 37.10.070, AS 37.14.110(c), 37.14.160, 37.14.170, or AS 39.35.080.  
19 However, the commissioner or the commissioner's designee is not liable  
20 for a breach of a duty that has been delegated to another person if  
21 the delegation is prudent under the applicable standard of prudence  
22 set out in statute or if the duty is assigned by law to another per-  
23 son, except to the extent that the commissioner or designee

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

27 (2) by failure to comply with this section in the adminis-  
28 tration of specific responsibilities, enables another person to commit  
29 a breach of duty; or

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

4 (e) The state shall defend and indemnify the commissioner or an  
5 officer or employee of the state against liability under (d) of this  
6 section to the extent that the alleged act or omission was performed  
7 in good faith and was prudent under the applicable standard of pru-  
8 dence.

9 (f) In this section, "commissioner of revenue" or "commissioner"  
10 means

11 (1) the commissioner of revenue for investments under  
12 AS 14.25.180 or AS 37.10.070; or

13 (2) the person or body provided by law to manage the inves-  
14 tments, for investments not subject to AS 14.25.180 or AS 37.10.070.

15 \* Sec. 21. AS 37.14.110(a) is amended to read:

16 (a) There is established as a separate endowment trust fund the  
17 public school trust fund.

18 \* Sec. 22. AS 37.14.110(c) is repealed and reenacted to read:

19 (c) The commissioner of revenue shall determine the net income  
20 of the fund in accordance with investment accounting principles and in  
21 a manner that preserves the distinction between principal and income  
22 and that excludes capital gains or losses realized on principal. The  
23 principal of the fund and the capital gains or losses realized on  
24 principal shall be perpetually retained in the fund for investment  
25 purposes.

26 \* Sec. 23. AS 37.14.140 is repealed and reenacted to read:

27 Sec. 37.14.140. UTILIZATION OF INCOME. The net income of the  
28 fund may not be appropriated for a purpose other than the support of  
29 the state public school program. The commissioner of revenue shall

1 invest realized net income that has not been appropriated or that has  
2 been appropriated but not expended until the income is appropriated  
3 and expended.

4 \* Sec. 24. AS 37.14.160 is repealed and reenacted to read:

5 Sec. 37.14.160. DUTIES OF THE COMMISSIONER OF REVENUE. The  
6 commissioner of revenue is the treasurer of the trust fund created in  
7 AS 37.14.110 and shall

8 (1) exercise the powers and duties established in AS 14.-  
9 25.180(c);

10 (2) deposit the principal and income from investments in  
11 separate principal and income accounts for the fund;

12 (3) invest and maintain accounting records that distinguish  
13 between the principal and income of the fund;

14 (4) provide reports to the board established under AS 37.-  
15 14.120 on the condition and investment performance of the fund.

16 \* Sec. 25. AS 37.14.170 is repealed and reenacted to read:

17 Sec. 37.14.170. INVESTMENTS. The commissioner of revenue is the  
18 fiduciary of the trust fund and shall invest the fund to provide  
19 increasing net income over long-term periods to the fund's income  
20 beneficiaries. The commissioner may invest the money in the fund on  
21 the basis of probable total rate of return to promote the long-term  
22 generation of income. In managing the trust fund, the commissioner  
23 shall

24 (1) consider the status of the fund's capital and the  
25 income generated on both a current and a probable future basis;

26 (2) determine the appropriate investment objectives;

27 (3) establish investment policies to achieve the objec-  
28 tives; and

29 (4) act only in regard to the financial interests of the

1 fund's beneficiaries.

2 \* Sec. 26. AS 39.25.110 is amended by adding a new paragraph to read:  
3 (25) investment officers in the Department of Revenue.

4 \* Sec. 27. AS 39.30.095(a) is amended to read:

5 (a) The commissioner of administration shall establish the group  
6 health and life benefits fund as a special account in the general fund  
7 to provide for group life and health insurance under AS 39.30.090 and  
8 39.30.160. The commissioner shall maintain accounts and records for  
9 the fund. The fund consists of employer contributions, employee  
10 contributions, appropriations from the legislature, and income [INTER-  
11 EST] earned on investment of the fund as provided in (d) of this  
12 section.

13 \* Sec. 28. AS 39.30.095(d) is amended to read:

14 (d) If the commissioner of administration determines that there  
15 is more money in the fund than the amount needed to pay premiums or  
16 benefits for the current fiscal year, the surplus, or so much of it as  
17 the commissioner of administration considers advisable, may be in-  
18 vested by the commissioner of revenue in the same manner as retirement  
19 funds are invested under AS 14.25.180 [AS 39.35.110].

20 \* Sec. 29. AS 39.35.020 is amended to read:

21 Sec. 39.35.020. ADMINISTRATION. The commissioner of adminis-  
22 tration is responsible for the administration of the system and for  
23 carrying out this chapter. In addition the commissioner shall [HAS  
24 THE FOLLOWING POWERS AND DUTIES:]

25 (1) maintain the accounts of the system;  
26 (2) make payments for the various purposes specified;  
27 (3) submit periodic reports or statements of account that  
28 are needed;

29 (4) issue a statement of account to an employee requesting

1 it showing the amount of the employee's contributions to the system;

2 (5) as soon as possible after the close of each fiscal  
3 year, and not later than six months after the close of each fiscal  
4 year, send to the governor, the legislature, and the board an annual  
5 statement on the operations of the system containing

6 (A) a balance sheet;

7 (B) a statement of income and expenditures for the  
8 year;

9 (C) a report on an actuarial valuation of its assets  
10 and liabilities;

11 (D) [REPEALED

12 (E)] a summary [LIST] of assets held in the pension  
13 fund listed by the categories of investment, as provided by the  
14 commissioner of revenue [INVESTMENTS OWNED];

15 (E) [(F)] other statistical financial data that are  
16 necessary for a proper understanding of the financial condition  
17 of the system and the result of its operations;

18 (6) establish a public employees retirement trust fund in  
19 which the assets of the system shall be deposited and held;

20 (7) engage an independent certified public accountant to  
21 conduct an annual audit of the system's accounts and the annual report  
22 of the system's financial condition and activity;

23 (8) report to the board concerning the condition and admin-  
24 istration of the system and distribute the report to the members of  
25 the system. [REPEALED]

26 \* Sec. 30. AS 39.35.080 is repealed and reenacted to read:

27 Sec. 39.35.080. DUTIES OF THE COMMISSIONER OF REVENUE. The  
28 commissioner of revenue is the treasurer of the system and the fidu-  
29 ciary of the fund. The commissioner has the same powers and duties

1 established under this chapter in regard to the fund as are provided  
2 in AS 14.25.035(d) and 14.25.180.

3 \* Sec. 31. AS 44.83.386 is amended to read:

4 Sec. 44.83.386. INVESTMENT OF FUND. The Department of Revenue  
5 shall invest the money in the fund in accordance with AS 37.10.070,  
6 37.10.071, and 37.10.075. The Department of Revenue shall provide  
7 money in the fund to the authority only after costs have been incurred  
8 or amounts in the fund have been otherwise obligated under contracts  
9 for the acquisition and construction of a project. Amounts that have  
10 been obligated, but for which costs have not yet been incurred, may be  
11 segregated by the Department of Revenue or transferred to the author-  
12 ity only with the prior approval or agreement of the commissioner of  
13 revenue. Income [INTEREST] received on money that is segregated or  
14 transferred under this section must be deposited in the general fund.

15 \* Sec. 32. AS 44.88.155(c) is amended to read:

16 (c) Money and other assets of the enterprise development account  
17 may be used to secure bonds of the authority issued to finance the  
18 purchase of loans for projects and shall be held and invested by the  
19 authority in accordance with AS 37.10.071 [THE TYPES OF INVESTMENTS  
20 DESCRIBED IN AS 37.10.070(a) AND AS 39.35.110(a)(9) AND (14)] or shall  
21 be used to purchase loans for projects.

22 \* Sec. 33. AS 18.55.375; AS 21.88.210(d); AS 26.15.060; AS 37.10.079,  
23 37.10.080; AS 37.14.130(3); AS 39.25.120(c)(13); AS 39.35.110; AS 45.95.-  
24 030, 45.95.040(b); and AS 45.98.050(b) are repealed.

25 \* Sec. 34. This Act takes effect immediately under AS 01.10.070(c).  
26  
27  
28  
29

STATE OF ALASKA  
1988 LEGISLATIVE SESSION

Bill Version: CSHB 547 (FIN)  
Publish Date: HOUSE 4/11/88

FISCAL NOTE

REQUEST:

Revision Date: \_\_\_\_\_  
Title: Investment & Management of  
Certain State Funds  
Sponsor: House Finance  
Requestor: House Finance

Agency Affected: Department of Revenue  
BRU: Treasury  
Components: \_\_\_\_\_

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 88	FY 89	FY 90	FY 91	FY 92	FY 93
OPERATING						
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LANDS & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0	0	0	0	0	0
CAPITAL						
REVENUE						

FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL						

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS: Attach a separate page for analysis.

Prepared By: Milt Barker *MB*  
Division: Treasury

Phone: 465-2350  
Date: March 30, 1988

Approved by Commissioner: *[Signature]*  
Agency: Department of Revenue

Date: 3/31/88

Distribution (by preparer):  
Legislative Finance  
Legislative Sponsor  
Requestor  
Office of Management and Budget  
Impacted Agency(ies)

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APR 4 1988 page 1 of 1

LEGISLATIVE FINANCE

Original sponsor: Finance Committee

1 IN THE HOUSE BY THE FINANCE COMMITTEE

2 CS FOR HOUSE BILL NO. 547 (Finance) am  
3 IN THE LEGISLATURE OF THE STATE OF ALASKA  
4 FIFTEENTH LEGISLATURE - SECOND SESSION

5 A BILL

6 For an Act entitled: "An Act relating to the investment and management of  
7 certain state funds; and providing for an effective  
8 date."

9 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

10 \* Section 1. AS 14.25.035(c) is repealed and reenacted to read:

11 (c) The board shall confer with the commissioner of adminis-  
12 tration regarding the administration of the system and may make rec-  
13 ommendations that it considers necessary.

14 \* Sec. 2. AS 14.25.035(d) is repealed and reenacted to read:

15 (d) The commissioner of administration shall report to the board  
16 concerning the condition and administration of the system. The re-  
17 ports shall be distributed to the members of the system. The commis-  
18 sioner of revenue shall provide reports to the board on the condition  
19 and investment performance of the teachers' retirement trust fund.

20 \* Sec. 3. AS 14.25.170 is amended to read:

21 Sec. 14.25.170. ADMINISTRATION. The commissioner of adminis-  
22 tration is responsible for the administration of the retirement system  
23 and for making the provisions of this chapter effective. The [AND  
24 THE] powers and duties of the commissioner for this purpose include  
25 [BUT ARE NOT LIMITED TO]

26 (1) maintaining the accounts of the system;

27 (2) making payments for the various purposes specified;

28 (3) submitting required [SUCH] periodic reports or state-  
29 ments of account [AS MAY BE REQUIRED];

1           (4) establishing [PRESCRIBING] by regulation the rate of  
2 interest that shall be credited to the individual contribution ac-  
3 counts of teachers each year; the rate of interest shall be adopted on  
4 the basis of the probable effective rate of interest on a long-term  
5 basis, and the rate may be changed from time to time by subsequent  
6 regulation;

7           (5) establishing a teachers' retirement trust fund in which  
8 the assets of the system shall be deposited and held; and

9           (6) engaging an independent certified public accountant to  
10 conduct an annual audit of the system's accounts and the annual report  
11 of the system's financial condition and financial activity.

12 \* Sec. 4. AS 14.25.180 is repealed and reenacted to read:

13           Sec. 14.25.180. INVESTMENT AND TREASURY. (a) The commissioner  
14 of revenue is the treasurer of the system and the fiduciary of the  
15 fund. In managing the fund, the commissioner of revenue shall

16           (1) consider the status of the fund's investments and the  
17 system's liabilities on both a current and a probable future basis;

18           (2) determine the appropriate investment objectives for the  
19 fund;

20           (3) establish investment policies aimed at achieving the  
21 objectives; and

22           (4) act only in regard to the best financial interests of  
23 the system's beneficiaries.

24           (b) The commissioner of revenue may invest the fund on the basis  
25 of probable total rate of return without regard to the distinction  
26 between principal and income or to the generation of income.

27           (c) In carrying out investment duties under this chapter, the  
28 commissioner of revenue has the same powers and duties in regard to  
29 the teachers' retirement trust fund as are provided in AS 37.10.071,

1       except that the standard of prudence that the commissioner must obey  
2       under AS 37.10.071(c) shall be in regard to the management of large  
3       trust investments rather than large investments.

4       \* Sec. 5. AS 14.40.255 is amended to read:

5               Sec. 14.40.255. INVESTMENT OF SURPLUS MONEY. If the Board of  
6       Regents determines that there is a surplus of money, received in the  
7       form of state and federal appropriations, above the amount sufficient  
8       to meet current and projected cash expenditure needs of the univers-  
9       ity, the surplus must be invested as [IN THE SAME INSTRUMENTS] set out  
10      in AS 37.10.071. Income [AS 37.10.070 APPROVED FOR INVESTMENT OF  
11      STATE TREASURY SURPLUS. INTEREST INCOME] earned on investments made  
12      under this section may be retained by the university and expended in  
13      accordance with the Executive Budget Act (AS 37.07).

14      \* Sec. 6. AS 14.40.400(a) is amended to read:

15              (a) The Department of Revenue shall establish a separate endow-  
16      ment trust fund in which all net income [MONEY] derived from the sale  
17      or lease of the land granted under the Act of Congress approved  
18      January 21, 1929, and in which all monetary gifts, bequests or endow-  
19      ments made to the University of Alaska for the purpose of the fund,  
20      shall be held in trust.

21      \* Sec. 7. AS 14.40.400(b) is repealed and reenacted to read:

22              (b) The commissioner of revenue is the fiduciary of the trust  
23      fund and shall account for and invest the fund as set out in AS 37.-  
24      14.110(c), 37.14.160, and 37.14.170, except that the commissioner  
25      shall report the condition and investment performance of the fund to  
26      the Board of Regents.

27      \* Sec. 8. AS 14.40.400(c) is amended to read:

28              (c) The net income from the trust fund shall be used exclusively  
29      for the Agricultura<sup>1</sup> College and School of Mines.

1 \* Sec. 9. AS 14.40.400(e) is amended to read:

2 (e) The Department of Administration shall disburse the net  
3 income from the trust fund upon vouchers approved by the president and  
4 treasurer of the University of Alaska specifying the purpose for which  
5 the money is to be used and showing it is to be used in conformity  
6 with this section.

7 \* Sec. 10. AS 14.42.200(8) is amended to read:

8 (8) invest or reinvest, subject to its contracts with  
9 noteholders and bondholders, money held by the corporation as set out  
10 in AS 37.10.071 [OBLIGATIONS OR OTHER SECURITIES AUTHORIZED FOR IN-  
11 VESTMENTS OF THE COMMISSIONER OF REVENUE UNDER AS 37.10.070(a)];

12 \* Sec. 11. AS 14.42.210(b) is amended to read:

13 (b) Money and other assets of the student loan fund may be used  
14 to secure bonds of the corporation, invested in student loans and  
15 investments under AS 37.10.071 [DESCRIBED IN AS 37.10.070(a)] and used  
16 to purchase loans approved under AS 14.43.090 - 14.43.325, 14.43.600 -  
17 14.43.700, or 14.43.710 - 14.43.790.

18 \* Sec. 12. AS 18.26.170 is amended to read:

19 Sec. 18.26.170. INVESTMENTS BY AUTHORITY. Except as otherwise  
20 provided by this chapter, the authority may invest any funds, not  
21 needed to meet current cash expenditure needs, as set out in AS 37.-  
22 10.071 [SECURITIES, OBLIGATIONS OR CERTIFICATES OF DEPOSIT APPROVED  
23 FOR INVESTMENT OF THE STATE TREASURY SURPLUS UNDER AS 37.10.-  
24 070(a)(1) - (4). THESE INVESTMENTS SHALL BE PURCHASED AT NO HIGHER  
25 PRICE THAN THE OFFERING OR MARKET PRICE OF THEM AT THE TIME OF THE  
26 PURCHASE].

27 \* Sec. 13. AS 18.56.095(b) is amended to read:

28 (b) In addition to any other fees and charges that the corpo-  
29 ration may charge on mortgage loans, it may collect or cause to be

1 collected on all mortgage loans made or purchased with the proceeds of  
2 the sale of mortgage insurance bonds, either or both a special mort-  
3 gage loan insurance commitment fee or a mortgage loan insurance premi-  
4 um. The special mortgage loan insurance commitment fees and special  
5 mortgage loan insurance premiums when received shall be deposited in  
6 the mortgage insurance fund by the corporation, or by any mortgage  
7 loan servicer, trustee, or agent designated by the corporation to  
8 receive them, and shall be held, invested and, together with all  
9 investment income derived from them, reinvested by the commissioner of  
10 revenue as set out in AS 37.10.071 [INVESTMENTS AUTHORIZED UNDER  
11 AS 37.10.070(a)], subject to any agreement with the corporation under  
12 (a) of this section.

13 \* Sec. 14. AS 22.25.048(a) is amended to read:

14 (a) The commissioner of administration shall establish a judi-  
15 cial retirement trust fund for the judicial retirement system in which  
16 the assets of the system are deposited and held. The commissioner  
17 [AND] shall maintain accounts and records for the [JUDICIAL RETIRE-  
18 MENT] system.

19 \* Sec. 15. AS 22.25.048(c) is repealed and reenacted to read:

20 (c) The commissioner of revenue is the treasurer of the system  
21 and the fiduciary of the fund and has the same powers and duties under  
22 this section in regard to the judicial retirement trust fund as are  
23 provided in AS 14.25.180.

24 \* Sec. 16. AS 26.05.228(a) is amended to read:

25 (a) The commissioner of administration shall establish a mili-  
26 tary retirement trust fund for the system in which the assets of the  
27 system are deposited and held. The commissioner shall [AND] maintain  
28 accounts and records for the system.

29 \* Sec. 17. AS 26.05.228(c) is repealed and reenacted to read:

1 (c) The commissioner of revenue is the treasurer of the system  
2 and the fiduciary of the fund and has the same powers and duties under  
3 this section in regard to the fund as are provided under AS 14.25.180.

4 \* Sec. 18. AS 36.30.850(b) is amended to read:

5 (b) This chapter applies to every expenditure of state funds,  
6 irrespective of their sources, including federal assistance except as  
7 otherwise specified in AS 36.30.890, by the state, acting through an  
8 agency, under a contract, except that this chapter does not apply to

9 (1) grants;

10 (2) contracts for professional witnesses to provide for  
11 professional services or testimony relating to existing or probable  
12 lawsuits in which the state is or may become a party;

13 (3) contracts of the University of Alaska where the work is  
14 to be performed substantially by students enrolled in the university;

15 (4) contracts for medical doctors and dentists;

16 (5) acquisitions or disposals of real property or interest  
17 in real property, except as provided in AS 36.30.080;

18 (6) disposals under AS 38.05;

19 (7) contracts for the preparation of ballots under AS 15.-  
20 15.030;

21 (8) acquisitions or disposals of property and other con-  
22 tracts relating to airports under AS 02.15.070, 02.15.090, and 02.15.-  
23 091;

24 (9) disposals of obsolete property under AS 19.05.060;

25 (10) disposals of obsolete material or equipment under  
26 AS 35.20.060;

27 (11) agreements with providers of services under AS 47.07;  
28 AS 47.08; AS 47.10; AS 47.17; AS 47.24; AS 47.25.195, and 47.25.310;

29 (12) contracts of the Department of Fish and Game for

1 flights that involve specialized flying and piloting skills and are  
2 not point-to-point;

3 (13) purchases of income-producing assets for the state  
4 treasury or a public corporation of the state;

5 (14) a contract that is a delegation, in whole or in part,  
6 of investment powers held by the commissioner of revenue under AS 14.-  
7 25.180, AS 14.40.400, AS 14.42.200, 14.42.210, AS 18.56.095, AS 22.-  
8 25.048, AS 26.05.228, AS 37.10.070, 37.10.071, AS 37.14, or AS 39.-  
9 35.080; or

10 (15) a contract that is a delegation, in whole or in part,  
11 of investment powers of the Board of Trustees of the Alaska Permanent  
12 Fund Corporation under AS 37.13.

13 \* Sec. 19. AS 37.10.070 is repealed and reenacted to read:

14 Sec. 37.10.070. INVESTMENT OF RESIDUAL MONEY. (a) The commis-  
15 sioner shall invest, as set out in AS 37.10.071, the money in the  
16 state treasury above an amount sufficient to meet immediate expendi-  
17 ture needs. In managing the invested assets, the commissioner shall

18 (1) consider the status of the assets and liabilities on  
19 both a current and a probable future basis;

20 (2) determine the appropriate investment objectives;

21 (3) establish investment policies to achieve the objec-  
22 tives; and

23 (4) act only in regard to the best financial interests of  
24 the state.

25 (b) The commissioner may invest on the basis of probable total  
26 rate of return without regard to the distinction between principal and  
27 income and without regard to the generation of income.

28 (c) In this section, "commissioner" means the commissioner of  
29 revenue.

1 \* Sec. 20. AS 37.10 is amended by adding a new section to read:

2 Sec. 37.10.071. INVESTMENT POWERS AND DUTIES. (a) In making  
3 investments under this section, the commissioner of revenue shall

4 (1) act as official custodian of cash and investments by  
5 securing adequate and safe custodial facilities for them;

6 (2) receive all items of cash and investments;

7 (3) collect and deposit the principal of and income from  
8 owned or acquired investments;

9 (4) invest and reinvest the assets in accordance with this  
10 section;

11 (5) receive and spend appropriations to cover the cost of  
12 the exercise of duties under this section;

13 (6) exercise the powers of an owner with respect to the  
14 assets;

15 (7) perform all acts, not prohibited by this section,  
16 whether or not expressly authorized, that the commissioner considers  
17 necessary or proper in administering the assets;

18 (8) maintain accounting records in accordance with invest-  
19 ment accounting principles;

20 (9) engage an independent certified public accountant to  
21 conduct an annual audit of the financial condition and investment  
22 transactions;

23 (10) enter into and enforce contracts or agreements con-  
24 sidered necessary, convenient, or desirable for the investment pur-  
25 poses of this section; and

26 (11) when choosing to acquire or dispose of investments,  
27 secure competitive national or international market rates or prices,  
28 or the equivalence of those rates or prices in the judgment of the  
29 commissioner.

1           (b) Under this section, the commissioner or the commissioner's  
2           designee may

3           (1) delegate investment, custodial, or depository authority  
4           on a discretionary or nondiscretionary basis to officers or employees  
5           of the state or to independent firms, banks, or trust companies, by  
6           designation through appointments, contracts, or letters of authority;

7           (2) acquire or dispose of investments either directly,  
8           indirectly, or through investment pools or trusts, by competitive or  
9           negotiated agreements, contracts, or auctions, in public or private  
10          markets;

11          (3) concentrate or diversify investments as the commis-  
12          sioner considers appropriate to increase the probable total rate of  
13          return or to decrease the overall exposure to potentially adverse  
14          market value risks;

15          (4) protect the market value or the rate of return of the  
16          investments by entering into forward agreements to buy or sell assets  
17          at a future date as a hedge against existing held assets or as a  
18          precommitment of future cash flows;

19          (5) lend assets, under an agreement and for a fee, against  
20          deposited collateral of equivalent market value;

21          (6) borrow assets on a short-term basis, under an agreement  
22          and for a fee, against the deposit of collateral consisting of other  
23          assets in order to accommodate temporary cash or investment needs;

24          (7) hold investments in bearer or registered form in the  
25          name of the state, a fund, or nominees authorized by the commissioner;

26          (8) utilize consultants, advisors, custodians, investment  
27          services, and legal counsel for assistance in investment matters on  
28          either a continuing or a limited-term basis and with or without com-  
29          pensation;

1           (9) declare records to be confidential and exempt from  
2 AS 09.25.110 and 09.25.120 if the records contain information that  
3 discloses the particulars of the business or the affairs of a private  
4 enterprise, investor, borrower, advisor, consultant, counsel, or  
5 manager.

6           (c) In exercising investment, custodial, or depository powers or  
7 duties under this section, the commissioner shall exercise the judg-  
8 ment and care under the circumstances then prevailing that an institu-  
9 tional investor of ordinary professional prudence, discretion, and  
10 intelligence exercises in managing large investments with considera-  
11 tion for the purpose of the fund, the investment objectives, the  
12 continuing disposition of the fund's investments, and the probable  
13 safety of the capital as well as the probable investment returns.

14           (d) In exercising investment, custodial, or depository powers or  
15 duties under this section, the commissioner or a designee of the  
16 commissioner is liable for a breach of a duty that is assigned or  
17 delegated under this section, or under AS 14.25.180, AS 14.40.400(b),  
18 AS 37.10.070, AS 37.14.110(c), 37.14.160, 37.14.170, or AS 39.35.080.  
19 However, the commissioner or the commissioner's designee is not liable  
20 for a breach of a duty that has been delegated to another person if  
21 the delegation is prudent under the applicable standard of prudence  
22 set out in statute or if the duty is assigned by law to another per-  
23 son, except to the extent that the commissioner or designee

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

27           (2) by failure to comply with this section in the adminis-  
28 tration of specific responsibilities, enables another person to commit  
29 a breach of duty; or

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

4           (e) The state shall defend and indemnify the commissioner or an  
5 officer or employee of the state against liability under (d) of this  
6 section to the extent that the alleged act or omission was performed  
7 in good faith and was prudent under the applicable standard of pru-  
8 dence.

9           (f) In this section, "commissioner of revenue" or "commissioner"  
10 means

11           (1) the commissioner of revenue for investments under  
12 AS 14.25.180 or AS 37.10.070; or

13           (2) the person or body provided by law to manage the inves-  
14 tments, for investments not subject to AS 14.25.180 or AS 37.10.070.

15 \* Sec. 21. AS 37.10.079(b) is amended to read:

16           (b) The commissioner of revenue may purchase bonds sold by  
17 political subdivisions of the state if [:

18           (1) THEY HAVE BEEN SOLD IN ACCORDANCE WITH THE TERMS OF THE  
19 NOTICE OF THEIR SALE SUBJECT ONLY TO DELIVERY OF THE BONDS WITH AN  
20 APPROVING OPINION OF BOND COUNSEL TO THE EFFECT THAT THE BONDS ARE  
21 VALID AND LEGALLY BINDING GENERAL OBLIGATIONS OF THE POLITICAL SUBDI-  
22 VISION AND A STATEMENT TO THE EFFECT THAT NO LITIGATION IS THREATENED  
23 OR PENDING WHICH AFFECTS THE VALIDITY OF THE BONDS; OR

24           (2)] the bond counsel nominated by the issuing political  
25 subdivision in connection with the original offer for sale of the  
26 bonds certifies that

27           (1) [(A) THAT] a lawsuit has been filed or is threatened  
28 that [WHICH] challenges the corporate existence of the issuer or its  
29 power to issue the bonds or to levy taxes to pay the bonds or

1 otherwise prevents a [THE] statement to the effect that no litigation  
2 is threatened or pending that affects the validity of the bonds;

3 (2) [AS TO LITIGATION REFERRED TO IN (1) OF THIS SUB-  
4 SECTION, (B) THAT] as a consequence of the filing of the suit, the  
5 bonds cannot be sold or can only be sold at interest rates substan-  
6 tially in excess of the interest rates the municipality would other-  
7 wise reasonably expect to pay; [,] and

8 (3) [(C) THAT,] in the opinion of counsel [,] the muni-  
9 cipality is or will be pursuing all available means to establish the  
10 validity of the bonds so that the lawsuit will be ultimately deter-  
11 mined so as to permit the delivery of the bonds with the statement as  
12 to litigation referred to in (1) of this subsection.

13 \* Sec. 22. AS 37.14.110(a) is amended to read:

14 (a) There is established as a separate endowment trust fund the  
15 public school trust fund.

16 \* Sec. 23. AS 37.14.110(c) is repealed and reenacted to read:

17 (c) The commissioner of revenue shall determine the net income  
18 of the fund in accordance with investment accounting principles and in  
19 a manner that preserves the distinction between principal and income  
20 and that excludes capital gains or losses realized on principal. The  
21 principal of the fund and the capital gains or losses realized on  
22 principal shall be perpetually retained in the fund for investment  
23 purposes.

24 \* Sec. 24. AS 37.14.140 is repealed and reenacted to read:

25 Sec. 37.14.140. UTILIZATION OF INCOME. The net income of the  
26 fund may not be appropriated for a purpose other than the support of  
27 the state public school program. The commissioner of revenue shall  
28 invest realized net income that has not been appropriated or that has  
29 been appropriated but not expended until the income is appropriated

1 and expended.

2 \* Sec. 25. AS 37.14.160 is repealed and reenacted to read:

3 Sec. 37.14.160. DUTIES OF THE COMMISSIONER OF REVENUE. The  
4 commissioner of revenue is the treasurer of the trust fund created in  
5 AS 37.14.110 and shall

6 (1) exercise the powers and duties established in AS 14.-  
7 25.180(c);

8 (2) deposit the principal and income from investments in  
9 separate principal and income accounts for the fund;

10 (3) invest and maintain accounting records that distinguish  
11 between the principal and income of the fund;

12 (4) provide reports to the board established under AS 37.-  
13 14.120 on the condition and investment performance of the fund.

14 \* Sec. 26. AS 37.14.170 is repealed and reenacted to read:

15 Sec. 37.14.170. INVESTMENTS. (a) The commissioner of revenue  
16 is the fiduciary of the trust fund and shall invest the fund to pro-  
17 vide increasing net income over long-term periods to the fund's income  
18 beneficiaries. The commissioner may invest the money in the fund on  
19 the basis of probable total rate of return to promote the long-term  
20 generation of income. In managing the trust fund, the commissioner  
21 shall

22 (1) consider the status of the fund's capital and the  
23 income generated on both a current and a probable future basis;

24 (2) determine the appropriate investment objectives;

25 (3) establish investment policies to achieve the objec-  
26 tives; and

27 (4) act only in regard to the long-term financial interests  
28 of the fund's beneficiaries.

29 \* Sec. 27. AS 39.25.110 is amended by adding a new paragraph to read:

1 (25) investment officers in the Department of Revenue.

2 \* Sec. 28. AS 39.30.095(a) is amended to read:

3 (a) The commissioner of administration shall establish the group  
4 health and life benefits fund as a special account in the general fund  
5 to provide for group life and health insurance under AS 39.30.090 and  
6 39.30.160. The commissioner shall maintain accounts and records for  
7 the fund. The fund consists of employer contributions, employee  
8 contributions, appropriations from the legislature, and income [INTER-  
9 EST] earned on investment of the fund as provided in (d) of this  
10 section.

11 \* Sec. 29. AS 39.30.095(d) is amended to read:

12 (d) If the commissioner of administration determines that there  
13 is more money in the fund than the amount needed to pay premiums or  
14 benefits for the current fiscal year, the surplus, or so much of it as  
15 the commissioner of administration considers advisable, may be in-  
16 vested by the commissioner of revenue in the same manner as retirement  
17 funds are invested under AS 14.25.180 [AS 39.35.110].

18 \* Sec. 30. AS 39.35.020 is amended to read:

19 Sec. 39.35.020. ADMINISTRATION. The commissioner of adminis-  
20 tration is responsible for the administration of the system and for  
21 carrying out this chapter. In addition the commissioner shall [HAS  
22 THE FOLLOWING POWERS AND DUTIES:]

- 23 (1) maintain the accounts of the system;  
24 (2) make payments for the various purposes specified;  
25 (3) submit periodic reports or statements of account that  
26 are needed;  
27 (4) issue a statement of account to an employee requesting  
28 it showing the amount of the employee's contributions to the system;  
29 (5) as soon as possible after the close of each fiscal

1 year, and not later than six months after the close of each fiscal  
2 year, send to the governor, the legislature, and the board an annual  
3 statement on the operations of the system containing

4 (A) a balance sheet;

5 (B) a statement of income and expenditures for the  
6 year;

7 (C) a report on an actuarial valuation of its assets  
8 and liabilities;

9 (D) [REPEALED]

10 (E)] a summary [LIST] of assets held in the pension  
11 fund listed by the categories of investment, as provided by the  
12 commissioner of revenue [INVESTMENTS OWNED];

13 (E) [(F)] other statistical financial data that are  
14 necessary for a proper understanding of the financial condition  
15 of the system and the result of its operations;

16 (6) establish a public employees retirement trust fund in  
17 which the assets of the system shall be deposited and held;

18 (7) engage an independent certified public accountant to  
19 conduct an annual audit of the system's accounts and the annual report  
20 of the system's financial condition and activity;

21 (8) report to the board concerning the condition and admin-  
22 istration of the system and distribute the report to the members of  
23 the system. [REPEALED]

24 \* Sec. 31. AS 39.35.080 is repealed and reenacted to read:

25 Sec. 39.35.080. DUTIES OF THE COMMISSIONER OF REVENUE. The  
26 commissioner of revenue is the treasurer of the system and the fidu-  
27 ciary of the fund. The commissioner has the same powers and duties  
28 established under this chapter in regard to the fund as are provided  
29 in AS 14.25.035(d) and 14.25.180.

1 \* Sec. 32. AS 44.83.386 is amended to read:

2           Sec. 44.83.386. INVESTMENT OF FUND. The Department of Revenue  
3 shall invest the money in the fund in accordance with AS 37.10.070,  
4 37.10.071, and 37.10.075. The Department of Revenue shall provide  
5 money in the fund to the authority only after costs have been incurred  
6 or amounts in the fund have been otherwise obligated under contracts  
7 for the acquisition and construction of a project. Amounts that have  
8 been obligated, but for which costs have not yet been incurred, may be  
9 segregated by the Department of Revenue or transferred to the author-  
10 ity only with the prior approval or agreement of the commissioner of  
11 revenue. Income [INTEREST] received on money that is segregated or  
12 transferred under this section must be deposited in the general fund.

13 \* Sec. 33. AS 44.88.155(c) is amended to read:

14           (c) Money and other assets of the enterprise development account  
15 may be used to secure bonds of the authority issued to finance the  
16 purchase of loans for projects and shall be held and invested by the  
17 authority in accordance with AS 37.10.071 [THE TYPES OF INVESTMENTS  
18 DESCRIBED IN AS 37.10.070(a) AND AS 39.35.110(a)(9) AND (14)] or shall  
19 be used to purchase loans for projects.

20 \* Sec. 34. AS 18.55.375; AS 21.88.210(d); AS 26.15.060; AS 37.10.080;  
21 AS 37.14.130(3); AS 39.25.120(c)(13); AS 39.35.110; AS 45.95.030, 45.95.-  
22 040(b); and AS 45.98.050(b) are repealed.

23 \* Sec. 35. This Act takes effect immediately under AS 01.10.070(c).

STATE OF ALASKA  
DEPARTMENT OF REVENUE

M E M O R A N D U M

TO: The Honorable Hugh Malone  
Commissioner  
Department of Revenue

FROM: Milton B. Barker <sup>MB</sup>  
Deputy Commissioner  
Treasury Division

DATE: March 30, 1988

RE: HB 547 (An Act relating to investment and management of  
certain state funds)

Goals of the Legislation

There are two principal goals HB 547 would help achieve:

1. strengthening the trust status and observance of fiduciary duties for trust funds under State management; and,
2. increasing the investment returns for all funds under State management.

Need for the Legislation

Evidence of the need for such legislation is that:

1. there is a lack of understanding in the public's mind about the trust status of certain funds;

Example: there was a suggestion during the 1987 legislative session that \$41 million could be taken from the Public Employees Retirement System to fully fund State employee salaries, overlooking the fact that municipalities as well as the State are contributors to the Fund and that the purpose of the Fund is to provide retirement income for public employees, both State and municipal; see attached column "My Turn" from the May 18, 1987 edition of the Juneau Empire.

2. improvements in investment performance can make a significant difference in State and municipal finances;

Example: a 1986 revision of actuarial assumptions, including an upward revision in the assumed investment rate of return as a result of favorable investments, reduced required employer contributions to the Public Employees' and Teachers' Retirement Systems by \$46,562,246 for fiscal year 1987; average employer contribution rates fell from 15.14% to 11.56% of salaries; see the attached table; continued annual savings at this level are expected in spite of the stock market crash.

3. the statutory lists of permissible investments for certain funds contain inherent contradictions;

Example: the attached Attorney General's opinion suggests that the retirement funds' investments in foreign common stocks--which totaled \$332,639,526 as of June 30, 1987 and reflected a 44.45% annual rate of return from inception on November 1, 1983--may be illegal.

4. the legal investment lists for certain funds conflict with fiduciary duties;

Example: AS 14.40.400 permits the University of Alaska Fund to be invested only in interest-bearing securities; the attached summary of a decision by the Court of Appeals of Washington in the case of Baker Boyer National Bank v. Garver indicates that a trustee is under a duty to diversify investments and that a court should award damages for appreciation in equity securities that is foregone as a result of a trustee's failure to diversify into such investments.

5. trust fund statutes fail to fully delineate fiduciary responsibilities;

Example: missing from trust fund statutes is any duty for the fiduciary to act only in the interests of the beneficiaries; this a requirement of section 401(a) of the Internal Revenue Code (attached) in order for a pension plan to be tax-exempt.

6. compensation for investment personnel is not competitive, jeopardizing the fulfillment of the statutory requirement that State funds be invested with the judgement and care which an institutional investor would exercise;

Example: statutory classification of investment officer positions as partially-exempt confines their salary levels to those of the State salary schedule; even with a reclass of the chief investment officer position to the highest level on the State salary schedule, the position's salary will not be competitive as demonstrated by the attached June 19, 1987 memo, especially considering the cost of living differential for Alaska.

7. statutory investment lists for certain funds contain ceilings on percentage allocations of fund assets to particular types of investments, limiting the long-run returns the funds could earn;

Example: no more than 50 percent of the retirement and Public School funds may be invested in corporate stocks and debt securities; yet, corporate pension funds, university endowments with over \$100 million in assets, and foundations all average approximately 60 percent in corporate stocks alone; the reason for such high allocations to stocks is their historically superior performance relative to alternative investments and the lack of any need for liquidity in these types of funds, which permits them to tolerate significant fluctuations in asset values over the short-run.

#### Financial Effects of the Legislation

In essence, this legislation is potentially of very significant financial benefit to the State as well as other parties. The strengthening of the trust status of trust funds is not a purely altruistic endeavor. Rather, the steps that would be taken to assure the observance of fiduciary duties would limit the State's potential liability as trustee. With over \$3 billion in trust funds under management by the State, and with the funds growing rapidly, breaches of fiduciary responsibilities will be increasingly likely to generate litigation that could result in very significant adverse judgments against the State (witness the Mental Health Lands Trust litigation, Weiss v. State).

In addition to protecting against possible losses from court actions, the legislation holds much promise of benefit as a direct revenue-raising measure. Few other proposals can offer generation of revenues of the magnitude possible with this legislation. Probably none can do so in the painless manner of these proposals.

Perhaps more importantly, the augmentation of investment earnings made possible by this legislation will grow in size as the funds grow. Even at the June 30, 1987 level of \$4,948,475,000 under investment by the State, an improvement in returns of only 10 basis points, or 0.1%, would mean increased earnings of \$4.9 million per annum. Enactment of the legislation should provide even greater relief in the more critical years ahead as Prudhoe production winds down.

Funds Subject to the Legislation

The funds under management by the State are:

	<u>Market Value</u> <u>June 30, 1987</u>
General Investment Fund	\$1,418,392,000
Public Employees' Retirement Fund	2,005,839,000
Teachers' Retirement Fund	1,295,178,000
Judicial Retirement Fund	17,714,000
Military Retirement Fund	3,881,000
Public School Fund	86,719,000
University of Alaska Fund	11,649,000
International Airports Funds	52,741,000
State Mortgage Insurance Fund	<u>26,789,000</u>
 Total	 \$4,948,475,000

All but the last two funds are directly affected by the proposed legislation. The last two funds are governed primarily by bond indentures, but would be affected by provisions of the legislation of general application, including the potential attraction or retention of superior investment personnel.

Trust Funds

The focus of this legislation is on trust funds. Because of the fiduciary responsibilities and potential liabilities attaching to trust funds, there is a need to clearly establish the roles of the parties involved.

A trust is an interest in property held by one person for the benefit of another. The person holding the property is a fiduciary or trustee. The person placing the property in trust is a trustor. The person which receives the benefits of the

property is a beneficiary.

The fiduciary or trustee has certain responsibilities under common law, including the duties of prudence and loyalty to the beneficiaries, and often under statutory law as well. Any party that feels aggrieved by the failure of the trustee to perform according to fiduciary responsibilities may sue the trustee. This could include trustors, who usually have an abiding purpose for having placed the property in trust, as well as the beneficiaries, who obviously would be injured by any failure in performance.

#### Retirement Funds

In the case of the Public Employees' and Teachers' Retirement Funds, municipalities and school districts contribute to the funds and are trustors as well as the State. Since these, as well as the Judicial Retirement Fund, are joint contributory funds to which employees as well as employers contribute, the public employees, teachers, and judges who are the beneficiaries are also trustors. The State is the only contributor in the case of the Military Retirement Fund.

All of the retirement plans are defined benefit, as opposed to defined contribution, plans. A defined benefit plan fixes the retirement benefits in some manner, for example, a certain dollar amount or percentage of salary for each year employed. In contrast, defined contribution plans fix the contributions and vary the benefits. Retirement benefits payable to a retiree under a defined contribution plan depend on the amount of contributions made to the plan by both employee and employer and on the amount of investment earnings, these being the two sources of income for the fund.

The guarantee of benefit amounts that occurs under defined benefit plans is achieved by adjusting the required employer contribution rates. Thus, the bottom line effect of any breach of fiduciary duty or improvement in investment earnings falls on the employers for all retirement funds under State management. Employers therefore would have--in addition to their general concern as trustors of being able to offer a viable retirement plan as an incentive for their employees--a very direct financial concern with the performance of the fiduciary. Deficient fiduciary conduct by the State as trustee thus would have a high likelihood of provoking litigation from trustors of the retirement funds as well as their beneficiaries.

Endowment Funds

The Public School Fund and the University of Alaska Fund are endowment trust funds. Endowment funds are funds which limit the expenditure of principal. These two particular endowment funds are permanent funds. The property placed in trust is placed in trust in perpetuity.

The trustor for these two funds is the federal government which originally constituted the trusts with land grants. The State is the trustee. Beneficiaries are public education programs and the University of Alaska, respectively. As demonstrated by the Mental Health Lands Trust litigation, the universe of affected persons or parties which might be considered beneficiaries is probably very broad.

Main Provisions of HB 547

The legislation would take five main steps in furtherance of the goals of strengthening the observance of fiduciary responsibilities and improving investment performance in general:

1. provide statutory underpinning of the trust status and fiduciary responsibilities of trust funds;

Discussion: four principal examples of the legislation's reinforcement of trust funds are:

- a. designation of trust funds as trusts in statute; current statutes do not identify trust funds as such;
- b. upgrading the standard of prudence required of fiduciaries to a professional level and amplifying its application (see section 20 of the bill analysis)
- c. requiring the fiduciary to act only in the interests of a fund's beneficiaries; and,
- d. requiring that investments be acquired or sold at internationally competitive market rates or prices; current statutes require only competitive national rates; yet, the retirement funds have significant holdings of foreign stocks and capital markets are becoming increasingly international at a rapid rate.

These foundation stones for a trust fund are so important that the State of California enacted an amendment placing the first three in their Constitution, applicable to all public pension systems in the state.

2. strengthen accountability;

Discussion: four main steps the legislation would take are:

- a. clarifying the Commissioner of Revenue's role as fiduciary; in some instances the statutes could be read to assign fiduciary responsibilities to the Commissioner of Administration, the Governor, or the boards of the retirement systems and Public School Fund; a fiduciary role for a board or committee is a desirable means of increasing accountability, provided that the body contains professional expertise; the Department of Revenue is developing a proposal for a state trust company that would provide such a structure; in the absence of a body with the requisite expertise, diffusion of fiduciary responsibility among administrative officials or boards reduces accountability and jeopardizes adherence to fiduciary obligations;
- b. establishing liability for the commissioner or the commissioner's designee for breaches of fiduciary or other investment responsibilities; liability would include co-fiduciary liability (liability for acts or omissions of other persons) according to standards that parallel the federal ERISA (Employee Retirement Income Security Act of 1974) provisions (ERISA governs employee pension or welfare benefit plans of corporations and unions); the liability and indemnification provisions of HB 547 reflect the recommendations of Willkie, Farr & Gallagher (investment counsel to the state on contract to the Department of Law) contained in their March 1, 1988 memorandum;
- c. requiring, as a matter of statute, annual audits by an independent firm of certified public accountants of funds managed by the State; and,
- d. requiring, as a matter of statute, that reports on the condition and investment performance of funds

managed by the State be made to the retirement boards, Public School Fund Advisory Board, and University of Alaska Board Regents; this at least would assure public exposure of investment activities, even though true accountability would require critical review by professional peers as contained in the trust company proposal.

3. repeal statutory investment lists;

Discussion: making an upgraded rule of prudence the guide for permissible investments rather than a legal list of specific instruments and percentage allocations would accomplish two main things:

- decrease risk by permitting greater diversification, subject to the rule of prudence; and,
- maximize earnings by permitting greater concentration in the highest yielding assets, subject to the rule of prudence.

Some of the problems with a legal list are:

1. internally inconsistent provisions, as noted under Need for the Legislation, item 3, in this memo;
2. conflicts with the rule of prudence, as noted under Need for the Legislation, item 4, in this memo;
3. legal lists become outdated; this is truer today than ever before; new markets, instruments, and investment techniques are being developed or evolving more rapidly than ever; some new developments such as options--which are not specifically permitted by Alaska statutes--offer an improved means to hedge or control investment risk; other developments--such as the emergence of a taxable municipal bond market, a result of Tax Reform Act of 1986's restrictions on tax-exempt debt--provide opportunities to diversify portfolios further and also earn a higher return than permitted under current law; a third example is the wave of privatization of government corporations that is sweeping many European countries; the public stock offerings for these companies--often

large, very profitable, and frequently de facto or legislated monopolies--is usually off-limits under Alaska statutes because of a requirement that the company have paid dividends for the last three years; as government corporations, such companies usually never paid dividends;

4. legal lists have a limited window of opportunity for revision--essentially 120 days of each year, in the spring, when the legislature is in session; yet, capital market developments can occur at any time;
5. legal list revisions, even if promptly initiated, often incur significant delays before enactment; yet, the best returns often occur early in the life of new developments before other investors become familiar with the investment or themselves receive authority to make such investments; delay also often means that authorization is out of phase with market cycles; an example is gold which required the lustre of a bull market to secure enactment of investment authority; such enactment at the peak of market cycles is not an auspicious way to initiate investments in new areas;
6. legal lists may result in the deferral or avoidance of legislative proposals containing needed revisions because of potential sponsors' concerns or fears about social or political issues being injected into the statutory framework; and,
7. legal lists may be an impediment to the attraction and retention of highly qualified investment personnel; in addition to compensation, the presence or absence of a legal list is one of the more important factors in securing competent professional staffing for investment programs; this factor is becoming more critical as states around the country drop such lists.

Legal lists do not assure prudence. Instances of imprudent investment activity are seldom illegal. The staggering investment losses of the City of San Jose and the losses of many municipalities and school districts around the country, including Alaska, in the repo market in recent years resulted from willfully

imprudent action or negligence due to a lack of professional competence, all within the bounds of applicable legal strictures.

This points up the fact that the greatest assurance of prudence lies with having professional career investment staff. It also requires clear accountability, outside professional review, and public reporting, disclosure, and exposure--measures that would be implemented under the proposed legislation.

The number of pension funds and other institutional investment funds which operate under a legal list has become a small minority:

1. the Employee Retirement Income Security Act of 1974 ("ERISA"), which governs employee pension or welfare benefit plans of corporations and unions, rejected the imposition of a legal list; the preamble to ERISA regulations states

"the Department (of Labor) does not consider it appropriate to include in the regulation any list of investments, classes of investments, or investment techniques that might be permissible under the 'prudence' rule. No such list could be complete."

2. the Tax Reform Act of 1969 likewise avoided a legal list in establishing rules governing investments for private foundations; section 53.4944-1(a)(2) of IRS regulations states

"No category of investments shall be treated as a per se violation of section 4944."

3. the Uniform Management of Institutional Funds Act ("UMIFA")--promulgated in 1972, adopted by 28 states, and applicable to endowments of universities, hospitals, and religious or other charitable institutions--in section 6 establishes a rule of prudence as the sole investment guideline;
4. a May, 1986 survey by the National Conference of State Legislatures indicates 23 states do not have legal lists for their retirement funds;

The Honorable Hugh Malone  
March 30, 1988  
Page 11

5. within Alaska state government, there are three State corporations that do not have legal lists restricting their investment powers--the Alaska Railroad Corporation, Alaska Power Authority, and Alaska Industrial Development Authority.

The case for jettisoning legal lists has been stated by Girard Miller, author of Investing Public Funds, published by the Government Finance Officers Association ("GFOA"),

"Investment research has demonstrated that fully diversified and balanced portfolios out-perform one-dimensional portfolios over long time periods, and that risk is best controlled by including assets that behave independently in different market environments. State laws that confine local pension plans to narrowly defined lists of permitted investments are therefore archaic, and usually work only to the benefit of the industries and vendors whose products hold a monopoly position. Accordingly, 35 reform-minded states have adopted 'prudent person' language for their state pension plans. A few states, including California, Iowa and Missouri, have adopted similar language for their local government retirement systems. Public officials in other states should take notice and campaign for similar legislation. Modern experience has shown that new investment instruments and strategies emerge faster than the legislatures can act, so the time has come for the authority to make prudent decisions to be delegated to those who will be responsible: the local government officials and representatives of the beneficiaries."

and by Assemblyman Louis Papan, author of the California Constitutional amendment which makes the prudent person rule the sole restriction on investments of state or local government retirement plans,

"This measure adopts the proven, conservative federal approach which cuts risks by allowing greater variety if the dictates of prudent judgment are met" (emphasis in original).

Attached are written communications from Citibank, J. P. Morgan Investment, Fred Alger Management, and Invesco Capital Management--firms which manage common stock investments for certain State funds--which provide their analyses or perceptions of the effects on investment performance of some of the State's statutory restrictions.

Also attached are minutes from the March 24, 1987 meeting of the retirement boards of the Public Employees' and Teachers' Retirement Systems at which the proposed legislation, including the trust company concept, was discussed.

4. provide for competitive compensation for investment staff;

Discussion: as indicated by the discussion under Need for the Legislation, item 6, in this memo and in the attached memo of June 19, 1987, current State salaries are not competitive for top flight investment professionals; not only is the pay better elsewhere, but, in what may be an emerging trend, four states, including California, South Dakota, and Virginia have instituted performance-based compensation or bonuses for investment personnel.

Recruitment and retention of State investment staff is difficult enough given Alaska's climate, remoteness from financial centers and metropolitan areas, lack of peers with which to associate, lack of opportunities for career advancement, and higher cost of living as well as the bureaucratic and political burdens associated with working for state government; it would be quite reasonable for the average investment professional to expect better than average compensation to locate in Juneau, just to offset some of the perceived drawbacks.

Recruitment of truly outstanding individuals requires compensation of a wholly different magnitude; yet, given the size of funds under management, the potential

The Honorable Hugh Malone  
March 30, 1988  
Page 13

increases in earnings, and the State's fiduciary obligations where trust funds are involved, it is a valid question whether the State can afford not to seek the most qualified investment talent it can find; the fact that the cost of such personnel would be paid mostly from retirement and other trust fund monies lends support to this idea.

The legislation would address these problems by transferring State investment officers from the partially-exempt to the exempt service; this would free the establishment of compensation from the State salary schedule.

5. exempt professional services contracts which are delegations of investment authority from the requirements of the State Procurement Code;

Discussion: delays in the review and approval process by the Department of Administration or their requirement to initiate and complete a new selection of contractors within a particular time frame can wreak havoc with the implementation of investment strategies, the reaction to sudden market moves or developments, or the execution of other critical tasks that are in process; the substantial documentation and formality of the contracting process as implemented under the Department of Administration's procedures is not a productive use of investment officers' time; their conversion from investment officers to contracting officers can be very detrimental to the earnings the State receives from its investments.

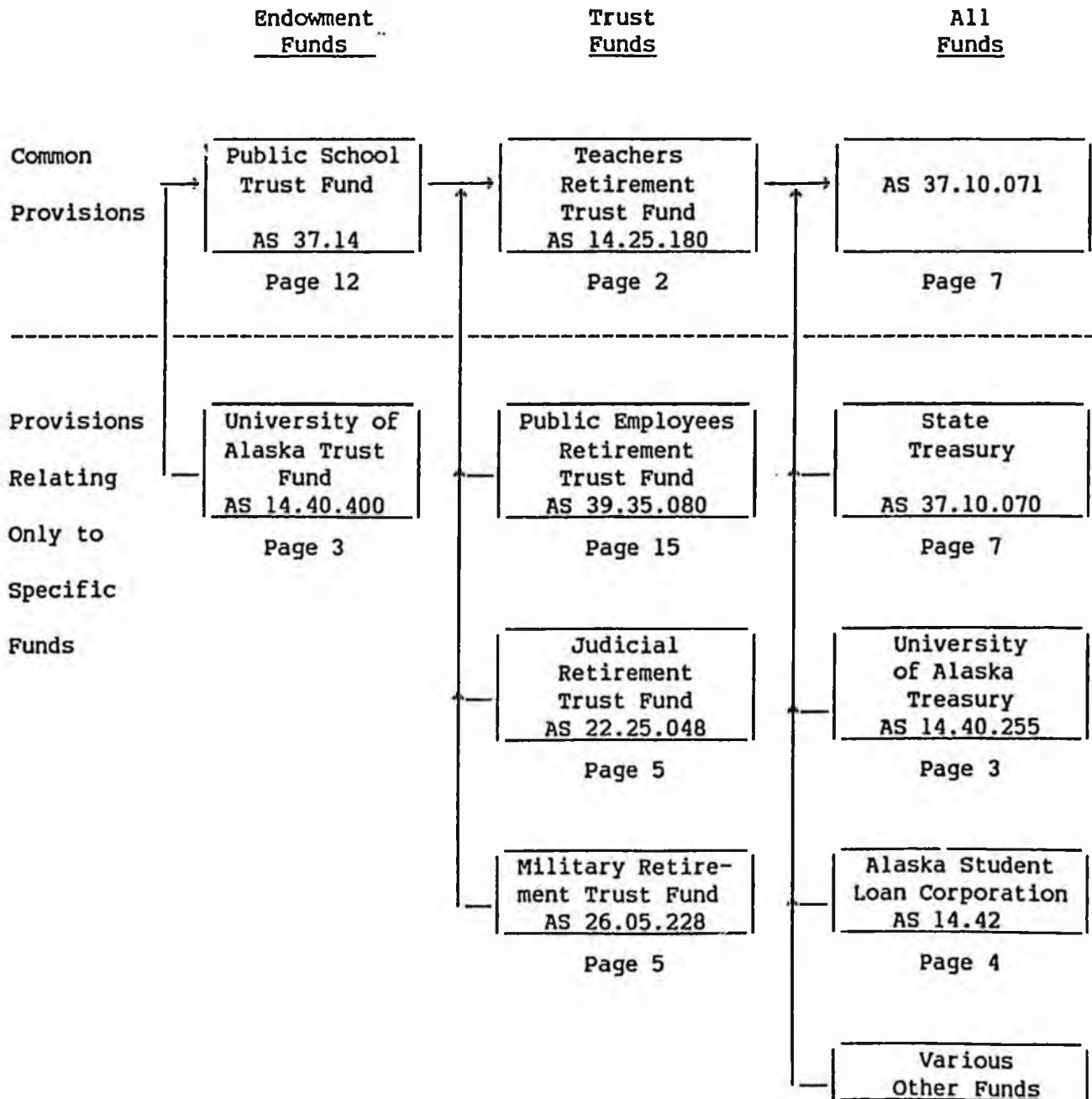
In place of the Procurement Code, regulations would be adopted to provide that contractor selection be on a competitive basis; most contracts for investment management services are subject to independent periodic performance evaluation, which would normally be the basis for their continuation or termination; assurance of not only proper but also the most conscientious possible selection of contractors follows from the mandates of fiduciary responsibilities and the rule of prudence in any event.

MBB/gb

Attachment

Schematic  
of  
HB 547

The various funds invested by the Department of Revenue or independent corporations have different elements in common. Trust funds have more specialized requirements and duties than other funds. Endowment funds have even more specialized requirements and duties than other types of trust funds such as retirement funds. The following schematic shows the statutory references used in the bill to invoke common provisions rather than repeat such provisions throughout Alaska Statutes.



of misconduct or unauthorized editing have been raised.<sup>2</sup>

Thus, we conclude the testimony of the officers was properly admitted in District Court; it is unnecessary to remand to the trial court for another hearing.

The judgment of the Superior Court is reversed; the verdict of the jury is reinstated.

THOMPSON and REED, JJ., concur.



**BAKER BOYER NATIONAL BANK, Appellant,**

v.

**Richard GARVER, Russell R. Garver, and Gregory L. Garver, Respondents and Cross Appellants.**

No. 6404-2-III.

Court of Appeals of Washington, Division 3, Panel Two.

May 15, 1986.

Trustee petitioned for approval of final accounting and remaindermen objected, alleging mismanagement of trusts. The Superior Court, Walla Walla County, Yancey Reser, J., surcharged the trustee for failing to properly diversify trust assets and for unauthorized transfer of trust property. Trustee appealed, and life estate holder and remaindermen cross-appealed. The Court of Appeals, Munson, J., held that: (1) trustee was under a duty to diversify trust investments pursuant to statutorily codified prudent investor rule; (2) granting remaindermen attorney fees and expenses and denying trustee its trustee and attorney fees was proper, given resolu-

2. Because we find admissibility of the testimony proper under *Rupe*, it is not necessary to address the State's argument under the RCW 9.73-

tion of surcharge issue; (3) trustee which had purportedly conveyed one-half interest in land that was not held in trust would be required to compensate for damages resulting from bringing quiet title action against party to whom land was purportedly conveyed; and (4) court should have considered in damage award lost appreciation in equity securities that would have been realized but for the trustee's improper failure to diversify.

Affirmed in part; remanded in part; and reversed in part.

Green, C.J., filed dissenting opinion.

**1. Trusts ⇨217.3(6)**

Trustee is under a duty to diversify trust investments, subject to at least two exceptions of express provision by settlor relieving trustee of duty to diversify or circumstances dictating that it is not prudent to diversify, under prudent investor rule codified by statute. West's RCWA 30.24.020 (now RCWA 11.100.020).

**2. Trusts ⇨217.3(6)**

Any new standards of care created by Trust Act statute setting out "total asset" approach to investment of assets by fiduciaries in considering whether there has been sufficient diversification applied only from effective date of January 1, 1985, even though the statutory provisions applied to instruments created before that time. West's RCWA 11.100.020, 11.100.050.

**3. Appeal and Error ⇨758.1**

Finding of fact that appellant did not assign error to in its opening brief was a verity on appeal, even though appellant claimed in its reply brief that finding of fact was not supported by substantial evidence.

**4. Trusts ⇨262**

Evidence supported finding that trustee did not consciously balance risk and advantages, weighing the amount invested

030(2) exception, recording of threats of extortion, blackmail, or bodily harm.

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## Amendments

P.L. 99-514, § 1805(c)(1):

Act Sec. 1805(c)(1) amended Code Sec. 386 by redesignating subsection (d) as subsection (e) and by inserting after subsection (c) new subsection (d) to read as above.

The above amendment is effective as if included in the provision of P.L. 98-369 to which such amendment relates.

P.L. 98-369, § 75(a):

Act Sec. 75(a) added Code Sec. 386 to read as above.

The above amendment applies to distributions, sales and exchanges made after March 31, 1984, in tax years ending after such date.

## Subchapter D—Deferred Compensation, Etc.

Part I. Pension, profit-sharing, stock bonus plans, etc.

Part II. Certain stock options.

## PART I—PENSION, PROFIT-SHARING, STOCK BONUS PLANS, ETC.

## Subpart A—General Rule

- Sec. 401. Qualified pension, profit-sharing, and stock bonus plans.  
 Sec. 402. Taxability of beneficiary of employees' trust.  
 Sec. 403. Taxation of employee annuities.  
 Sec. 404. Deduction for contributions of an employer to an employees' trust or annuity plan and compensation under a deferred-payment plan.  
 Sec. 404A. Deduction for certain foreign deferred compensation plans.  
 Sec. 406. Employees of foreign affiliates covered by section 3121(l) agreements.  
 Sec. 407. Certain employees of domestic subsidiaries engaged in business outside the United States.  
 Sec. 408. Individual retirement accounts.  
 Sec. 409A. Qualifications for tax credit employee stock ownership plans.

## [Sec. 401]

## SEC. 401. QUALIFIED PENSION, PROFIT-SHARING, AND STOCK BONUS PLANS.

## [Sec. 401(a)]

(a) REQUIREMENTS FOR QUALIFICATION.—A trust created or organized in the United States and forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries shall constitute a qualified trust under this section—

(1) if contributions are made to the trust by such employer, or employees, or both, or by another employer who is entitled to deduct his contributions under section 404 (a) (3) (B) (relating to deduction for contributions to profit-sharing and stock bonus plans), for the purpose of distributing to such employees or their beneficiaries the corpus and income of the fund accumulated by the trust in accordance with such plan;

(2) if under the trust instrument it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, purposes other than for the exclusive benefit of his employees or their beneficiaries (but this paragraph shall not be construed, in the case of a multiemployer plan, to prohibit the return of a contribution within 6 months after the plan administrator determines that the contribution was made by a mistake of fact or law (other than a mistake relating to whether the plan is described in section 401(a) or the trust which is part of such plan is exempt from taxation under section 501(a), or the return of any withdrawal liability payment determined to be an overpayment within 6 months of such determination));

(3) if the plan of which such trust is a part satisfies the requirements of section 410 (relating to minimum participation standards); and

(4) if the contributions or benefits provided under the plan do not discriminate in favor of employees who are—

## Sec. 401

Teachers' Retirement Board

Resolution Regarding House Bill 547  
An Act relating to the investment and management  
of certain state funds

WHEREAS, the Teachers' Retirement ("TRS") Board is authorized by AS 14.25.035(e) to consider and adopt resolutions regarding revisions of Chapter 14.25 of the Alaska Statutes;

WHEREAS, the TRS Board has reviewed and considered House Bill 547, "An Act relating to the investment and management of certain state funds, and providing for an effective date;"

WHEREAS, HB 547 significantly reinforces the trust status of the TRS retirement fund by:

- a) designating the fund as a trust fund;
- b) upgrading the standard of prudence required of the fund's fiduciary; and
- c) requiring the fund's fiduciary to act only in the interests of the fund's beneficiaries;

WHEREAS, HB 547 strengthens accountability for investment of the fund by:

- a) clarifying the Commissioner of Revenue's role as the fiduciary for the fund;
- b) establishing liability for breaches of fiduciary responsibilities;
- c) requiring annual audits of the fund; and
- d) requiring reports on the condition and investment performance of the fund;

WHEREAS, HB 547 removes impediments to the ability of the fiduciary, subject to the standards of professional prudence, to

- a) diversify fund assets among the full range of investment opportunities; and
- b) maximize investment income of the fund over the long run

by repealing statutory specification of permissible investment classes and percentage allocations to particular classes;

WHEREAS, HB 547 assists the recruitment and retention of highly qualified professional investment staff by placing them in the exempt service, permitting the establishment of competitive compensation; and

WHEREAS, HB 547 provides for timely execution of investment strategies by exempting professional services contracts which are delegations of investment authority from the requirements of the State Procurement Code, AS 36.30; and


WHEREAS, the improvement in investment returns that can be expected as a result of HB 547 will be of critical importance to TRS beneficiaries and employers as State petroleum revenues decline,

BE IT HEREBY RESOLVED by the TRS Board that the Board supports enactment into law of HB 547.

DATED this 7 day of April, 1988.

TEACHERS' RETIREMENT BOARD

By

  
Charles Arteaga, Chair

Public Employees' Retirement Board

Resolution Regarding House Bill 547  
An Act relating to the investment and management  
of certain state funds

WHEREAS, the Public Employees' Retirement ("PERS") Board is authorized by AS 39.35.040(3) to consider and adopt resolutions regarding revisions of Chapter 39.35 of the Alaska Statutes;

WHEREAS, the PERS Board has reviewed and considered House Bill 547, "An Act relating to the investment and management of certain state funds, and providing for an effective date;"

WHEREAS, HB 547 significantly reinforces the trust status of the PERS retirement fund by:

- a) designating the fund as a trust fund;
- b) upgrading the standard of prudence required of the fund's fiduciary; and
- c) requiring the fund's fiduciary to act only in the interests of the fund's beneficiaries;

WHEREAS, HB 547 strengthens accountability for investment of the fund by:

- a) clarifying the Commissioner of Revenue's role as the fiduciary for the fund;
- b) establishing liability for breaches of fiduciary responsibilities;
- c) requiring annual audits of the fund; and
- d) requiring reports on the condition and investment performance of the fund;

WHEREAS, HB 547 removes impediments to the ability of the fiduciary, subject to the standards of professional prudence, to:

- a) diversify fund assets among the full range of investment opportunities; and
- b) maximize investment income of the fund over the long run

by repealing statutory specification of permissible investment classes and percentage allocations to particular classes;

WHEREAS, HB 547 assists the recruitment and retention of highly qualified professional investment staff by placing them in the exempt service, permitting the establishment of competitive compensation; and

WHEREAS, HB 547 provides for timely execution of investment strategies by exempting professional services contracts which are delegations of investment authority from the requirements of the State Procurement Code, AS 36.30; and

WHEREAS, the improvement in investment returns that can be expected as a result of HB 547 will be of critical importance to PERS beneficiaries and employers as State petroleum revenues decline,

BE IT HEREBY RESOLVED by the PERS Board that the Board supports enactment into law of HB 547, provided that it is amended to include reporting provisions parallel to AS 14.25.035(d).

DATED this 7 day of April, 1988.

PUBLIC EMPLOYEES' RETIREMENT BOARD

By C. R. "Steve" Hafling  
C. R. "Steve" Hafling, Chair

HOUSE BILL 507

INVESTMENT AND MANAGEMENT OF CERTAIN STATE FUNDS

<u>GOALS</u>	<u>MAIN PROVISIONS OF THE BILL</u>	<u>RESULTS</u>
Establish Fiduciary Duties for State Trust Funds	Confirm Trust Status of Trust Funds	Assures Trust Funds Meet Beneficiaries' Needs
	Upgrade Standard of Prudence	Reduces Chances of Lawsuits or Liability
	Invoke Duty of Loyalty to Beneficiaries for Trust Funds	
	Establish Liability for Breaches of Investment Responsibilities	

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Increase Investment Earnings on All State Funds	Broaden Investment Authority	Increases Diversification of Investments
	Permit Competitive Compensation for Investment Staff	Reduces Investment Risk
	Exempt Delegations of Investment Powers from Procurement Code	Increases Investment Returns

House Bill 547  
Investment and Management of Certain State Funds

EXECUTIVE SUMMARY

House Bill 547 represents a comprehensive revision of statutes governing the investment responsibilities of the Department of Revenue. The department is responsible for investment of all state funds, exclusive of the funds of independent corporations. State funds include retirement and endowment funds, which are both types of trust funds.

The legislation focuses on trust funds. Such funds carry a greater weight of responsibilities, duties, and care due to the fact that they are for the benefit of other persons. These fiduciary duties and standards have been elaborated under common law, various statutory laws such as ERISA (the Employee Retirement Income Security Act), and case law pursuant to statutory provisions.

The legislation places fiduciary duties and standards into Alaska Statutes, both clarifying and elevating the responsibilities.

The other main revision contained in the bill is the broadening of permissible investments. HB 547 places investment authority under the elevated standards of care contained in the bill, eliminating the narrow lists of investments currently in statutes. This would open up investment opportunities, permit greater diversification, reduce risk, and increase earnings on all state funds.

Legal lists evolved as a response to early judicial views of the fiduciary duty of prudence. These restrictive views often prohibited equity investments. Legal lists were a way to specifically authorize such investments.

With the development of modern portfolio theory--which assesses risk based on the total investment portfolio rather than an individual asset or security--and the adoption of this theory by the courts, legal lists have become obsolete. In fact, given the rapid evolution of securities markets, instruments, and practices in recent years, legal lists now conflict with or restrain rather than facilitate prudent investment and diversification.

Elimination of legal lists does not mean that investment will proceed without any guidelines. It only means that the guidelines will not be cast in stone and incapable of timely response to changes in the financial markets due to the limited

window of opportunity, uncertainty, and delay inherent in the legislative process. The attached publication, "General Investment Policies," discusses the policies and guidelines that govern investment of funds by the Department of Revenue.

The enhancement of investment returns that can be expected by moving away from inflexible statutory guidelines can be of significant financial benefit to the State, municipalities, and trust fund beneficiaries. The attached "PERS and TRS Financial Projections" prepared by the state's actuary demonstrates how significant a small enhancement in returns can be in the case of the retirement funds.

The legislation has been reviewed by the Department of Law and Willkie, Farr & Gallagher, investment counsel to the state on contract to the Department of Law. Willkie Farr's analysis is contained in their attached March 1, 1988 memoranda. HB 547 contains Willkie Farr's recommendations on liability for fiduciary duties. The legislation has been endorsed by resolutions of the Public Employees' and Teachers' Retirement boards. The Department of Revenue strongly supports passage of HB 547.

#### Goals of the Legislation

There are two principal goals HB 547 would help achieve:

1. strengthening the trust status and observance of fiduciary duties for trust funds under State management; and,
2. increasing the investment returns for all funds under State management.

#### Need for the Legislation

The legislation is needed because:

1. there is a lack of understanding in the public's mind about the trust status of certain funds;
2. improvements in investment performance can make a significant difference in State and municipal finances;
3. the statutory lists of permissible investments for certain funds contain inherent contradictions;
4. the investment lists for certain funds conflict with fiduciary duties;
5. trust fund statutes fail to fully delineate fiduciary responsibilities;

6. compensation for investment personnel is not competitive, jeopardizing the fulfillment of the statutory requirement that State funds be invested with the judgment and care which an institutional investor would exercise;
7. statutory investment lists for certain funds contain ceilings on percentage allocations of fund assets to particular types of investments, limiting the long-run returns the funds could earn.

#### Financial Effects of the Legislation

HB 547 is potentially of very significant financial benefit to the State as well as trust fund beneficiaries and municipalities (participating in the "Public Employees' and Teachers' Retirement Systems). The legislation holds much promise of benefit as a direct revenue-raising measure. At the June 30, 1987 level of \$4,948,475,000 under investment by the State, an improvement in returns of only 10 basis points, or 0.1%, would mean increased earnings of \$4.9 million per annum.

In addition, the steps the bill would take to assure the observance of fiduciary duties would limit the State's potential liability as trustee.

#### Main Provisions of HB 547

The legislation would take five main steps in furtherance of the goals of strengthening the observance of fiduciary responsibilities and improving investment performance in general:

1. strengthen the trust status and fiduciary responsibilities of trust funds by:
  - a. designation of trust funds as trusts in statute;
  - b. upgrading the standard of prudence;
  - c. requiring the fiduciary to act only in the interests of a fund's beneficiaries; and,
  - d. requiring that investments be acquired or sold at internationally competitive market rates or prices;
2. strengthen accountability by
  - a. clarifying the Commissioner of Revenue's role as fiduciary;

- b. establishing liability for the commissioner or the commissioner's designee for breaches of fiduciary or other investment responsibilities;
  - c. requiring annual audits by an independent firm of certified public accountants; and,
  - d. requiring reports on the condition and investment performance of funds;
3. repeal statutory investment lists;

Making an upgraded rule of prudence the guide for permissible investments rather than a legal list of specific instruments and percentage allocations would accomplish two main things:

- a. decrease risk by permitting greater diversification, subject to the rule of prudence; and,
- b. maximize earnings by permitting greater concentration in the highest yielding assets, subject to the rule of prudence.

The number of pension funds and other institutional investment funds which operate under a legal list has become a small minority.

Employee pension or welfare benefit plans of corporations and unions under ERISA; private foundations under the Internal Revenue Code; endowments of universities, hospitals, and religious or other charitable institutions in 28 states under the Uniform Management of Institutional Funds Act; and 23 state retirement funds operate free of legal list restrictions.

- 4. provide for competitive compensation for investment staff by placing them in the exempt service; and
- 5. exempt professional services contracts which are delegations of investment authority from the requirements of the State Procurement Code; most contracts for investment management services are subject to independent periodic performance evaluation; competitive selection of contractors follows from the mandates of fiduciary responsibilities and the rule of prudence.

HOUSE BILL 547

Investment and Management of Certain State Funds

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- J. Department of Revenue Memorandum Regarding Alaska State Trust Company

HOUSE BILL 547

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EXECUTIVE SUMMARY

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The legislation focuses on trust funds. Such funds carry a greater weight of responsibilities, duties, and care due to the fact that they are for the benefit of other persons. These fiduciary duties and standards have been elaborated under common law, various statutory laws such as ERISA (the Employee Retirement Income Security Act), and case law pursuant to statutory provisions.

The legislation places fiduciary duties and standards into Alaska Statutes, both clarifying and elevating the responsibilities. One of the significant financial effects of HB 547 would be the limitation of the State's potential liability as a trustee by virtue of the steps taken in the bill to assure observance of fiduciary duties.

The other main revision contained in the bill is the broadening of permissible investments. HB 547 places investment authority under the elevated standards of care contained in the bill, eliminating the narrow legal lists of investments currently in statutes. This would open up investment opportunities, permit greater diversification, reduce risk, and increase earnings on all state funds.

Legal lists evolved as a response to early judicial views of the fiduciary duty of prudence. These restrictive views often prohibited equity investments. Legal lists were a way to specifically authorize such investments.

With the development of modern portfolio theory--which assesses risk based on the total investment portfolio rather than an individual asset or security--and the adoption of this theory by the courts, legal lists have become obsolete. In fact, given the rapid evolution of securities markets, instruments, and practices in recent years, legal lists now conflict with or impair rather than facilitate prudent investment and diversification.

Elimination of legal lists means that investment guidelines will not be cast in stone and incapable of timely response to changes in the financial markets. The attached publication, "General Investment Policies," discusses the policies and guidelines that govern investment of funds by the Department of Revenue. The enhancement of investment returns that can be expected by moving away from inflexible statutory guidelines can be of significant financial benefit to the State, municipalities, and trust fund beneficiaries. The attached "PERS and TRS Financial Projections" prepared by the state's actuary demonstrates how significant a small enhancement in returns can be in the case of the retirement funds.

The legislation has been reviewed by the Department of Law and Willkie, Farr & Gallagher, investment counsel to the state on contract to the Department of Law. Willkie Farr's analysis is contained in their attached March 1, 1988 memoranda. HB 547 contains Willkie Farr's recommendations on liability for fiduciary duties.

The legislation has been endorsed by resolutions of the Public Employees' and Teachers' Retirement boards. The Department of Revenue strongly supports passage of HB 547.

### Goals of the Legislation

1. Strengthening the trust status and observance of fiduciary duties for trust funds under State management; and,
2. Increasing the investment returns for all funds under State management.

### Main Provisions of HB 547

1. Strengthen the trust status and fiduciary responsibilities of trust funds by:
  - a. designation of trust funds as trusts in statute;
  - b. upgrading the standard of prudence;
  - c. requiring the fiduciary to act only in the interests of a fund's beneficiaries; and,
  - d. requiring that investments be acquired or sold at internationally competitive market rates or prices;
2. Strengthen accountability by
  - a. clarifying the Commissioner of Revenue's role as fiduciary;
  - b. establishing liability of the commissioner or the commissioner's designee for breaches of fiduciary or other investment responsibilities;
  - c. requiring annual audits by an independent firm of certified public accountants; and,
  - d. requiring reports on the condition and investment performance of funds;
3. Broaden investment authority;

Making an upgraded rule of prudence the guide for permissible investments:

- a. decrease risk by permitting greater diversification, subject to the rule of prudence; and,
- b. maximize earnings by permitting greater concentration in the highest yielding assets, subject to the rule of prudence.

The number of pension and other institutional funds which operate under a legal list has become a small minority. Corporate and union pensions under ERISA; private foundations under the Internal Revenue Code; endowments of universities, hospitals, and religious or other charitable institutions in 28 states under the Uniform Management of Institutional Funds Act; and 23 state retirement funds operate free of legal list restrictions.

4. Provide for competitive compensation for investment staff by placing them in the exempt service; current compensation levels jeopardize the statutory requirement that State funds be invested with the judgment and care which an institutional investor would exercise; and
5. exempt professional services contracts which are delegations of investment authority from the State Procurement Code; contracts for investment management are subject to independent periodic performance evaluation; competitive selection is required by fiduciary duty and the rule of prudence.

HB 547  
Bill Analysis

Teachers Retirement System

- Section 1 Removes an ambiguity about the commissioner of revenue's fiduciary role for the retirement fund by recognizing the board's role as limited to administration of the system.
- Section 2 Redefines responsibility for reports furnished to the board so that the commissioner of administration provides reports on the condition and administration of the system, and the commissioner of revenue provides reports on the condition and performance of the retirement fund.
- Section 3 Expressly establishes the Teachers' Retirement Trust fund and adds the requirement for an annual independent audit of the system.
- Section 4 Clarifies that the commissioner of revenue is the fiduciary manager of the retirement fund. Imposes duties on the commissioner relating to investment of retirement funds in general, including
- (a) to establish investment policies and objectives based on the then current and probable future structure of the system's assets and liabilities; and
  - (b) to act only in the interests of the fund's beneficiaries.

Authorizes investment without regard to generation of income, that is, permits emphasis on capital gains, if appropriate, recognizing the long-term nature of the fund's liabilities and without regard to the distinction between principal and income, recognizing, in theory, that the principal, as well as the income, will ultimately be paid out in benefits.

References another section of statutes (AS 37.10.071) for specification of investment powers and duties generally applicable to all funds.

University of Alaska

Section 5 Reference for University of Alaska investments to general statutory provisions regarding investment powers and duties (AS 37.10.071).

University of Alaska Fund

Section 6 Adds "endowment trust" to the fund designation to better state the purpose of the fund and to distinguish it by title from other funds which do not have similar limitations.

Section 7 Clearly establishes the commissioner of revenue's role as the fiduciary for the fund and imposes the same powers and duties as for the Public School Fund (AS 37.14).

Section 8 Adds "net" as an adjective before income (clarifying that it is after expenses, costs, and amortizations of bond premiums or discounts).

Section 9 Adds the adjective "net" before income to prevent confusion with gross income.

Alaska Student Loan Corporation

Sections 10 & 11 Reference for Alaska Student Loan Corporation and its student loan fund investments to general statutory provisions regarding investment powers and duties (AS 37.10.071).

Alaska Medical Facility Authority

Section 12 Reference to general statutory provisions regarding investment powers and duties (AS 37.10.071).

Alaska Housing Finance Corporation

Section 13 Reference for the corporation's state mortgage insurance fund investments to general statutory provisions regarding investment powers and duties (AS 37.10.071).

Judicial Retirement System

Section 14 Expressly establishes the Judicial Retirement Trust Fund and what it will hold.

Section 15 States the role of the commissioner of revenue and references general statutory provisions regarding retirement fund investment powers and duties (AS 14.25.180)

#### Military Retirement System

Section 16 Expressly establishes the Military Retirement Trust Fund and what it will hold.

Section 17 States the role of the commissioner of revenue and references general statutory provisions regarding retirement fund investment powers and duties (AS 14.25.180)

#### Public Contracts

Section 18 Excludes delegations of investment powers from state procurement code procedures.

#### State Treasury

Section 19 Repeal of the existing section of law eliminates the list of permissible Treasury investments and consequently makes investment selections subject to the more general and inclusive "prudent institutional investor rule" stated in the subsection. Eliminating the list increases the commissioner's ability to achieve investment objectives, improves the adaptability of investment policies to changing conditions, instruments, and markets, removes inconsistencies in the current list, and avoids conflicts between the limitations of the list and the requirements of the "prudent institutional investor rule." Corporate and union pension funds (ERISA) and 26 states' pension funds now are governed solely by the "prudent man" or prudent institutional investor" standard.

Reenactment states the commissioner of revenue's specific responsibilities for Treasury investments and references general statutory provisions regarding investment powers and duties (AS 37.10.071).

#### Investment Powers and Duties

Section 20 This section specifies powers and duties of the commissioner of revenue generally applicable to the investment of all funds.

Subsection (a) specifies powers and duties more completely and generally than current statutes including the obligations to maintain investment accounting records and secure annual independent audits. Raises the standard to acquire or dispose of discretionary investments at competitive market prices or rates to include internationally competitive rates or prices.

Subsection (b) lists certain actions the commissioner may take. The list is not necessary from the standpoint of authorizing or limiting the investment powers of the commissioner, or of stating the types of activity presumed under the "prudence rule." It's inclusion in the statute is considered desirable in order to minimize the risk of possible litigation concerning the activities by specifying some of the activities which may not be obvious as being derived from the broad investment powers.

Section (c) restates and amplifies the "prudent institutional investor rule." The "prudent rule" standard of care is raised to a professional (sophisticated or expert) level and applied to the whole fund rather than to separate investments, and it is amplified to require consideration of the fund's purpose and objectives.

Subsection (d) establishes liability of the commissioner or a designee of the commissioner for a breach of investment duties. Includes co-fiduciary liability under standards comparable to ERISA.

Subsection (e) indemnifies the commissioner or a designee against liability for prudent actions taken in good faith.

### Municipal Bonds

#### Section 21

Eliminates blanket authority of commissioner of revenue to purchase debt of Alaska municipalities. The amendment would permit such purchase when litigation forestalls issuance. Purchase of Alaska municipal debt would also be authorized under general investment powers contained in the bill if such purchase met the standards of prudence.

### Public School Trust Fund

- Section 22 Adds "endowment" and "trust" to the fund designation to better state the purpose of the fund and to distinguish it from other funds which do not have similar limitations.
- Section 23 Redefines the income as being "net," provides for its determination, and requires the accounting distinction between principal and income. Provides for the inclusion of realized capital gains or losses as part of the principal of the fund and the perpetual retention of the principal in keeping with its endowment nature.
- Section 24 Modifies income to "net income" and imposes a duty to invest unexpended income.
- Section 25 Restates the role and the powers and duties of the commissioner of revenue with regard to the investment of the fund as being similar to those for the retirement funds except that additional duties to separately invest and account for principal and income are imposed due to the endowment nature of the fund.
- Section 26 Clearly establishes the commissioner of revenue as the fiduciary of the fund and imposes duties and authorities relating to investment policy and acting in the interests of beneficiaries.

### Investment Officers

- Section 27 Places Department of Revenue investment officers in exempt status with respect to the State Personnel Act.

### State Group Health and Life Insurance

- Section 28 Substitutes the appropriate, more comprehensive, word "income" for "interest."
- Section 29 Reference to general statutory provisions for retirement fund investment powers and duties (AS 14.25.180).

### Public Employees Retirement System

- Section 30 Changes the investment list to a summary. This removes confusing details, makes the

report more succinctly informative, and conforms it to investment accounting principles.

Expressly establishes the Public Employees Retirement Trust Fund and adds the requirement for an annual independent audit of the system.

Section 31 States the fiduciary role of the commissioner of revenue and references general statutory provisions for retirement fund investment powers and duties (AS 14.25.180).

Power Development Fund (Alaska Power Authority)

Section 32 Reference to general statutory provisions for investment powers and duties (AS 37.10.071).

Enterprise Development Fund (Alaska Industrial Development and Export Authority)

Section 33 Reference to general statutory provisions for investment powers and duties (AS 37.10.071).

Repealers

Section 34 Alaska State Building Authority (ASBA)

Removes authority for the General Fund to purchase from ASBA mortgage loans made to cooperatives (AS 18.55.375).

Medical Indemnity Corporation of Alaska (MICA)

Removes requirement for General Fund to purchase MICA notes up to \$6 million (AS 21.88.210(d)).

Veterans Revolving Loan Fund

Repeals authority of Department of Revenue to purchase commercial paper from this fund which became defunct July 1, 1981 when its authority to make new loans was terminated by Sec. 71, Ch. 106, SLA 1980 (AS 26.15.060).

Sale of Bond Investments

Removes requirement for governor's approval of the sale of bonds held as investments by the Department of Revenue (AS 37.10.080).

Public School Fund Advisory Board

Removes the board's responsibility for long-range investment plans to avoid conflict with the commissioner of revenue's role as fiduciary for the fund (AS 37.14.130(3)).

State Investment Officers

Removes state investment officers from partially-exempt status under the State Personnel Act (AS 39.25.120(c)(13)). Section 27 of the bill places them in exempt status.

Public Employees Retirement System

Repeals investment statutes made unnecessary by reference in section 31 of the bill to general statutory provision for investment powers and duties (AS 39.35.110).

Small Business Revolving Loan Fund

Repeals authority of Department of Revenue to purchase commercial paper, mortgages, and notes from this fund which became defunct July 1, 1981 when its authority to make new loans was terminated by Section 71, Ch. 106, SLA 1980 (AS 45.95.030 and AS 45.95.040(b)).

Historical District Loan Fund

Removes authority for the General Fund to purchase Historical District Revolving Loans (AS 45.98.050(b)).

House Bill 547  
Investment and Management of Certain State Funds

INTRODUCTION

HB 547 is a comprehensive revision of Department of Revenue investment statutes. The department invests all state funds, excluding funds of independent corporations.

The bill focuses on trust funds, which include retirement and endowment funds. Trust funds carry a greater weight of care because they are for the benefit of other persons. Fiduciary duties and standards of care for trusts have been elaborated under common law, statutory law such as ERISA (the Employee Retirement Income Security Act), and case law pursuant to statutory provisions.

One of the bill's major changes puts fiduciary duties and standards into Alaska law, both clarifying and elevating them. One significant financial effect of HB 547 would be to limit the State's potential liability as trustee by providing guidance and personal liability for observance of fiduciary duties.

The other major change is the broadening of permissible investments. HB 547 places investment authority under the elevated standards of care contained in the bill, eliminating the narrow legal lists of investments currently in statutes. This would open up investment opportunities, permit greater diversification, reduce risk, and increase earnings on all state funds.

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Elimination of legal lists means that investment guidelines will not be cast in stone and incapable of timely response to changes in financial markets. The enhancement of investment returns that can be expected by moving away from inflexible statutory guidelines can be of great financial benefit to the State, municipalities, and trust fund beneficiaries.

The legislation has been reviewed by the Department of Law and Willkie, Farr & Gallagher, investment counsel to the state. HB 547 contains Willkie Farr's recommendations on liability for fiduciary duties.

The bill has been endorsed by resolutions of the Public Employees' and Teachers' Retirement boards. The Department of Revenue supports passage of HB 547.

### Goals of the Legislation

1. Strengthening the trust status and observance of fiduciary duties for trust funds under State management; and,
2. Increasing the investment returns for all funds under State management.

### Main Provisions of HB 547

1. Strengthen the trust status and fiduciary responsibilities of trust funds by:
  - a. designation of trust funds as trusts in statute;
  - b. upgrading the standard of prudence;
  - c. requiring the fiduciary to act only in the interests of a fund's beneficiaries; and,
  - d. requiring that investments be acquired or sold at internationally competitive market rates or prices;
2. Strengthen accountability by
  - a. clarifying the Commissioner of Revenue's role as fiduciary;
  - b. establishing liability of the commissioner or the commissioner's designee for breaches of fiduciary or other investment responsibilities;
  - c. requiring annual audits by an independent firm of certified public accountants; and,
  - d. requiring reports on the condition and investment performance of funds;
3. Broaden investment authority by:

Making an upgraded rule of prudence the guide for permissible investments:

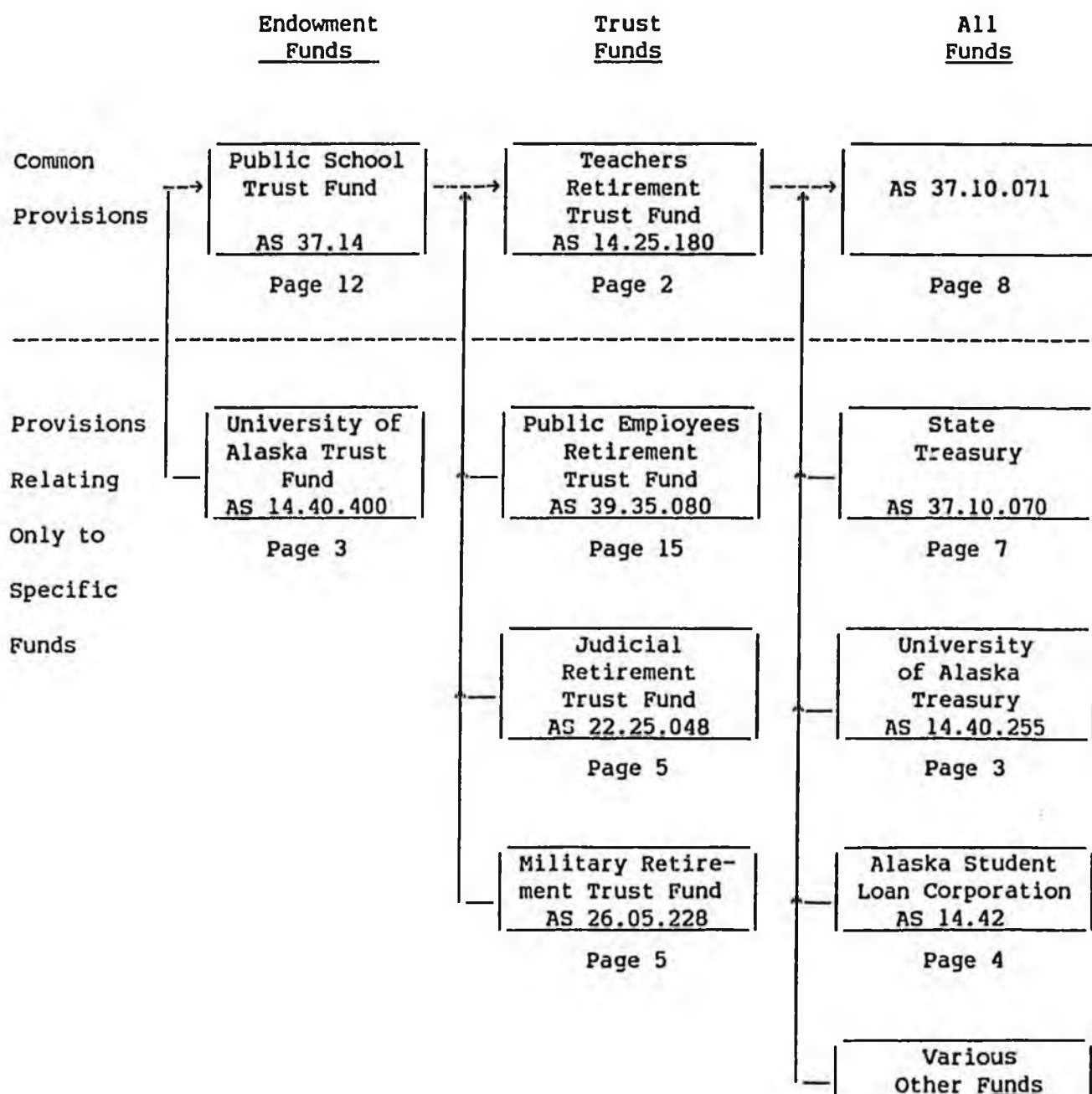
- a. decrease risk by permitting greater diversification, subject to the rule of prudence; and,
- b. maximize earnings by permitting greater concentration in the highest yielding assets, subject to the rule of prudence.

The number of pension and other institutional funds which operate under a legal list has become a small minority. Corporate and union pensions under ERISA; private foundations under the Internal Revenue Code; endowments of universities, hospitals, and religious or other charitable institutions in 28 states under the Uniform Management of Institutional Funds Act; and 23 state retirement funds operate free of legal list restrictions.

4. Provide for competitive compensation for investment staff by placing them in the exempt service; current compensation levels jeopardize the requirement that State funds be invested with the judgment and care which an institutional investor would exercise; and
5. exempt professional services contracts which are delegations of investment authority from the State Procurement Code; contracts for investment management are subject to independent periodic performance evaluation; competitive selection is required by fiduciary duty and the rule of prudence.

Schematic  
of  
CS HB 547 (Finance) am

The various funds invested by the Department of Revenue or independent corporations have different elements in common. Trust funds have more specialized requirements and duties than other funds. Endowment funds have even more specialized requirements and duties than other types of trust funds such as retirement funds. The following schematic shows the statutory references used in the bill to invoke common provisions rather than repeat such provisions throughout Alaska Statutes.



STATE OF ALASKA  
ROUTE SLIP

TO: Mail Station 3200	Department	Division
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Attention

Senate Finance - Vicki

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|--|---|
| <input type="checkbox"/> Approval      | <input type="checkbox"/> Note & Return        |
| <input type="checkbox"/> Signature     | <input type="checkbox"/> Initial & Return     |
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| <input type="checkbox"/> For Your File | <input type="checkbox"/> For Your Information |

Remarks:

Per your request

FROM: Mail Station 0400	Department Revenue	Division Treas
By Alouia		Date 4/21

02-002 (REV 3-84)

To the Reader:

The enclosed "Memorandum Concerning the State of Alaska Legislative Proposals Regarding Commissioner of Revenue's Investment Powers and Duties" is a review by Willkie, Farr & Gallagher, investment counsel to the state, on contract to the Department of Law, of draft legislation and other materials.

The recommendations of Willkie, Farr & Gallagher on liability and indemnification for breaches of fiduciary duty have been incorporated in HB 547 and subsequent House versions of the bill. These recommendations can be found in the Executive Summary on pages 4 and 5 and in the body of the Memoranda on pages 47 through 61.

Alaska Department of Revenue

MEMORANDA CONCERNING THE STATE OF ALASKA  
LEGISLATIVE PROPOSALS REGARDING  
COMMISSIONER OF REVENUE'S INVESTMENT POWERS AND DUTIES

WILLKIE FARR & CALLAGHER  
One Citicorp Center  
153 East 53rd Street  
New York, New York 10022

March 1, 1988

# WILLKIE FARR & GALLAGHER

New York  
Washington, DC  
London  
Paris

## M E M O R A N D U M

TO: State of Alaska Department of Revenue

FROM: Willkie Farr & Gallagher

RE: Executive Summary of WF&G Memorandum Examining  
Legislative Proposals Regarding Commissioner of  
Revenue's Investment Powers and Duties

DATED: March 1, 1988

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### Introduction

This Memorandum is designed to serve as an Executive Summary of the content of the attached Memorandum from Willkie Farr & Gallagher to the State of Alaska Department of Revenue (the "Investment Proposals Memorandum"). The Investment Proposals Memorandum examines the legal issues relevant to, and the rationale for, certain changes proposed by the Commissioner of Revenue of the State (the "Commissioner") to be made to the statutory framework currently governing investments made with the monies of certain public funds established by the State of Alaska (the "Funds"). For convenience, the discussion set out below follows the same organizational structure used in the Investment Proposals Memorandum. Section I thus sets out the legal background of each of the legislative proposals (the "Bill") prepared by the Commissioner. Section II summarizes issues related to the Bill proposals, but not covered by the express terms of the Bill. Section III summarizes the separate proposal to establish an independent trust company. Capitalized terms not otherwise defined in this Memorandum have the same meanings that they do in the Investment Proposals Memorandum.

### Section I: Background of the Bill Proposals

#### A. Establishment and Designation of Certain Funds as Trusts

The Bill clarifies the legal status of the Funds by expressly establishing separate funds for the deposit of the assets of the Retirement Systems and Endowment Funds and specifically designating those Funds as trusts. Trust designation establishes the basic fiduciary responsibility of the Treasurer, as trustee of the Funds, to segregate the assets

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of the Funds from all other monies under the Commissioner's control and to earmark those assets as trust property. The Bill, by specifically conferring trust status, may provide a basis for liability in the event of loss resulting from the commingling of assets. It may also encourage in those responsible for administration of plan assets a sense of duty toward plan beneficiaries, by providing a framework for them to discharge that duty.

B. Designation of the Commissioner as a Fiduciary of the Funds and Requirement to Act Only in the Interest of Beneficiaries.

The Bill expands statutory guidance with respect to proper behavior toward trust property and beneficiaries by expressly designating the Commissioner as a "fiduciary" of certain of the Funds and by requiring the Commissioner to act "only in regard to the best financial interests" (or long-term interests, in the case of the Endowment Funds) of Fund beneficiaries. Under common law, two primary duties flow from the "fiduciary" relationship: a duty to act prudently in the administration of the trust and a duty of loyalty to trust beneficiaries. The duty of loyalty requires a trustee to administer the trust solely in the interest of its beneficiaries; a trustee is prohibited from self-dealing, favoring certain beneficiaries over others, and dealing with trust property for the benefit of third parties. The Bill proposal incorporates and expands upon this common law duty of loyalty. Guidance as to the parameters of permissible behavior under the Bill may be found by looking to case law interpreting the "exclusive purpose" rule contained in the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), which is generally similar in intent to the Bill's "only in the financial interest" standard.

C. Repeal of Legal Lists and Implementation of a New Rule of Prudence.

The Bill repeals the current statutes' "legal list" restrictions, which are limitations on the Commissioner's investment authority as to type of investments that may be held by a Fund and, in some instances, as to maximum percentage or dollar amount of Fund assets that may be invested in particular instruments. The legal lists serve to restrict investment choices, lessen investment performance, and preclude investments that, when viewed in the context of a Fund, would clearly be deemed prudent by an institutional investor. In addition to repealing the legal list provisions, the Bill imposes a stringent statutory obligation requiring the Commissioner to act with "professional" prudence by exercising

the judgment and care of an institutional investor managing large investments under a trust relationship. This standard appears to require that the Commissioner, as fiduciary, exercise the care and skill of a sophisticated professional investor whose knowledge and ability is substantially greater than that expected of an ordinarily prudent layman. A court would, therefore, in interpreting the provisions of the Bill, in all probability, look to the regulations and case law construing ERISA as the body of law governing the conduct of private, professional institutional investors. The significance of the State's adopting an ERISA-type approach to prudence, especially in conjunction with repeal of the legal list statutes, is that it would permit a much larger universe of investments to be considered in investing the monies of the Funds, thereby benefiting Fund beneficiaries.

#### D. Authorization to Delegate Responsibilities

The Bill authorizes the Commissioner expressly to delegate his investment, custodial and depository authority with respect to the Funds to officers or employees of the State or to independent firms, banks or trust companies. This proposal is a necessary corollary to the fiduciary duty of prudence. The cases construing ERISA's prudent man rule suggest that the Commissioner, in seeking to meet the prudent institutional investor rule, has an affirmative duty to obtain competent professional assistance by hiring qualified employees or by entering into contracts with qualified outside professionals. The Bill's proposal serves to emphasize this general duty of delegation and to provide a framework for the discharge of that duty.

#### E. Establishment of Reporting and Statutory Auditing Requirements

The Bill requires the Commissioner to cause periodic reports on the condition and investment performance of certain of the Funds to be prepared and furnished to the board overseeing the operation of those Funds. In addition, annual audits of the Funds must be conducted by an independent firm of public accountants. This, in large part, reflects current practice. The Commissioner's reporting and auditing proposal, which is comparable to reporting requirements under ERISA, should facilitate the Commissioner's fulfilling his fiduciary obligations toward the Funds.

### Section II: Related Issues

#### A. Federal Income Tax Implications

The Bill's proposal to designate the Retirement Funds as trusts will serve to ensure compliance with the implicit

requirement of Section 401 of the Internal Revenue Code (the "Code") that the assets of public plans be held in trust. In addition, the Bill's proposal that the assets of the Retirement Funds be used only in regard to the financial interests of their beneficiaries should act to ensure compliance with the exclusive benefit rule contained in Section 401(a) of the Code.

B. Liability, Indemnification and Insurance

The increase in the extent of the fiduciary obligations of the Commissioner and his staff under the Bill, raises the issues of: potential liability in the event of breach of those obligations; the extent to which those the Commissioner employs may be indemnified; and the extent to which insurance may be obtained.

(1) Liability

[A] Liability of the State, the Commissioner and State Employees

Although no specific liability provisions are contained in the Bill, the Commissioner and those he employs, as fiduciaries of the Funds, may be potentially liable for breaches of their fiduciary obligations. In addition, the State may be liable for these employee breaches. Although it is unlikely that the State can claim "sovereign immunity" under Alaska case law interpreting that doctrine, employees of the Commissioner may be immune from suit under the broader "official immunity" doctrine. Because immunity may be viewed as inconsistent with the public policy considerations underlying the Bill, the Commissioner should consider amending current law to provide explicitly that a State employee will generally be liable for breach of a fiduciary obligation, unless he acted prudently, in good faith, and within the scope of his employment.

[B] Liability of Service Providers

The Bill does not address the potential liability of third parties for breaches of fiduciary duties, nor does it deal with the potential liability of the Commissioner for the actions of third party service providers. Under an ERISA-type analysis, a third party service provider is liable if that party meets ERISA's broad definition of "fiduciary." Most third parties to which the Commissioner would typically delegate responsibilities for the Funds are likely to fall within the ERISA definition of fiduciary and, thus, under an ERISA analysis, would be potentially liable for breach of fiduciary duty. ERISA's provisions and case law with respect

to co-fiduciary liability, however, suggest that the Commissioner may limit his potential liability for misconduct of third party service providers by diligently selecting those entities and monitoring their services. Because the issue of third party conduct is a significant one, the Commissioner should consider dealing with it by express statute rather than by application of analogous provisions of law.

(2) Indemnification and Insurance

The Bill in its current form contains no specific provision for indemnification of the Commissioner's employees for alleged breach of fiduciary duty. In view of the increased amount of fiduciary obligations that would be imposed on those employees under the Bill, the Commissioner might consider adding indemnification provisions to the Bill. In addition, the Commissioner may wish to consider obtaining insurance covering potential breaches, although we note that a meaningful amount of insurance is currently quite difficult to obtain at acceptable prices.

Section III: Establishment of Independent Trust Company

The Commissioner has presented, in a legislative package separate from the Bill, a proposal to create an independent trust company (the "Trust Company") that would be responsible for the management of the investments and the custody of the assets of the Funds. The proposal to create the Trust Company reflects an attempt to insulate investment of Fund assets from political pressures and to deal with the conflicts of interest inherent in investment management by State officials. Substitution of an independent professional corporation, expert in investment management, for the State as trustee, may reduce the chance of political or administrative factors interfering with the Funds' investing in a manner consistent with the financial interest of Fund beneficiaries.

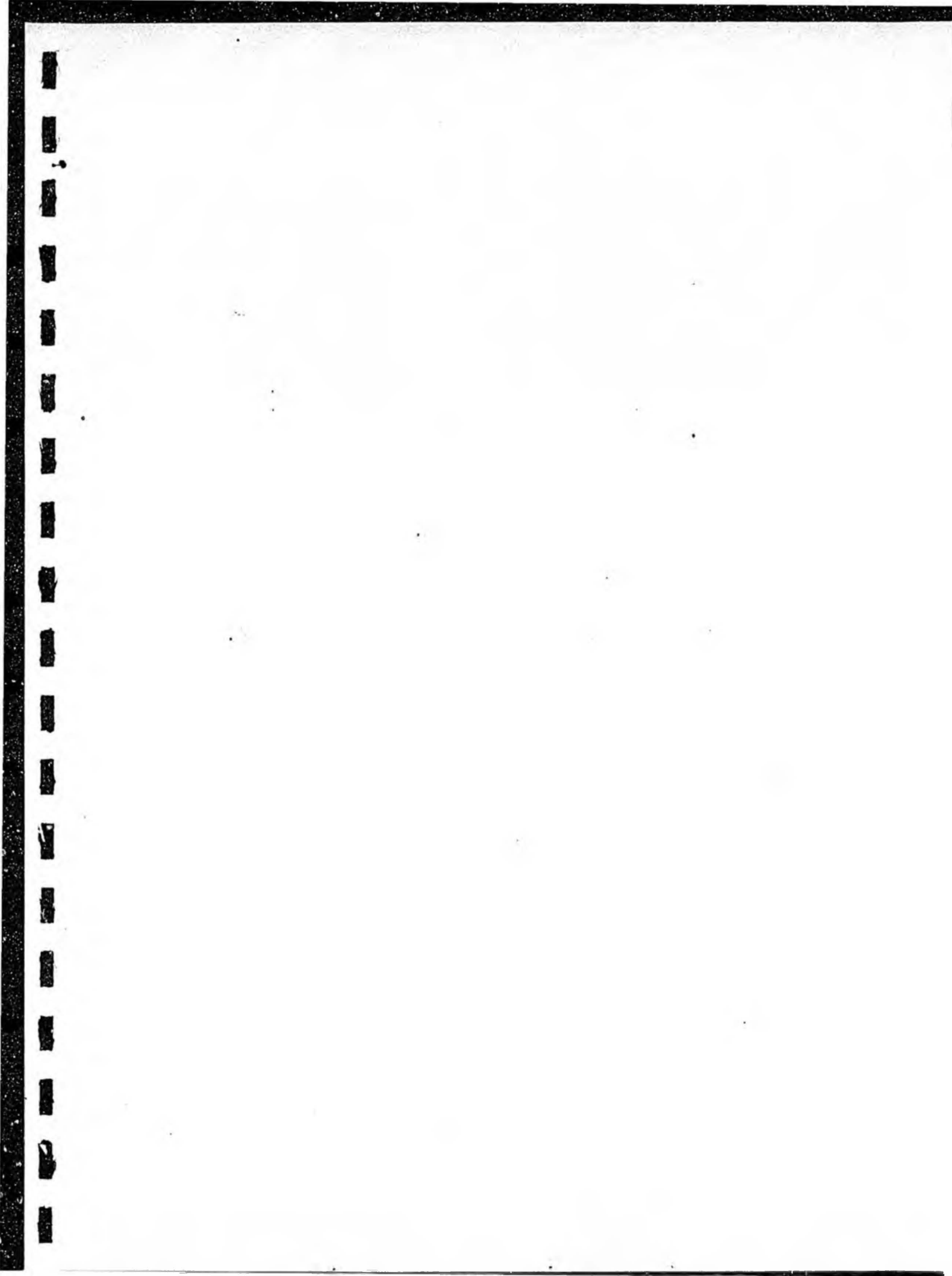
Although the Trust Company proposal contemplates a fundamental change in the structure of the Funds' investment operations, the proposal is not without some precedent; most notable is the Minnesota retirement system's statutory scheme. Even though the proposal reflects a significant improvement over the Minnesota scheme and similar structures in place outside Alaska, the Commissioner should consider adding to the proposal provisions that (1) clearly specify who would be potentially liable to Fund beneficiaries, and designate those persons as "fiduciaries", and (2) specifically authorize beneficiaries of the Funds to institute appropriate legal actions against the Company for any potential breaches of fiduciary duty, thereby strengthening the accountability of

those individuals responsible for managing the assets of the Funds and ensuring compliance with fiduciary standards imposed under Alaska law.

#### Conclusion

The Bill, if adopted, should serve to modify and clarify the Commissioner's investment powers and fiduciary obligations under the statutory scheme governing the investment of Fund assets. In general, the Bill's proposals would increase the amount of the Commissioner's investment flexibility and at the same time increase the Commissioner's responsibility and accountability with respect to the Funds' investments. The Trust Company proposal, which reflects a more dramatic form of changing current Alaska law regarding the Funds' investment operations, may serve to insulate Fund investment operations from political pressure, and provide the Funds with skilled, professional investment management.

WILLKIE FARR & GALLAGHER



# WILLKIE FARR & GALLAGHER

New York  
Washington, DC  
London  
Paris

## M E M O R A N D U M

TO: State of Alaska Department of Revenue  
FROM: Willkie Farr & Gallagher  
RE: Legislative Proposals Regarding Commissioner of  
Revenue's Investment Powers and Duties  
DATED: March 1, 1988

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### Introduction

This Memorandum responds to the request of the State of Alaska Department of Revenue for an examination of the legal issues relevant to, and the rationale for, proposed changes in the statutory framework currently governing investments made with the monies of certain public funds established by the State of Alaska (the "Funds"). Included among the Funds are: the State of Alaska General Investment Fund, the Public Employees' Retirement Fund, the Teachers' Retirement Fund, the Judicial Retirement Fund, the Alaska National Guard and Alaska Naval Militia Retirement Fund, the Public School Fund and the University of Alaska Fund.

Under current law, the Commissioner of Revenue of the State (the "Commissioner") has the general authority to invest all State monies under Alaska Stat. § 44.25.010 and Alaska

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Stat. § 44.25.020(2), and has either the primary or secondary authority to invest all monies deposited or held in the Funds and to safekeep the assets of the Funds under a number of other specific statutory provisions. The Commissioner's investment authority is limited by statute as to types of investments that may be held by a Fund and, in some instances, as to the maximum percentage or dollar amount of Fund assets that may be invested in particular instruments. Supplementing these limitations is a general statutory obligation imposed on the Commissioner, when investing on behalf of all of the Funds, to act prudently by exercising the judgment and care of an institutional investor managing large investments under a trust relationship.

The Commissioner has found that the current statutory framework governing the investment of the Funds' monies restricts the Commissioner's ability to invest effectively on behalf of the Funds. The various statutory limitations have, in the view of the Commissioner, served in many instances to reduce investment returns, impede the Commissioner's ability to invest in a manner appropriate to the purposes of the Funds, and limit the adaptability of the investment policies followed by the Funds to changing markets and newly developing instruments and techniques.

In an attempt to address the problems raised by current investment provisions, the Commissioner has prepared a set of legislative proposals (the "Bill") that, if adopted, would make fundamental changes to those provisions. The Bill

seeks, among other things (1) to clarify the legal status of certain of the Funds, (2) to clarify the legal relationship of the Commissioner to certain of the Funds, (3) to repeal the limitations on the types and amounts of investments that may be made by the Funds, and restate and amplify the rule of prudence applicable to the Commissioner, (4) to authorize the Commissioner expressly to delegate investment, custodial and depository responsibilities with respect to certain of the Funds to officers or employees of the State or to independent firms, banks or trust companies, and (5) to establish reporting and statutory auditing requirements applicable to the Funds. The Commissioner has also presented a proposal separate from the Bill providing for the establishment of an independent trust company that would assume the responsibility for the custody of the assets and the management of the investments of certain of the Funds.

The first section of the discussion that follows sets out the legal background of each of the Bill proposals described above. Section II discusses certain issues related to the Bill proposals, but not covered by the express terms of the proposals. Finally, Section III discusses the independent trust company proposal.

### Discussion

#### Section I: Background of the Proposals

##### A. Establishment and Designation of Certain Funds as Trusts

Current Alaska statutory law creates systems for the payment of retirement, disability and death benefits for

the teachers (the "Teachers' Retirement System"),<sup>1</sup> judges (the "Judicial Retirement System"),<sup>2</sup> military personnel (the "Military Retirement System")<sup>3</sup> and other employees (the "Public Employees' Retirement System")<sup>4</sup> of the State of Alaska (collectively, the "Retirement Systems") and authorizes and requires the Alaska Commissioner of Administration to take certain actions for the administration of each of these Systems, including maintenance of accounts for the System and preparation of periodic reports.<sup>5</sup> The statutes also designate the Commissioner of Revenue as Treasurer of the Retirement Systems and assign the responsibility for investing and safekeeping the assets of the Retirement Systems to the Commissioner, thereby implicitly making him sole fiduciary for the funds of the Retirement Systems. Current statutes governing the Retirement Systems do not, however, require that the assets maintained in these Systems be segregated from other public

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1 Alaska Stat. § 14.25.010 (1987).

2 Alaska Stat. § 22.25.010 (1982).

3 Alaska Stat. § 26.05.222 (1986).

4 Alaska Stat. § 39.35.010 (1987).

5 Alaska Stat. § 14.25.030 (1987), § 22.25.025 (1982). (general delegation of responsibility for administration of the system; no delegation of specific duties). § 26.05.228 (1986), § 39.35.060 (1987).

monies.<sup>6</sup> Current statutory law also creates a "separate fund" in which all money derived from the sale or lease of certain public lands, and all monetary gifts made to the University of Alaska for the purpose of the fund, are to be held "in trust" (the "University of Alaska Fund")<sup>7</sup> and establishes "as a separate fund the public school fund" the income of which "may not be appropriated for a purpose other than for the support of public education programs" (the "Public School Fund")<sup>8</sup> (collectively, the "Endowment Funds").

The Bill proposes to amend the statutes governing the Retirement Systems to expressly require the establishment of a "Teachers' Retirement Trust Fund," a "Judicial Retirement Trust Fund," a "Military Retirement Trust Fund" and a "Public Employees' Retirement Trust Fund" (collectively, the "Retirement Funds") in which "the assets of the [relevant] system shall be deposited and held."<sup>9</sup> The Bill also proposes specifically to designate the University of Alaska Fund as an

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<sup>6</sup> Alaska Stat. § 22.25.048(a) and § 26.05.228(a) require the Commissioner of Administration to establish "funds" for the Judicial Retirement System and the Military Retirement System and to maintain accounts and records for the Systems, but do not prohibit the commingling of other monies with the assets of the Systems within these funds.

<sup>7</sup> Alaska Stat. § 14.40.400(a) (1987).

<sup>8</sup> Alaska Stat. §§ 37.14.110(a), 37.14.140 (1983).

<sup>9</sup> Sections 3, 16, 18 and 35, respectively, of the Bill.

"endowment trust" fund and to establish the Public School Fund as a "separate endowment trust" fund.<sup>10</sup>

(1) The Retirement Funds

Without the creation of separate funds for the assets of the Retirement Systems and the designation of these funds as trusts, the Commissioner has no clear mandate for the manner in which the assets of these Systems are to be held. In the event that these assets are commingled with other monies and/or appropriated for a purpose other than for the benefit of the beneficiaries of the Retirement Systems, resulting in a loss to these beneficiaries, the basis for recovery against the Commissioner, therefore, is correspondingly unclear.<sup>11</sup>

Designating the Retirement Funds as trusts addresses a problem that has historically characterized public plans in the United States. In a 1978 task force report on the operation of public employee retirement systems in the United States (the

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<sup>10</sup> Sections 10 and 26, respectively, of the Bill.

<sup>11</sup> Staff of the House Comm. on Education and Labor, 95th Cong., 2d Sess., Task Force Report on Public Employee Retirement Systems 197 (Comm. Print 1978) [hereinafter cited as the "Task Force Report"] (the absence of clear statutory fiduciary standards for public pension trustees often results in the ripening of conflicts of interest into clear examples of fiduciary abuse); Leibig & Kalman, How Much Federal Regulation do Public Funds Need?, Pension World, August 1978 at 25 (traditional fiduciary obligations are difficult to enforce where no specific "fund" is involved nor an explicit declaration of trust with respect to fund assets).

"Task Force Report"),<sup>12</sup> Congress noted that, although the nature of the responsibility vested in those who have control over and direct the investment of public plan assets dictates that these persons be held to the high standards of behavior normally reserved to those in a fiduciary relationship, such as a trustee to a trust, state and local government retirement systems rarely create a clear fiduciary relationship or impose on these persons clear standards for behavior. The report states that:

The substance of the standard of conduct to which plan trustees and fiduciaries with plan management and investment responsibilities are subject is . . . seldom set forth with any clarity. Thus, even when it is perceived that a trustee's conduct or an investment manager's performance has been unsatisfactory, or even irresponsible and highly imprudent, the absence of a codified, substantive standard of conduct to which the fiduciary can be held frequently precludes recovery by the plan or its aggrieved participants. A review of well-known public plan 'abuses' demonstrates that the erring plan fiduciary is seldom held liable to the plan for the damages the fiduciary's irresponsible actions

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12 The Task Force Report was undertaken in accordance with a requirement contained in the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). ERISA, which regulates the conduct of private employee benefit plans in the United States, was originally intended to include public pension plans within its scope. Prior to enactment, however, ERISA's scope was narrowed to private pension plans because of the unavailability of information regarding public plans generally and questions regarding the constitutionality of federally regulating state and local pension plans. Task Force Report at 1; Note, Public Pension Funds: The Need for Federal Regulation of Trustee Investment Decisions, 4 Yale L. & Pol'y Rev. 188, 207 & n.111 (1985) [hereinafter cited as "Public Pension Funds"].

have caused to the plan, its participants and the sponsoring governmental entity.<sup>13</sup>

The Bill proposal to require the establishment of separate funds for the Retirement Systems and the designation of those funds as trust funds clearly establishes a trust relationship between the Treasurer of the Retirement Systems and the assets of the Retirement Systems. By establishing a trust, the Treasurer is placed under a duty, as the trustee, to segregate the assets of each of the Retirement Systems from all other monies under the Commissioner's control and to earmark those assets as trust property.<sup>14</sup> The creation of separate trust funds to hold assets may not, by itself, be sufficient to establish the clear standards of behavior advocated by Congress for the broad spectrum of responsibility involved in the administration of public trusts such as the Retirement Funds and the investment of their assets. Trust designation is,

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13 Task Force Report at 188-89.

14 Restatement (Second) of Trusts § 179 (1959) [hereinafter cited as the "Restatement"]; A. Scott, Abridgment of the Law of Trusts §§ 2.6, 179 (1960) [hereinafter cited as "Scott on Trusts"] ("A trust involves rights and duties with respect to property. . . . In every trust there is something more than a merely personal relationship between trustee and beneficiary; there is a duty on the part of the trustee to deal with property for the benefit of another.").

We would suggest, however, the addition of the words "in trust" after the words "deposited and held" in Sections 3, 16, 18 and 35, respectively, of the Bill to conform that language to the existing statutory language governing the Endowment Funds and thereby avoid any possible ambiguity that might otherwise be created upon adoption of the Bill.

however, sufficient to establish the basic responsibility of a trustee to segregate trust property and earmark it as such.<sup>15</sup> Indeed Congress, in regulating private pension systems through the Employee Retirement Income Security Act of 1974, as amended ("ERISA"),<sup>16</sup> also uses the trust mechanism to assure segregation of pension assets.<sup>17</sup>

As a corollary to providing necessary guidance with respect to a fundamental aspect of conduct toward assets of the Retirement Systems, the Bill proposal may provide a basis for liability in the event of loss resulting from the commingling of assets.<sup>18</sup> The proposal may also benefit the Retirement

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15 Use by a legislature of terms such as "trust" and "trustee" indicate an intent to establish a traditional trustee relationship. Campbell & Josephson, Public Pension Trustees' Pursuit of Social Goals, 24 Wash. U.J. Urb. & Contemp. L. 43, 48, 51 (1983) (citing Savings Bank of New London v. New York Trust Co., 27 N.Y.S. 2d 963 (Sup. Ct. 1941); NLRB v. Amax Coal Co., 453 U.S. 322 (1981); and Withers v. Teachers' Retirement Sys., 447 F. Supp. 1248, 1254 (S.D.N.Y. 1978), aff'd mem. 595 F.2d 1210 (2d Cir. 1979)).

16 29 U.S.C.A. §§ 1001-1461 (West 1985 & Supp. 1986) [hereinafter cited as "ERISA"].

17 ERISA § 403(a) ("All assets of an employee benefit plan shall be held in trust by one or more trustees [who shall be] named in the trust instrument."). The Department of Labor has stated that "the underlying rationale for [ERISA's] requirement that a trust be utilized [is] to prevent commingling of plan assets with assets belonging to the person managing the plan assets. . . ." 39 Fed. Reg. 44456 (Dec. 24, 1974); Department of Labor Opinion 76-35 (April 13, 1976).

18 A private trustee is chargeable with any loss or depreciation in value of the trust estate resulting from a breach of any duty which he owes as a trustee to the  
(Footnote Continued)

Systems in a way that is perhaps less tangible, but no less necessary according to commentators on public pension plans generally, by encouraging in those responsible for the administration of plan assets a sense of duty toward plan participants and beneficiaries, by providing a framework and incentive for them to discharge that duty, and by encouraging them to be viewed by others as fiduciaries vis-a-vis Fund assets and beneficiaries.<sup>19</sup>

(2) The Endowment Funds

As noted above, current statutes already establish separate funds for the assets of the University of Alaska Fund and the Public School Fund. Although not specifically designated as a "trust fund," the Public School Fund is created under Chapter 14 of Title 37 of the Alaska Statutes, which is entitled "Trust Funds," and the statute creating the University of Alaska Fund specifies that the monies deposited in the Fund shall be held "in trust." As discussed above with respect to the Retirement Funds, legal commentators generally interpret the use of words such as "in trust" as an indication of intent

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- (Footnote Continued)
- 18 beneficiaries, any profit made by the trustee through such breach or any profit that would have accrued to the trust estate had no breach of trust occurred.  
Restatement § 205; Scott on Trusts § 205.
- 19 L. Kohlmeier, Conflicts of Interest: State and Local Pension Fund Asset Management (1976), contained as Appendix XIV to the Task Force Report at 888 ("[V]ery few public pension fund trustees are viewed or view themselves as fiduciaries responsible solely to public employees.").

to create a traditional fiduciary relationship. The Bill proposal specifying the Endowment Funds as "endowment trust" funds is, therefore, less necessary to impose trust status on these Funds than the proposal creating the Retirement Funds and designating them as trusts. The Endowment Funds proposal is more in the nature of a clarifying and conforming change that serves primarily to emphasize the special nature of these monies as trust property and the concomitant fiduciary duties that attach to those vested with responsibility for administering these assets.

The inclusion of the word "endowment" in the Bill proposal serves to distinguish the Endowment Funds from the Retirement Funds, which may expend, if necessary, the entire principal for plan benefits. In contrast, none of the principal of the Endowment Funds, which consists of gifts or the proceeds from the lease or sale of certain public lands or mineral rights, may be expended. The traditional duty of a trustee to preserve the trust corpus<sup>20</sup> is, therefore, heightened with respect to trusts of this nature. The particular emphasis on preservation of principal in the case of Endowment Funds is also supported by the Bill proposal's

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<sup>20</sup> Scott on Trusts §176. The various specific duties that attach to the traditional fiduciary relationship are discussed more fully in Sections I.B and I.C of this Memorandum, and the specific duties that attach to the Commissioner as the party responsible for investing the assets of the Funds under the current statutory framework and under the Bill proposal are discussed more fully in Section I.C.

requirement that net income of each Endowment Fund be accounted for separately from principal and that all realized capital gains be added to the principal and permanently maintained in the Fund for investment purposes.<sup>21</sup>

The Bill proposes certain changes that go beyond clarifying the nature of these Funds and reinforcing the traditional fiduciary responsibilities that attach to these Funds and their beneficiaries. By replacing the current statutory mandate to invest the assets of these Funds only in interest-bearing securities and allowing the Commissioner instead to invest these assets on the basis of "probable total return as a means of promoting the long-term generation of income,"<sup>22</sup> the Bill proposal would provide the Commissioner with the opportunity to increase, rather than merely preserve, the principal available for future investment and generation of income for application in accordance with the stated purposes of the Endowment Funds.

The Bill proposal also recognizes and emphasizes, however, that the factors to be considered in making investments that put the principal of the Endowment Funds at risk may be different from the investment criteria for other

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21 Sections 11, 27 and 30 of the Bill. The Bill's requirement to account separately for principal and interest comports with the common law duty of a trustee to keep and render accounts in the case of trusts established for successive beneficiaries. See Scott on Trusts § 172 ("If the trust is created for beneficiaries in succession, the accounts should show what receipts and what expenditures are allocated to principal and what are allocated to income.").

22 Sections 11 and 31 of the Bill.

types of trust property. The Commissioner is expressly required to consider the status of both principal and income on a current as well as a probable future basis and to act only in regard to the long-term financial interests of the Endowment Funds' beneficiaries.<sup>23</sup> In contrast, the Bill requires only that the Commissioner consider the "best financial interests" of the beneficiaries when investing the assets of the Retirement Funds.<sup>24</sup> The explicit language of the Bill proposal thus provides the Commissioner guidance with respect to the weight to be accorded the various factors to be considered in connection with an investment on behalf of the Endowment Funds and the appropriate level of risk to be assumed. At the same time, however, the requirement to consider only long-term financial interests may heighten a conflict that many commentators have found inherent in the statutory appointment of public officials, who are generally judged on the basis of short-term performance, as investment managers of public trusts.<sup>25</sup>

B. Designation of the Commissioner as a Fiduciary of the Funds and Requirement to Act Only in the Interest of Beneficiaries

As suggested in the discussion above, although certain fiduciary duties are created merely by establishing a trust, these duties may be limited in nature. The Bill effectively

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<sup>23</sup> Sections 11 and 31 of the Bill.

<sup>24</sup> Sections 5, 17, 19 and 36 of the Bill.

<sup>25</sup> See, e.g., Public Pension Funds, supra note 12, at 196.

expands statutory guidance with respect to proper behavior toward trust property and beneficiaries by expressly designating the Commissioner as a "fiduciary" of certain of the Funds<sup>26</sup> and by requiring the Commissioner to act "only in regard to the best financial interests" of the beneficiaries of the Retirement Funds<sup>27</sup> and "only in regard to the long-term financial interests" of the beneficiaries of the Endowment Funds.<sup>28</sup> Absent specific statutory definition or administrative interpretation of the duties arising in connection with "fiduciary" status and the "only in the financial interest" standard, however, one must look to common law and analogous statutory law, particularly, ERISA,<sup>29</sup> to define more clearly the responsibilities that attach to these terms.

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26 Sections 5, 11, 17, 19, 31 and 36 of the Bill.

27 Sections 5, 17, 19 and 36 of the Bill. For purposes of clarity, we would suggest the addition of the words "participants and" before the word "beneficiaries" in Section 5 of the Bill (and incorporated into Sections 17, 19 and 36) to make clear that the Commissioner is a fiduciary with respect to all who have an interest in the Retirement Systems, including currently contributing plan participants as well as retirees, whose interests may not be identical. Our suggestion is supported by the language of ERISA §404(a)(1)(A), which is discussed in the text below, and which refers to "participants and beneficiaries."

28 Sections 11 and 31 of the Bill.

29 One legal commentator suggested recently that ERISA may eventually become a more extensive source of law than the common law in assessing issues relating to fiduciary obligations. See Gordon, The Puzzling Persistence of the Constrained Prudent Man Rule, 62 N.Y.U. L. Rev. 52, 56 n.10 (1987).

Common law has established that two primary duties flow from the fiduciary relationship: a duty to act prudently in the administration of the trust<sup>30</sup> and a duty of loyalty to trust beneficiaries.<sup>31</sup> The common law duty of prudence is discussed below as part of Section I.C of this Memorandum.

The common law duty of loyalty has been termed the most fundamental duty owed by a fiduciary.<sup>32</sup> The duty is present in all fiduciary relationships, but is particularly intense in the case of a trust.<sup>33</sup> The duty of loyalty inherent in the trust relationship is a duty to administer the trust solely in the interest of its beneficiaries.<sup>34</sup> The

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<sup>30</sup> Scott on Trusts § 174.

<sup>31</sup> Id. §§ 163A, 170.

<sup>32</sup> Id. § 170.

<sup>33</sup> Id.

<sup>34</sup> Probably the most famous enunciation of the fiduciary duty of loyalty is Chief Judge (later Justice) Cardozo's statement that

many forms of conduct permissible in a work-a-day world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. . . . Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty. . . . Only thus

(Footnote Continued)

fiduciary duty of loyalty requires a trustee to administer the trust as if he had no interest to protect other than that of the trust and its beneficiaries.<sup>35</sup> This duty therefore prohibits a trustee from dealing with trust property for his own account,<sup>36</sup> from unreasonably favoring certain beneficiaries over others in the administration of trust assets (unless authorized to do so in the trust instrument)<sup>37</sup> and from dealing with trust property for the benefit of a third party.<sup>38</sup> The Bill proposal requiring that the Commissioner act only in regard to the best financial interests of the beneficiaries of the Retirement Funds and only in regard to the long-term financial interests of the beneficiaries of the Endowment Funds incorporates the common law duty of loyalty and

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34 (Footnote Continued)  
has the level of conduct for  
fiduciaries been kept at a level  
higher than that trodden by the  
crowd. . . .

Meinhard v. Salmon, 249 N.Y. 458, 164 N.E. 545 (N.Y. 1928).

35 Campbell & Josephson, supra note 15, at 50.

36 Withers v. Teachers Retirement Sys., 447 F. Supp. at 1256; Scott on Trusts § 170. Under certain circumstances, a trustee may be justified in dealing with trust property for his own account. Among other things, the trustee must disclose all material facts concerning the transaction to the beneficiaries, the transaction must be fair and reasonable in all respects and the beneficiaries must freely give their consent. Id.

37 Withers v. Teachers' Retirement Sys., 447 F. Supp. at 1257-58; Scott on Trusts § 183.

38 Id. § 170.

appears to expand it by requiring the Commissioner to act only in the best financial interests of trust beneficiaries.

Some guidance as to the parameters of permissible behavior toward Fund property and beneficiaries under the standards established by the Bill may be found in court decisions interpreting Section 404(a)(1)(A) of ERISA, which requires a fiduciary of a plan subject to ERISA "to discharge his duties with respect to [the] plan solely in the interest of the participants and beneficiaries and . . . for the exclusive purpose of . . . providing benefits to [the] participants and their beneficiaries [and] defraying reasonable expenses of administering the plan." This "exclusive purpose" rule of Section 404(a)(1)(A) has been found to have been violated, for example, by a plan fiduciary who causes the plan to invest substantially all of its assets in unsecured promissory notes of the sponsoring corporation, when the fiduciary stands to gain personally, or represents third parties who stand to benefit from the use by that corporation of the monies loaned by the trust to repurchase stock or repay stockholder loans.<sup>39</sup> A court similarly has found a violation of Section 404(a)(1)(A) when pension plan fiduciaries caused plan assets to be invested in the securities of corporations involved in a contest for control when the fiduciaries themselves were actively engaged

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<sup>39</sup> Freund v. Marshall and Ilsley Bank, 485 F. Supp. 629, 639 (W.D. Wis. 1979).

in the battle for control of these corporations.<sup>40</sup> It seems clear that conduct similar to that found inconsistent with ERISA's "exclusive purpose" rule would be violative of the Bill's "only in the financial interest" standard.

C. Repeal of Legal Lists and Implementation of a New Rule of Prudence

Under Alaska law, the Commissioner has the general authority and responsibility to invest all monies deposited or held in the Funds.<sup>41</sup> In administering the Funds, the Commissioner has sought to achieve the general objective of increasing the amount of monies available for the benefit of each of the Funds over a time period appropriate to the specific nature of the Fund.<sup>42</sup> Under Alaska's current

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40 Leigh v. Engle, 727 F.2d 113, 124 (7th Cir. 1984). The investments in question in both the Freund and Leigh cases also raise questions under the fiduciary duty of prudence, discussed in Section I.C of this Memorandum.

41 The source of the Commissioner's authority for each Fund is as follows:  
Alaska Stat. § 37.10.070 (1983) (Alaska General Investment Fund);  
Alaska Stat. § 39.35.10 (1987) (Public Employees' Retirement Fund);  
Alaska Stat. § 14.25.180 (1987) (Teachers' Retirement Fund);  
Alaska Stat. § 22.25.048(c) (1982) (Judicial Retirement Fund);  
Alaska Stat. § 26.05.228(c) (1986) (Alaska National Guard and Naval Militia Retirement Fund);  
Alaska Stat. § 37.14.170 (1983) (Public School Fund);  
Alaska Stat. § 14.40.400 (1987) (University of Alaska Fund).

42 See State of Alaska Department of Revenue Treasury Division, Memorandum Concerning General Investment Policies 8-13 (January 1988) [hereinafter referred to as "Treasury Policy Memo"].

statutory scheme, the Commissioner is responsible for implementing this general investment policy, subject to certain limitations mandated by statute. Specifically, the Commissioner's investment authority is limited with respect to certain Funds to specific types of investments and, in the case of the Retirement Funds and the Public School Fund, is limited as to the maximum percentage or dollar amount of Fund assets that may be invested in particular instruments.<sup>43</sup>

The permissible investments or so-called "legal lists" for all of the Funds are further limited by a statutory "prudent institutional investor" rule, which is derived from, and expands upon, the common law of trust's "prudent man" standard.<sup>44</sup> In implementing the rule, the statutes dictate that the Commissioner "exercise the judgment and care under the circumstances then prevailing which an institutional investor of ordinary prudence, discretion and intelligence exercises in the management of large investments entrusted to it."<sup>45</sup> This

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<sup>43</sup> Currently, the Public Employees' Retirement Fund and the Teachers' Retirement Fund are restricted by identical lists of permissible investments and percentage allocations. Alaska Stat. §§ 39.35.110 (1987) and 14.25.180 (1987). The Judiciary and Military Retirement Systems incorporate those limitations by reference, Alaska Stat. §§ 22.25.048(c) (1982) and 26.05.228(c) (1986), as does the Public School Fund. Alaska Stat. § 37.14.170 (1983). The University of Alaska Fund is subject to different investment criteria. Alaska Stat. § 14.40.400 (1987).

<sup>44</sup> Alaska Stat. §§ 39.35.110(c) (1987), 14.25.180(c) (1987), 22.25.048(c) (1982), 37.14.170 (1983).

<sup>45</sup> Id.

rule is not applicable expressly to the University of Alaska Fund, but the 1963 Opinion No. 13 of the Attorney General concluded that the "prudent man rule" is the proper investment standard for that Fund, and the Governor of Alaska subsequently imposed the higher standard in delegating investment authority with respect to the Fund to the Commissioner. The Alaska General Investment Fund is also statutorily subject to the standard, even though it is not a trust.<sup>46</sup>

The Commissioner has found that the current statutory framework governing the investment of Fund monies restricts the Commissioner's ability to invest effectively on behalf of the Funds. In particular, the various statutory restrictions have been said to reduce investment returns of the Funds, impede the Commissioner's ability to invest in a manner appropriate to the purposes of each Fund, limit the adaptability of the investment policy followed by the Commissioner to changing markets, and in some cases, conflict with, or are logically inconsistent with, the dictates of the prudent institutional investor rule.

In light of the problems it has faced in managing the Funds, the Commissioner has presented as part of the Bill a proposal that would alter fundamentally the investment standards governing the Fund's investments. Specifically, the Bill proposes to repeal the "legal list" restrictions, while imposing a stringent statutory obligation requiring the

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<sup>46</sup> Alaska Stat. § 37.10.070(b) (1983). See generally, Treasury Policy Memo, supra note 42, at 5.

Commissioner to act with "professional" prudence by exercising the judgment and care of an institutional investor managing large trust investments.<sup>47</sup> The Bill further clarifies the Commissioner's duties under the new prudence standard by explicitly delineating the factors to be considered when investing the monies of the Funds. These include consideration of the purpose of the particular Fund, the continuing disposition of the Fund's investments, and the probable safety of the Fund's capital as well as probable investment return.<sup>48</sup> In addition to setting out these general factors for investment of monies of the Funds, the Bill gives the Commissioner specific statutory guidance as to the purposes and goals that should be considered in investment of the Funds.<sup>49</sup>

An analysis of the Bill provisions amending the investment standards to which the Commissioner is subject requires a brief consideration of the development of investment standards applicable to public plans in the United States. Most state and federal statutes applicable to the investment of public funds derive from, and in some way incorporate, the common law of private trusts.<sup>50</sup> As noted above in Section

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47 Section 6 of the Bill. Sections 17, 19, 22, 30 and 36 of the Bill incorporate this standard by reference.

48 See supra note 47.

49 Sections 22, 27, 30 and 31 of the Bill.

50 See Public Pension Funds, supra note 12, at 201-205; Campbell & Josephson, supra note 15, at 48, 50, 57.

I.B of this Memorandum, under common law, trustees have two basic fiduciary duties in making investments--a duty to invest prudently by maximizing return on and safety of the trust assets, and a duty of undivided loyalty to the beneficiaries of their trusts.<sup>51</sup> Over the years, most states have developed and supplemented these basic fiduciary standards by placing specific restrictions on certain types of investments or by codifying the common law prudent man standard, or by using some combination of, or variation on, these concepts.<sup>52</sup> Although until very recently a majority of states prescribed a combination of specific legal list restrictions and statutory variations of the fiduciary duty of prudence, the modern trend is to abandon legal lists in favor of a broad, statutorily-mandated prudence standard.<sup>53</sup> As of the end of 1987, 26 states (including California and Washington) had adopted some form of prudence standard as the sole criterion by

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51 Scott on Trusts §§ 170 and 174; See generally, Public Pension Funds, supra note 12, at 193; Campbell & Josephson, supra note 15, at 67-109.

52 See Public Pension Funds, supra note 12, at 201-202.

53 See L. Eig & J. Luckey, An Analysis of the Fiduciary Responsibility Requirements of the Major Pension and Retirement Plans for Employees of the Fifty States (Congressional Research Service, April 19, 1984). This survey lists 19 states that utilize solely a prudence standard (though some of these place percentage limitations on certain investments). Since the time of the Eig & Luckey study, seven more states have adopted a prudence standard. See also Public Pension Funds, supra note 12, at 202 (listing a 1983 study of legal limitations on investment).

which to measure investment undertaken on behalf of their state employee pension plans.<sup>54</sup>

A host of reasons have been given for the shift away from a legal list approach,<sup>55</sup> but the trend has been given great impetus by the enactment of the rule of prudence contained in Section 404(a) of ERISA, which, as suggested above, incorporates and expands upon common law fiduciary investment standards. The Department of Labor's regulations interpreting the Section specifically reject the use of legal list restrictions in private pension fund investing.<sup>56</sup> In effect, the Bill adopts the rationale underlying those regulations.

The Bill not only reflects the modern trend in public fund investment standards, but also seeks to deal with several fundamental problems with Alaska's current bifurcated statutory scheme. The first problem is the statutory interpretation that should be followed in applying the mandates of these two distinctly different rules of investment. Several courts and commentators have addressed this issue in examining statutes

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54 See supra note 53.

55 See infra text accompanying notes 62-73.

56 See 29 C.F.R. § 2550.404a-1 (1987). In adopting these regulations, the Department of Labor stated that it did "not consider it appropriate to include . . . any list of investments, classes of investments, or investment techniques that might be permissible under the 'prudence' rule. No such list could be complete. . . ." 44 Fed. Reg. 37221, 37225 (June 26, 1979).

similar to the Alaska scheme.<sup>57</sup> The general approach that has been suggested is first to examine whether the particular investment is authorized by the legal list applicable to investing fund, and then to determine whether the fund's fiduciary exercised its duty of prudence in making that investment choice. Thus, under this approach, the presence of a particular type of security or other investment on a legal list makes it eligible for investment consideration, but does not authorize the fiduciary to invest in particular investments of that type. The fiduciary is only empowered to authorize prudent investment, and must, therefore, satisfy its duties to exercise care and skill in investing for the benefit of the fund.<sup>58</sup> In Delafield v. Barret,<sup>59</sup> an early New York case, for example, the court found that a fiduciary who invested in securities specified in the New York statutes was not thereby free from liability when he failed to exercise reasonable judgment and discretion in making the investments.<sup>60</sup>

Even though a legal list and a prudence standard may be interpreted as being consistent, they often conflict. As

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57 See, e.g. Withers v. Teachers Retirement Sys., 447 F. Supp. 1248 (S.D.N.Y. 1978) (in which the court decided that municipal bonds, which were permitted under the legal list, were prudent investments); Delafield v. Barret, 270 N.Y. 43, 200 N.E. 67 (1936); Campbell & Josephson, supra note 15, at 53-54.

58 See supra note 57.

59 270 N.Y. 43, 200 N.E. 67 (1936).

60 Id. at 48, 200 N.E. at 69.

discussed in detail below, under most modern formulations of the prudence rule, a fiduciary investing on behalf of a fund is under an obligation to make investments with a view toward ensuring that the investment objective of the fund will be achieved.<sup>61</sup> The general consensus among commentators is that specific investment limitations overly restrict fiduciaries in making those kinds of investment choices.<sup>62</sup> The statutory legal list formulations are, as one commentator put it, "cumbersome, inflexible and too slow to adapt to a changing environment."<sup>63</sup> Moreover, as the Task Force Report concluded: "[t]he investment performance of many state and local pension funds continues to be hampered because of statutory and policy restrictions on investment expenses and portfolio composition."<sup>64</sup> By restricting investment choices and lessening investment performance, legal lists often preclude investments that, when viewed in the context of the objectives of a fund, would clearly be deemed prudent by an institutional investor.

Several other arguments have been raised by commentators criticizing legal list approaches to investing. First, legal lists have been said to reduce the flexibility

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61 See infra text accompanying notes 86-102.

62 See, e.g. Public Pension Funds, supra note 12, at 206; Campbell & Josephson, supra note 15, at 115-116.

63 Campbell & Josephson, supra note 15, at 115.

64 Task Force Report at 196.

that may be needed if sufficient fund assets are to be invested with a view toward significant capital appreciation.<sup>65</sup>

Higher returns through capital appreciation is, in many cases, necessary to maintain impartiality by fiduciaries to the divergent interests of participants of particular funds.<sup>66</sup>

The need for impartiality is especially important in the context of retirement funds, where the relative interests of various fund participants in current income versus capital appreciation varies due to the range of retirement dates and life expectancies of those participants. Legal lists, however, may impede the fiduciary's ability to generate high returns on investments.

A second argument made by opponents of legal lists is that a legislature is not a proper body to determine investment strategies for public plans. Legislators, for example, may have overt political interests in promoting local investments that conflict with the interest of fund participants.<sup>67</sup> In addition, public plans have different investment needs determined by size, time focus, and the structure of workforce. No legislature, it has been argued, could promulgate a list of investments that would be broad enough to encompass the needs

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65 Campbell & Josephson, supra note 15, at 116.

66 Id.

67 Public Pension Funds, supra note 12, at 206.

of all funds and their participants and limited enough to ensure a prudent portfolio for each of those funds.<sup>68</sup>

A third argument often made against legal lists is that by limiting the field of permissive investment choices, they may cause the portfolio of a fund to be under-diversified, thereby subjecting the fund to uncompensated risks. These risks, it is asserted, could be eliminated if legal list restrictions were not so limited in scope, and conservative in approach.<sup>69</sup>

The Commissioner's experience with Alaska's current legal list statutes attests to the validity of the various arguments described above. Legal lists applicable to certain of the Funds, for instance, permit investment in equity securities only if the issuer of the securities has paid dividends for the three previous years.<sup>70</sup> Such a standard may have been an appropriate requirement in the past, but in today's market, few institutional investors would accept payment of dividends as an appropriate indicator of investment worthiness.<sup>71</sup>

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68 Id.

69 Id.

70 Alaska Stat. §§ 39.35.110(a)(21)(1987),  
14.25.180(b)(21)(1987).

71 Fred Alger Management Inc., one of the outside investment managers utilized by certain of the Funds, has pointed out that this restriction has prevented the Funds from investing in the stock of Digital Equipment Corporation,  
(Footnote Continued)

Perhaps the clearest example of the restrictive character of current legal lists to which the Commissioner is subject is a provision limiting investment for the University of Alaska Fund to interest-bearing securities.<sup>72</sup> The Commissioner believes that the nature and purpose of this Fund would more appropriately be served through equity investments, in order to maximize the future income of the Fund.<sup>73</sup> Under the current statutory restrictions, however, this end could not be achieved.

In light of the problems inherent in a legal list approach to investment, the Bill seeks to repeal these statutory restrictions and put in its place a more refined version of the prudent institutional investor rule. The new rule would require that the Commissioner "exercise the judgment and care under the circumstances then prevailing which an institutional investor of ordinary professional prudence, discretion and intelligence exercises in managing trust investments."<sup>74</sup> To best understand the effect that such a

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(Footnote Continued)

- 71 which increased in value in 1986 by 58%. Citibank N.A. and Invesco, two other managers employed on behalf of certain of the Funds, have also stated that the requirement of three years of current dividends does not signal a prudent investment.
- 72 Alaska Stat. § 14.40.400 (1987).
- 73 See Treasury Policy Memo, supra note 42, at 27-28.
- 74 Section 6 of the Bill (Proposed Alaska Stat. § 14.25.18(b)). Sections 17, 19, 22, 30 and 36 of the Bill incorporate this standard by reference.

standard will have on the investment conduct of the Commissioner and how the standard should be interpreted by a court of law, it is necessary to trace the development of the "prudence" rule.

The common law "prudent man" standard was first articulated by the Supreme Court of Massachusetts in the 1830 case of Harvard College v. Amory.<sup>75</sup> The original formulation, which has been adopted by decision or statute by a majority of states, is a model of flexibility. It dictates that in investing trust funds, the trustee is obligated to "observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income, as well as the probable safety of the capital to be invested."<sup>76</sup>

Although the court in Harvard College formulated a flexible guideline for trustee investment conduct, over the years it has been given a rather narrow interpretation by many courts and commentators.<sup>77</sup> The reasoning behind that interpretation has been that prudent decisionmaking for a trustee entails greater caution than that expected of a private

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<sup>75</sup> 26 Mass. (9 Pick.) 446 (1830).

<sup>76</sup> Harvard College v. Amory, 26 Mass. at 461.

<sup>77</sup> See, e.g. King v. Talbot, 40 N.Y. 76 (1869); In re Bank of New York, 35 N.Y.2d 512, 323 N.E.2d 700 364 N.Y.S. 2d 164 (1974); Scott on Trusts § 227. See generally Gordon, supra note 29, at 57-74.

investor.<sup>78</sup> Thus, a trustee is not only obligated to consider the yield of his investment, but is also under a duty to avoid risks that would be seen as incompatible with his obligation to safeguard the property of others.<sup>79</sup> In other words, under common law, the security of the trust corpus and acquisition of a reasonable income were to be a trustee's paramount objective, even if at the expense of capital appreciation.<sup>80</sup>

Courts applying these principles have interpreted the "prudent man" rule to require that each individual investment made by a trustee be prudent.<sup>81</sup> The fact that the trust's portfolio had increased substantially in value during the period under scrutiny would not insulate the fiduciary from responsibility for imprudence in selecting or retaining particular investments.<sup>82</sup> Prudence, it is reasoned, is a matter of conduct, not investment performance, and no inherent connection exists between a loss sustained on an investment and

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78 King v. Talbot, 40 N.Y. 76,86 (1869); Scott on Trusts § 227.

79 King v. Talbot, 40 N.Y. at 86.

80 See Campbell & Josephson, supra note 15, at 49.

81 See, e.g. In re Bank of New York, 35 N.Y. 2d at 517, 323 N.E. 2d at 703. See generally, Campbell & Josephson, supra note 15, at 49; Public Pension Funds, supra note 12, at 194 n. 33.

82 Campbell & Josephson, supra note 12, at 49-50.

imprudence in the investment selection.<sup>83</sup> Thus, in analyzing individual investment decisions, by trustees, the common law requires that a trustee investigate the safety of each individual investment along with its probable income and exercise reasonable care in making that investigation.<sup>84</sup> Profit or loss to the portfolio has no bearing in this formulation.

Although the common law interpretation of the prudent man rule has persisted in some jurisdictions,<sup>85</sup> a general trend away from this position has been evident. Several reasons for the trend have been identified. Commentators have argued that the common law standard is formed on a narrow concept of risk and safety that severely limits the ability of a trustee to maintain an economically efficient portfolio of assets for his funds.<sup>86</sup> These commentators have generally expressed a "modern portfolio theory" of trust investment, which emphasizes the portfolio as a whole rather than a particular investment, as the relevant factor in determining whether prudent investment decisions have been made.<sup>87</sup>

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83 Id. at 50 (citing In re Morgan Guaranty Trust Co., 89 Misc. 2d 1088, 1091, 396 N.Y.S.2d 781, 784 (Sur. Ct. 1977)).

84 See Public Pension Funds, supra note 12, at 203-204.

85 See generally Gordon, supra note 29, at 70-74.

86 See Gordon, supra note 29; Public Pension Funds, supra note 12, at 204-205.

87 Id.

A second cause of the development of a new prudent man standard has been a shift in the nature of funds from an individual to an institutional setting. The conservative common law approach to prudence was developed for private trusts to resolve the basic conflict between the interests of income beneficiaries and remaindermen. That conflict does not arise in many of the new forms of institutional trusts--employee pension plans, for example--because these trusts typically do not terminate and have no remaindermen to whom principal would eventually be distributed. In addition, these types of trusts receive capital infusions throughout their existence. The common law rule was found to be ill-suited to the varying natures and objectives of institutional funds.

The trend away from the use of common law prudence has been reflected in new formulations of the prudent investor rule by Congress and state legislatures. The most prominent of these formulations is embodied in Section 404 of ERISA and the regulations and case law interpreting that Section. Under Section 404, private pension plan fiduciaries are required to discharge their investment duties "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a

like character and with like aims."<sup>88</sup> Although this language clearly codifies certain principles from the common law, Congress instructed the courts to interpret the rule "bearing in mind the special nature and purposes of employee benefit plans intended to be effectuated by [ERISA]."<sup>89</sup> To date, courts and commentators have indicated that the rule establishes a standard of skill of an expert in making pension investments.<sup>90</sup>

In 1979, the Department of Labor issued regulations under Section 404 that explicitly set out criteria for fiduciary conduct that are consistent with the modern portfolio approach to investing.<sup>91</sup> Under the regulations, no investment decision on behalf of a plan is per se prudent or imprudent, but is to be judged in the context of overall portfolio design with reference to the objectives of the plan. To carry out a prudent investment policy, a trustee should take into consideration the following factors in making an investment decision: (1) the composition of the portfolio with regard to diversification; (2) the liquidity and current return of the portfolio relative to the anticipated cash flow

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88 ERISA § 404(a).

89 S. Rep. No. 127, 93rd Cong., 2d Sess. 28-29, reprinted in 1974 U.S. Code Cong. & Ad. News 4838, 4865.

90 Marshall v. Glass/Metal Ass'n & Glaziers & Glassworkers Pension Plan, 507 F. Supp. 378 (D. Hawaii 1980); Campbell & Josephson, supra note 15, at 103.

91 29 C.F.R. § 2550.404a-1(b)(1)(1987).

requirements of the plan; and (3) the projected return of the portfolio relative to the funding objectives of the plan.<sup>92</sup>

Interpretations of the ERISA prudence rule by federal courts provide additional guidance in scrutinizing trustee investment conduct. In general, the courts have examined whether trustees have employed the appropriate method to investigate the merits of an investment.<sup>93</sup> Court analysis has been focused, for example, on a review of the trustee's independent investigation of the merits of a particular investment transaction.<sup>94</sup> Courts have held that a trustee's lack of knowledge of investment is no excuse; trustees are to be judged "according to the standard of others 'acting in a like capacity and familiar with such matters.'"<sup>95</sup>

Cases construing ERISA's rule of prudence may be expected to be of major significance in interpreting the prudent institutional investor rule reflected in the Bill. Although ERISA is not explicitly applicable to any of the funds established by the State, the Attorney General has in recent years embraced an ERISA-type standard in interpreting the

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92 Id.

93 Donovan v. Mazzola, 716 F.2d 1226,1232 (9th Cir. 1983), cert. denied, 464 U.S. 1040 (1984).

94 Donovan v. Cunningham, 716 F.2d 1455,1467 (5th Cir. 1983), cert. denied 467 U.S. 1251 (1984).

95 Katsaros v. Cody, 744 F.2d 270, 279 (2d Cir.), cert. denied, 469 U.S. 1072 (1984)(quoting Marshall v. Glass/Metal Ass'n & Glaziers & Glassworkers Pension Plan, 507 F. Supp. 378, 384 (D. Hawaii 1980).

prudent investor rule.<sup>96</sup> In an opinion discussing the investment powers of the Department of Revenue, the Attorney General set out the general policy of that office:

We interpret the prudent investor rule...to require that all investment decisions be consistent with an investment strategy which gives consideration to the risks and benefits to each portfolio as a whole. . . . Each of the funds which you invest (teachers' retirement fund, public employees' retirement fund, general fund, and Alaska permanent fund) represents a separate portfolio for this purpose.<sup>97</sup>

Indeed, in a 1984 opinion dealing with the prudence of a proposed investment of the Alaska Permanent Fund Corporation (the "Permanent Fund"), the Attorney General specifically referred to the Department of Labor's ERISA regulations for guidance in rendering its decision.<sup>98</sup>

Even in the absence of these opinions, it seems clear that a standard that refers to an "institutional investor of ordinary professional prudence," by its very language, professes to adopt the standard of conduct that governs other institutional investors. The standard would appear to require that the Commissioner, as fiduciary, exercise the care and skill of a sophisticated professional investor whose knowledge and ability is substantially greater than that expected of an ordinarily prudent layman. A court, in analyzing the proposed

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<sup>96</sup> See, e.g. Op. (Inf.) Att'y Gen. (Nov. 3, 1986); Op. (Inf.) Att'y Gen. (Oct. 17, 1984); Op. (Inf.) Att'y Gen. (June 17, 1982).

<sup>97</sup> Op. (Inf.) Att'y Gen. (June 17, 1982).

<sup>98</sup> Op. (Inf.) Att'y Gen. (Oct. 17, 1984).

formulation, therefore, would in all probability look to the body of law that governs the conduct of private, professional institutional investors in rendering a decision. The ERISA standards, and the case law interpreting these standards are, therefore, instructive.

The significance of the State's adopting an ERISA-type approach to prudence especially in conjunction with repeal of the legal list statutes, is that it permits a much larger universe of investments to be considered in investing the monies of the Funds. The Department of Labor, in interpreting ERISA's prudence rule, has stated that investment in securities issued by a small or new company, which could be riskier than those of a "blue chip" company, may be entirely proper under the rule.<sup>99</sup> The Department of Labor has also recognized that investments not producing current income might play a legitimate role in a portfolio. This rationale would suggest that in appropriate circumstances, these and other "nontraditional" investments, such as certain types of venture capital or futures investment, might be permissible as well under the statutory formulation contained in the Bill.<sup>100</sup>

This "modern-portfolio theory" approach to the prudence rule could be criticized as establishing too

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<sup>99</sup> 44 Fed. Reg. 37,221, 37,222 (June 26, 1979).

<sup>100</sup> Id. at 37,225.

permissive a standard for evaluation of trustee behavior.<sup>101</sup>  
A claim could be made that such a broad standard would enable a fiduciary to invest in any vehicle striking its fancy, and be insulated from liability for its investment decisions.<sup>102</sup>  
Under the formulation set forth in the Bill, however, the Commissioner, as a fiduciary of the Funds, cannot ignore his obligation to evaluate a particular investment to ensure its being consistent with Fund characteristics and objectives. The Commissioner has the duty, under the prudent professional institutional investor standard of care, to investigate investments made for a Fund with the prudence of a professional to assure an appropriate risk level is maintained in light of the needs of the Fund. The extensive body of law interpreting ERISA provides general guidelines for the proper scrutiny of that investment conduct. Thus, the prudence rule reflected in the Bill, in conjunction with repeal of the existing legal lists, should provide the Commissioner with the broadest scope of investment options. At the same time, the requirement that the Commissioner meet the standard of care exercised by an institutional investor of professional prudence should provide significant protection to Fund beneficiaries and participants.

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101 Gordon, supra note 29, at 94; see also Hutchinson & Cole, Legal Standards for Governing Investment of Pension Assets for Social and Political Goals, 128 U. Pa. L. Rev. 1340, 1357 (1980).

102 Hutchinson & Cole, supra note 101, at 1357.

D. Authorization to Delegate Responsibilities

The Bill proposes to authorize the Commissioner expressly to delegate his investment, custodial and depository authority with respect to the Retirement Funds to officers or employees of the State or to independent firms, banks or trust companies.<sup>103</sup> This proposal is consistent with court interpretations of delegation as a necessary corollary to the fiduciary duty of prudence.

As indicated in Section I.C of this Memorandum, the rule of prudence provided for in the Bill, like ERISA's prudent person standard, requires the conduct of a prudent expert. To date, several courts have interpreted the prudent expert rule of ERISA to require delegation of authority under certain circumstances. Courts have generally held that an ERISA fiduciary cannot avoid liability with respect to investments, simply because he lacks familiarity with those investments.<sup>104</sup> If a fiduciary is ill-equipped to evaluate the soundness of a proposed investment, the courts have indicated, then he has the affirmative duty to seek outside assistance; only then will the fiduciary be found to have "employed the appropriate methods to investigate the merits of the investment"<sup>105</sup> and, thus, to

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<sup>103</sup> Section 7 of the Bill. This section is incorporated by reference in other sections of the Bill.

<sup>104</sup> Katsaros v. Cody, 744 F.2d 270 (2d Cir.), cert. denied, 469 U.S. 1072 (1984); Marshall v. Glass/Metal Ass'n & Glaziers & Glassworkers Pension Plan, 507 F. Supp. 378 (D. Hawaii 1980).

<sup>105</sup> Donovan v. Mazzola, 716 F.2d 1226, 1232 (9th Cir. 1983), cert. denied, 464 U.S. 1040 (1984).

have fulfilled his duty to act prudently. Applying these principles, the court in Marshall v. Glass/Metal Ass'n & Glaziers & Glassworkers Pension Plan held, for example, that plan trustees who lacked prior lending experience violated their fiduciary duty under ERISA by failing to follow the type of procedure that a prudent and skillful lender would utilize in making a real estate investment.<sup>106</sup>

The cases construing ERISA's prudent man rule noted above suggest that the Commissioner, in seeking to meet the prudent institutional investor rule specified in the Bill, has an affirmative duty to obtain competent professional assistance by hiring qualified employees or by entering into contracts with qualified outside professionals. The Bill's proposal regarding delegation serves to emphasize this general duty and to provide a framework for the discharge of this duty. Moreover, by, in effect, raising the standard of prudence to which the Commissioner will be subject, the Bill would seem to increase the extent of the Commissioner's duty to delegate.

E. Establishment of Reporting and Statutory Auditing Requirements

The Commissioner has presented as part of the Bill a proposal that would require the Commissioner to cause periodic reports on the condition and investment performance of certain of the Funds to be prepared and furnished to the board overseeing the operation of those Funds. Supplementing these periodic report

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<sup>106</sup> 507 F. Supp. 378 (D. Hawaii 1980).

provisions under the Bill is a provision requiring that an independent firm of certified public accountants be hired (1) to audit the accounts of the Public Employees' Retirement and Teachers' Retirement Systems annually; (2) to audit the annual report of the financial condition and financial activity of each of the Public Employees' Retirement and Teachers' Retirement Systems; and (3) to the annually audit the Retirement and Endowment Funds' financial condition and investment transactions.

In large part, the Commissioner's reporting and auditing proposals reflect current practice. At present, annual financial audits of both the Public Employees' Retirement and Teachers' Retirement Funds, including a review of internal controls and securities custody and safekeeping procedures, are conducted by independent certified public accountants. In addition, the Treasury Division of the Department of Revenue has contracted with independent organizations to receive comparative investment performance reviews of the two Funds.

The Commissioner's proposals regarding reporting and auditing are a necessary corollary to the proposals designating the Public Employees' Retirement and Teachers' Retirement Funds as trusts and designating the Commissioner as the fiduciary of the Funds. As the Task Force Report noted:

The establishment and maintenance of professional accounting, auditing, and actuarial practices is part of the general fiduciary responsibility which plan officials owe to the plan participants. Obviously an accurate accounting

of the plan's assets and liabilities, estimation of funding status and experiences, and auditing of plan procedures are essential to the honest and responsible operation of the pension system.<sup>107</sup>

Recognition of the importance of reporting and auditing standards to the fiduciary obligations of plan managers is reflected in ERISA, which requires private employee benefit plans subject to ERISA to file detailed annual reports with the Department of Labor and to be audited by independent public accountants.<sup>108</sup> Many states now require analogous reports covering their public plans.<sup>109</sup> The Commissioner's reporting and auditing proposal is comparable to these state and federal provisions and should facilitate the Commissioner's fulfilling his fiduciary obligations toward the Public Employees' Retirement and Teacher's Retirement Funds.

## Section II: Related Issues

### A. Federal Income Taxation Implications

At the present time, the federal government regulates the conduct of public pension plans through the application of

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<sup>107</sup> Task Force Report at 185-86 (emphasis added).

<sup>108</sup> ERISA § 103(a). The legislative history of ERISA makes clear that Congress believed that annual audit and reporting requirements provide important safeguards to plan beneficiaries by making plan fiduciaries aware that their handling of plan assets will be open to inspection. S. Rep. No. 127, 93d Cong., 1st Sess. 27 (1973), reprinted in 1974 U.S. Code Cong. & Ad. News 4838, 4863; H.R. Rep. No. 533, 93d Cong., 1st Sess. 11 (1973), reprinted in 1974 U.S. Code Cong. & Ad. News 4639, 4649.

<sup>109</sup> See, for example, Cal. Gov't Code §§ 20206.5, 20233 (Deering Supp. 1987); Cal. Ed. Code §§ 22218, 22220 (Deering Supp. 1987).

the Internal Revenue Code of 1986 (the "Code"). Under the Code, three principal forms of tax benefits are available with respect to a public pension plan: (1) the public entity sponsoring the plan is entitled to deduct amounts contributed to the plan up to certain limits;<sup>110</sup> (2) the earnings of the plan are not taxed currently;<sup>111</sup> and (3) the contributions made by the public entity to the plan on behalf of an employee are not currently imputed to the employee, even if vested.<sup>112</sup> To be entitled to these benefits, a funded, government-sponsored plan must, among other things, meet certain of the requirements specified in Section 401(a) of the Code for private retirement plans seeking tax-exempt status.<sup>113</sup> Section 401(a) conditions tax-exempt status on,

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<sup>110</sup> I.R.C. § 404(a)(1986).

<sup>111</sup> Id. § 501(a).

<sup>112</sup> Id. § 402(a). The provisions of Section 402(a) are, in effect, an exception to the general rule stated in Section 83 of the Code. Under Section 83, if an employer sets aside contributions to fund deferred compensation or retirement benefits for an employee, the contributions will be included in the employee's income, so long as the employee is not subject to a substantial risk of forfeiture of the benefits. Thus, under Section 83, an employee having a vested interest in a benefit will be currently taxed on the benefit.

<sup>113</sup> Rev. Rul. 72-14, 1972-1 C.B. 106. The passage of ERISA in 1974 resulted in many changes in the provisions of the Code applicable to private plans seeking to qualify for tax-exempt status. Public plans are expressly exempted  
(Footnote Continued)

among other things, the plan's (1) being organized "for the exclusive benefit" of employees, (2) providing definitely determinable benefits, (3) satisfying anti-discrimination rules and (4) providing full vesting on discontinuance or termination of the plan.<sup>114</sup> Section 401(a) also implicitly requires the assets of a plan seeking to meet the Section's conditions be maintained in trust.<sup>115</sup>

To date, enforcement by the Internal Revenue Service (the "IRS") of the requirements of Section 401(a) against public pension plans has been, for the most part, non-existent.<sup>116</sup> Recognizing that enforcement of the requirements would serve only to harm innocent plan participants, the IRS announced in 1977 that, until a study of the application of Section 401(a) to public plans could be completed, disputes over compliance with the Section would be

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(Footnote Continued)  
113 from ERISA and, thus, are not subject to most of the qualification requirements added by ERISA. Public plans are, however, subject to the qualification requirements applicable prior to ERISA. See, for example, Sections 410(c)(2) and 411(e)(2) of the Code.

114 I.R.C. § 401(a).

115 Section 401(a) states that "[a] trust. . . forming part of a stock bonus, pension or profit-sharing plan of an employer. . . shall constitute a qualified trust. . ." if the various requirements listed in the Section are met. See also 26 C.F.R. § 1.401-(a)(3) (1987); Rev. Rul. 69-231, 1969-1 C.B. 118; Internal Revenue Service Publication 778(2-72), Parts 2(b) and 2(f).

116 Task Force Report at 129; Public Pension Funds, supra note 12, at 191 n. 17; Campbell & Josephson, supra note 15, at 62.

settled in favor of the taxpayer or governmental unit.<sup>117</sup>

The announcement continues in effect at present.

An IRS decision to change its current policy on enforcement of the requirements of Section 401(a) would not necessarily affect public plans significantly. Historically, the Section's key substantive requirement--the exclusive benefit rule--has not been a stringent constraint.<sup>118</sup> The IRS has interpreted the rule, which has been called a codification of the common law duty of loyalty imposed on a trustee,<sup>119</sup> to permit parties other than the employees covered by the plan to benefit from the plan's investments.<sup>120</sup> Courts considering the issue have agreed that an incidental benefit to a third party is not sufficient to disqualify the plan from tax-exempt status.<sup>121</sup>

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<sup>117</sup> I.R.S. Info. Rel. IR-1869 (August 10, 1977).

<sup>118</sup> Hutchinson & Cole, supra note 101, at 1348.

<sup>119</sup> Campbell & Josephson, supra note 15, at 62.

<sup>120</sup> In 1969, the IRS indicated that collateral benefits to other parties are acceptable if four requirements are met with respect to an investment: (1) the cost of the investment may not exceed fair market value at the time the investment is purchased; (2) a fair return commensurate with the prevailing rate must be provided by the investment; (3) sufficient liquidity must be maintained to permit distributions in accordance with the terms of the plan; and (4) the safeguards and diversity that a prudent investor would adhere to must be present. Rev. Rul. 69-494, 1969-2 C.B. 88.

<sup>121</sup> Hutchinson & Cole, supra note 101, at 1348; See Shelby U.S. Distribs., Inc. v. Commissioner, 71 T.C. 874, 885 (1979); Feroleto Steel Co. v. Commissioner, 69 T.C. 97, 113 (1977).

Notwithstanding the IRS' position with respect to enforcement of the Code's provisions against public plans, and the manner in which the IRS and courts have interpreted those provisions, at least two commentators have suggested that a trustee of a public plan would breach a fiduciary duty if it caused the plan to jeopardize the tax benefits available under the Code.<sup>122</sup> Underlying this suggestion is the assertion that the tax benefits offered by the Code--particularly the ability of an employee of a public plan to defer taxes--are quite significant.<sup>123</sup>

We are aware of no judicial decision supporting the view that a breach of a fiduciary obligation would be deemed to result if a public plan failed to meet the requirements of the Code. Indeed, the Task Force Report noted in 1978 that well over three-quarters of all public plans have failed to seek an IRS determination letter of tax-exempt status and that about 57 percent of the representatives of public plans surveyed by the

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122 Campbell & Josephson, supra note 15, at 59.

123 Id. Commentators have noted that of the three benefits generally available to public plans under the Code, only the ability of employees to defer tax is of real significance. The other benefits are available to state or local governments even in the event of non-compliance with the provisions of Section 401(a), because state and local governments are generally exempt from federal taxes. See Public Pension Funds, supra note 12, at 192 n.19; Task Force Report at 33.

task force's staff indicated an unfamiliarity with the application of the Code to their plans.<sup>124</sup>

We understand that the Commissioner currently seeks to operate the Public Employees' Retirement Fund and the Teachers' Retirement Fund in accordance with the provisions of the Code.<sup>125</sup> We believe that this policy with respect to compliance with the Code is appropriate. We do note, however, that versions of a proposed federal law governing the operation of public plans, entitled the "Public Employee Pension Plan Reporting and Accountability Act" ("PEPPRA"), would relieve those plans of the obligation to comply with the requirements of the Code to preserve favorable tax treatment for plan participants.

The Commissioner's proposal to designate the Public Employees' Retirement Fund and the Teachers' Retirement Funds as trusts will serve to ensure compliance with the implicit requirement of Section 401 of the Code that plan assets be held

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124 Task Force Report at 77.

125 An examination of whether these Funds are in fact in compliance with all applicable rules of the Code is beyond the scope of this Memorandum. Note, for example, that Section 503(b) of the Code effectively prohibits certain transactions between these Funds and the State. Among the transactions prohibited are (1) loans made without adequate security and a reasonable rate of interest and (2) any transaction that results in a substantial diversion of income or corpus to the State.

in trust.<sup>126</sup> In addition, the Commissioner's proposal that the assets of the Public Employees' Retirement Fund and the Teachers' Retirement Fund be used only in regard to the financial interests of their beneficiaries should act to ensure compliance with the exclusive benefit rule contained in Section 401(a) of the Code.

B. Liability, Indemnification and Insurance

The Commissioner's proposals discussed in Section I of this Memorandum, if adopted, would have the general effect of increasing the fiduciary obligations of the Commissioner and his staff in investing on behalf of the Funds. The increase in the extent of those obligations raises the issues of (1) the potential liability in the event of a breach of those obligations, (2) the extent to which the Commissioner's employees may be indemnified in connection with investment activity undertaken on behalf of the Funds and (3) the extent to which insurance may be obtained covering employees responsible for the Funds' investments. Each of these issues is discussed below.

(1) Liability

[A] Liability of the State, the Commissioner and State Employees

Currently, none of the provisions governing

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<sup>126</sup> Note that versions of PEPBRA introduced to date have included a requirement that assets of public plans be held in trust.

investments that may be made on behalf of the Funds specifies the parties that may be found liable for a breach of any obligation imposed by those provisions. In light of the Commissioner's general investment authority with respect to the Funds under Alaska Stat. § 44.25.010 and Alaska Stat. § 44.25.020(2), however, an Alaska court could reasonably conclude that the Commissioner and those he employs are each potentially liable for breach of any of the investment provisions relating to the Funds. The likelihood of a court's finding potential liability on the part of the Commissioner and those he employs would increase significantly to the extent the assets of a Fund were required by statute to be held in trust and the Commissioner were deemed a fiduciary of the Fund. As noted above in Section I.A of this Memorandum, at common law, a trustee who commits a breach of trust is chargeable for any loss or depreciation in value of the trust estate resulting from the breach or any profit made by the trustee through the breach.<sup>127</sup> Drawing on this common law principle, Section 409(a) of ERISA states that a fiduciary of an employee benefit plan that breaches an obligation toward the plan will be:

personally liable to make good to such plan any losses to the plan resulting from [the] breach, and to restore to such plan any profits of such fiduciary which have been made through use of assets of the plan by the fiduciary, and shall be subject to such other equitable or remedial

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<sup>127</sup> Restatement § 205. See note 18 supra.

relief as the court may deem appropriate, including removal of such fiduciary.<sup>128</sup>

Assessing the potential liability of the Commissioner and those he employs for breaches of fiduciary obligations towards the Funds requires consideration of the doctrines of sovereign immunity and official immunity as interpreted by Alaska courts. The doctrine of sovereign immunity is incorporated in Alaska Stat. § 9.50.250, under which the State may be sued for contract and quasi-contract claims only after they have been reviewed administratively. No tort claim may be brought against the State under Alaska Stat. § 9.50.250 that is based upon the act or omission of a State employee exercising due care in the execution of a statute or regulation, and no tort claim may be brought against the State that is based upon the exercise or failure to exercise or perform a discretionary function or duty, whether or not discretion is abused.

In interpreting the term "discretionary function or duty" under Alaska Stat. § 9.50.250, the Alaska Supreme Court has applied a "planning-operational" test to distinguish between protected and unprotected levels of government decision-making.<sup>129</sup> Under this standard, "only decisions that rise to the level of basic planning or policy formulation will be considered discretionary; decisions that implement policy decisions and are ministerial or operational in nature

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128 ERISA § 409(a).

129 Div. of Corrections v. Neakok, 721 P.2d 1121, 1133 (Alaska 1986).

will not be immune."<sup>130</sup> The Alaska Supreme Court has narrowly construed this standard, refusing to immunize "even acts that involve substantial exercise of discretion, but that do not rise to the level of policy decisions."<sup>131</sup> The doctrine of sovereign immunity thus has been interpreted to attach only under those limited circumstances in which basic policy-making is involved.

Whether the role of State employees with respect to the Funds would be deemed to be policy-making in nature under the planning-operational test, as articulated by the Alaska Supreme Court, is questionable. The investment operations of the Funds, by their nature, clearly involve the use of some amount of discretion on the part of employees of the Department of Revenue and/or professionals hired by the State. These discretionary acts, however, could be viewed as merely involving the implementation of the policies of the State reflected in the statutes governing the investment operations of the Funds. A court's accepting this characterization of the role of those persons having investment responsibility for the Funds would result in the State's not being immune from suit under Alaska Stat. § 9.50.250 for breaches of fiduciary duty on the part of those State employees.

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130 Id.

131 Id.

Alaska Stat. § 9.50.250, by its terms, applies only to State immunity, but does not insulate employees of the State from suit.<sup>132</sup> Under the doctrine of official immunity formulated by Alaska courts, however, State employees may be immunized from personal liability for discretionary acts they undertake within the scope of their official authority.<sup>133</sup> The Alaska courts have held that the standards for determining what constitutes a discretionary act for purposes of official immunity is broader than the sovereign immunity planning-operational standard.<sup>134</sup> Discretionary acts, for the purposes of the doctrine of official immunity, have been defined by the courts as "those requiring personal deliberation, decision and judgment," as distinguished from ministerial acts, which are those acts amounting "only to obedience of orders, or the performance of a duty in which the officer is left with no choice of his own."<sup>135</sup>

Under the broader interpretation of discretionary functions used by the courts in applying the doctrine of official immunity, the decisions undertaken by those persons employed by the Commissioner in connection with the Funds' investment operations would appear to be of a discretionary

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132 Aspen Exploration Corp. v. Sheffield, 739 P.2d 150, 162 n.29 (Alaska 1987).

133 Bridges v. ASHA, 375 P.2d 696, 702 (Alaska 1962).

134 Aspen, 739 P.2d at 155.

135 Id.

nature, involving the personal deliberation, decision and judgment of the employees.<sup>136</sup> Thus, under current law, those employed by the Commissioner may be immune from suit for nonmalicious breach of their fiduciary obligations toward the Funds.<sup>137</sup>

That an employee of the Commissioner may be immune to suit for breach of a fiduciary obligation to a Fund may be viewed as inconsistent with the public policy considerations underlying many of the Commissioner's proposals; an employee

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<sup>136</sup> The conclusion that employees of the Commissioner may be immune from suit is supported by a 1982 informal opinion of the Alaska Attorney General regarding the Alaska Permanent Fund Corporation. In that opinion, the Attorney General concluded that "[t]he immunity for discretionary acts [as defined by Alaska courts] probably covers most decisions and actions of the trustees [of the Permanent Fund]. Relationship of Alaska Permanent Fund Corporation to State, Op. (Inf.) Att'y Gen. (Dec. 1982).

<sup>137</sup> Note that once an official act is deemed to be of a discretionary nature, the Alaska Supreme Court has utilized a balancing test to determine whether an official is entitled to "absolute immunity," applicable even if improper motives were involved in the official's acts, or "qualified immunity," which is applicable only when the acts under scrutiny were done in good faith, free of malice or corruption. The Court has stated that in making such a determination, a balance must be struck between the public's interest in vigorous, unfettered administration of policy by state officials and the interests of maliciously injured parties. The following factors should be considered in deciding whether motives are to be considered in granting employee immunity: (1) the nature and importance of the function that the officer performed to the administration of government; (2) the likelihood that the officer will be subjected to frequent accusations of wrongful motives and how easily the officer can defend against these allegations; and (3) the availability to the injured party of other forms of relief. Aspen Exploration Corp. v. Sheffield, 739 P.2d at 159-60.

who has no concern regarding potential suits may be less diligent in meeting his fiduciary obligations.<sup>138</sup> Thus, the Commissioner may wish to consider amending current law to provide explicitly that an employee of the Commissioner will generally not be immune from a suit asserting a breach of a fiduciary obligation, but will not be liable for a breach so long as in seeking to fulfill his obligation he acted in good faith, acted within the scope of his employment and acted prudently under the circumstances. This standard for limitation of liability of a fiduciary is generally consistent with one deemed acceptable by the staff of the Securities and Exchange Commission (the "SEC") for investment advisers registered under the Investment Advisers Act of 1940, as amended.<sup>139</sup>

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138 ERISA reflects the view that immunity from suit is inconsistent with fiduciary obligations. Section 410 of ERISA specifies that, subject to certain limited exceptions, "any provision in an agreement or instrument which purports to relieve a fiduciary from responsibility or liability for any responsibility, obligation, or duty under [ERISA] shall be void as against public policy.

139 See, e.g., Auchincloss & Lawrence, SEC No-Action Letter (February 8, 1974); Funds Advisory Co., SEC No-Action Letter (December 12, 1974); Westamerica Securities, Inc., SEC No-Action Letter (March 14, 1974). In these letters the SEC staff suggests that indemnification of an adviser guilty of negligence is inappropriate. The United States Supreme Court has stated that a registered investment adviser is a fiduciary who owes his clients an affirmative duty of utmost good faith and full and fair disclosure of all material facts. SEC v. Capital Gains Research Bureau, 375 U.S. 180 (1963).

[B] Liability of Service Providers

As suggested in Section I.D of this Memorandum, the Bill, if adopted, would serve not only to authorize the Commissioner to delegate certain responsibilities with respect to the Funds to independent third parties, but also to require delegation to third parties under certain circumstances. Neither the Bill nor the statutes governing the operation of the Funds currently in effect, however, address the potential liability of third parties for breaches of fiduciary obligations toward the Funds. Moreover, neither the Bill nor current law deals with the potential liability of the Commissioner for the actions or non-actions of third parties providing services to the Fund.

In the absence of an express provision dealing with the issue of third party liability to the Funds, an Alaska court might well look to the provisions of ERISA for guidance. Under ERISA, a third party service provider is liable under Section 409(a) of ERISA,<sup>140</sup> if the party meets the definition of "fiduciary." ERISA defines the term quite broadly to include any person who (1) has discretionary authority or control regarding management or administration of a plan, (2) gives investment advice to the plan or (3) exercises control or authority with respect to management or disposition of a plan's

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<sup>140</sup> The terms of Section 409 are set out in full in the text in the immediately preceding sub-section of this Memorandum.

assets.<sup>141</sup> Most third party service providers to which the Commissioner would typically delegate responsibilities for the Funds are likely to fall within the ERISA definition of fiduciary and, thus, under an ERISA analysis, would be potentially liable for breaches of their obligations toward the Funds.<sup>142</sup>

ERISA provides guidance with respect to not only the potential liability of independent third parties rendering services to the Funds, but also the potential liability of the Commissioner for misconduct of those parties. ERISA expressly authorizes a fiduciary of a plan to delegate investment responsibility for the plan to any entity meeting the definition of an "investment manager."<sup>143</sup> If the delegation is undertaken in accordance with procedures specified in

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<sup>141</sup> ERISA § 3(21).

<sup>142</sup> In general, third party service providers who do not come within ERISA's definition of fiduciary are those that perform administrative functions within a framework of policies and interpretations made by other persons. See O'Toole v. Arlington Trust Co., 681 F.2d 94 (1st Cir. 1982) (non-trustee custodial bank having only physical control of plan assets and limited responsibilities for certain ministerial functions held not a fiduciary under ERISA); see also Donovan v. Williams, 4 Employee Benefits Cas. (BNA) 1237 (N.D. Ohio 1983).

<sup>143</sup> ERISA § 405 (d)(1). Under Section 3(38) of ERISA, an investment manager is limited to an investment adviser registered under the Investment Advisers Act of 1940, as amended, a bank, as defined in that Act, or an insurance company qualified under the laws of more than one state to manage, acquire or dispose of any assets of a plan.

ERISA,<sup>144</sup> then the fiduciary is generally relieved of any direct liability incurred by the investment manager.<sup>145</sup> The Department of Labor has taken the position that the delegating fiduciary retains the duty to monitor the activities of his managers<sup>146</sup> and is not relieved of responsibility merely because he has followed the advice of his investment managers.<sup>147</sup>

Like its rules regarding delegation, ERISA's provisions dealing with co-fiduciary liability are instructive in analyzing the Commissioner's potential liabilities for breaches of fiduciary obligations towards the Funds by independent third parties. Section 405(a) of ERISA provides that a plan fiduciary is liable for a breach of fiduciary responsibility of another fiduciary to the same plan if (1) the plan fiduciary participates knowingly in, or knowingly undertakes to conceal, an act or omission of the co-fiduciary that the plan fiduciary knows constitutes a breach; (2) by his failure to comply with the prudence, diversification, exclusive

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144 See ERISA § 402(c).

145 ERISA § 405(d)(1). Section 405(d)(1) may be viewed as generally similar to the common law rule of delegation by a trustee. Under common law, a trustee may delegate its responsibilities so long as delegation is authorized by the terms of the trust. Restatement § 171 comment j; Bogert, Trusts & Trustees § 555 (2d ed. 1980).

146 Department of Labor letter to J.J. O'Donnell and Frank Borman (June 2, 1980).

147 H.R. Rep. 1280, 93d Cong., 2d Sess. 302 (1974).

purpose and plan document requirements of Section 404(a)(1) of ERISA in the administration of his own fiduciary duties, the plan fiduciary enables another fiduciary to commit a breach; or (3) the plan fiduciary has knowledge of a breach of the other fiduciary and does not make reasonable efforts under the circumstances to remedy the breach.

The Department of Labor has stated its views regarding remedial actions that should be taken to prevent co-fiduciary breaches under ERISA.<sup>148</sup> The Department has suggested co-fiduciaries must take all reasonable and legal steps to prevent the breach. Those steps might include obtaining a court injunction of the breach,<sup>149</sup> notifying the Department of the breach, notifying the plan sponsor or publicizing the action. In addition, according to the Department, all meetings with respect to management and control of plan assets should be documented and an objection on grounds of potential violations of fiduciary responsibility provisions should be made part of the record. The Department has also suggested that, if a fiduciary believes a co-fiduciary has already committed a breach, resignation as a protest against the breach will not

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148 Fiduciary Responsibility Question and Answer 10 appearing in ERISA I.B. 75-5, 29 C.F.R. § 2509.75-5 (1987).

149 See ERISA § 502(a)(3).

generally be considered sufficient to discharge the duty to make reasonable efforts to remedy the breach.<sup>150</sup>

Cases decided to date under Section 405(a) of ERISA indicate instances in which co-fiduciary liability may be present. In Freund v. Marshall & Ilsley Bank,<sup>151</sup> for example, the court found that certain trustees' lack of involvement in a company sale transaction did not relieve them of their fiduciary duties, because their failure to monitor the conduct of the seller trustees enabled and facilitated the seller trustees' breach. In Donovan v. Williams,<sup>152</sup> the court found a fiduciary to have violated Section 405 when he failed to make reasonable efforts to correct a wide range of breaches committed by a co-fiduciary and others. The court held that given his unique responsibilities for, and knowledge of, the financial books of the plans involved, and his failure to provide trustees access to those books, the fiduciary enabled the plan administrator to violate ERISA's reporting and disclosure provisions. The court also found that the fiduciary's detailed knowledge of the finances and operations of the collection account, plan book accounts and unions covered by the plans was sufficient to establish the type of knowledge required for a violation of Section 405, when the

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150 Fiduciary Responsibility Question and Answer 10 appearing in ERISA I.B. 75-5, 29 C.F.R. § 2509.75-5 (1987).

151 485 F. Supp. 629 (W.D. Wis. 1979).

152 4 Employee Benefit Cas. (BNA) 1237 (N.D. Ohio 1983).

fiduciary failed to make reasonable efforts to remedy the trustees' failure to collect amounts owed to the plan. In Free v. Briody,<sup>153</sup> the court concluded that a trustee's nonfeasance enabled a co-fiduciary to entrust plan assets with an embezzler. Although the majority of the losses occurred only four days after he assumed trustee status, the court found the trustee liable, noting that no grace period exists between the date one becomes a trustee and the date one is expected to assume the duties of the office.

ERISA's provisions with respect to delegation and co-fiduciary liability and court and administrative interpretations of those provisions suggest that the Commissioner may limit its potential liability for misconduct of third party service providers by diligently selecting those entities and monitoring their services. Perhaps more importantly, the various interpretations of ERISA's delegation and co-fiduciary provisions suggest that the issue of third party conduct is a significant one with which the Commissioner may wish to deal by express statute rather than by application of analogous provisions of law.

(2) Indemnification

Related to the issue of potential liability of the Commissioner for breaches of fiduciary obligations owed the Funds is the question of indemnification by the State of

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153 732 F.2d 1331 (7th Cir. 1984).

employees of the Commissioner in connection with alleged breaches.<sup>154</sup> A 1982 informal opinion of the Attorney General noted that "[t]o the extent that the state is exposed to liability due to the acts or omissions of an officer or employee, it is state policy to defend and indemnify the officer or employee against any personal liability, but there is no statute expressing this policy."<sup>155</sup> The same opinion continued by saying that Alaska "law regarding . . . indemnification of public officers is somewhat confusing, and the adoption of a statute stating the scope of indemnity would undoubtedly ease the concerns of state employees or officers who have considered the issue."<sup>156</sup>

The Bill in its current form contains no specific provision for indemnification of the Commissioner's employees for alleged breaches of fiduciary duty. In view of the increased amount of fiduciary duties that would be imposed on those employees under the Bill, if adopted, the Commissioner

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154 We assume that the State would not as a matter of policy wish to indemnify independent third parties in connection with alleged breaches. We understand that many state pension plans and other state authorities have adopted such a policy on the basis of notions of sovereign immunity. To our knowledge, the State has not adopted such a policy to date.

155 Relationship of Alaska Permanent Fund Corporation to State, Op. (Inf.) Att'y Gen. (Dec. 2, 1982).

156 Id. As of the date of this opinion, the Alaska Commercial Fishing and Agriculture Bank was the only Alaskan public corporation specifically providing by statute for indemnification of its officers and employees.

might consider adding a provision to the Bill concerning indemnification, even if the Bill is not amended to provide specifically that those employed by the Commissioner are not immune from suit for a breach of fiduciary responsibility toward the Funds. We suggest that, at the very least, such a provision condition indemnification on an employee's acting prudently and in good faith within the scope of his employment.

(3) Insurance

The Commissioner, in addition to providing indemnification for his employees in connection with alleged breaches of fiduciary duties, may wish to consider obtaining insurance covering those breaches. That the purchase of insurance is consistent with a policy of promoting a high level of fiduciary conduct is suggested by Section 410(b) of ERISA, which specifically authorizes the obtaining of insurance covering ERISA fiduciaries.<sup>157</sup> We note our general understanding, however, that a meaningful amount of insurance is currently quite difficult to obtain at acceptable prices. Due to the proliferation of fiduciary suits under ERISA, many insurance companies have significantly increased premiums for fiduciary insurance, while cutting back the coverage offered. In other cases, insurance companies have ceased completely to offer fiduciary insurance.

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<sup>157</sup> ERISA § 410(b).

### Section III: Establishment of Independent Trust Company

The Commissioner has presented, in a legislative package separate from the Bill, a proposal to create an independent trust company (the "Trust Company") that would be responsible for the management of the investments and the custody of the assets of the Public Employees' Retirement Fund, the Teachers' Retirement Fund, the Judicial Retirement Fund, the Alaska National Guard and Alaska Naval Militia Retirement Fund, the Public School Fund and the University of Alaska Fund. The Trust Company would operate under the general supervision of a board of directors (the "Board") composed of a Chairman, proposed to be either the Commissioner or Deputy Commissioner of Revenue, three outside directors, each of whom would be a professional executive trust officer from outside the State and unconnected in any way with the State, and two in-state directors, one an elected member of the administrative board of the Public Employees' Retirement System, and the other a member of the board of the Teachers' Retirement System selected by that board. Compensation of the Chairman of the Board and the in-state directors would be limited to travel expenses, a per diem and out-of-pocket expenditures, whereas outside directors would receive a flat annual fee equal to a percentage of the market value of the assets administered by the Trust Company at the start of each year.

Under the Commissioner's proposal, the Trust Company's budget would not be controlled by the Executive or Legislative branches of the State, the Trust Company's operations would not

be subject to review, approval or control by the State's Department of Administration, and the Trust Company's employees and management would not be State employees. The Trust Company's management, which would include a chief executive officer, a chief investment officer, an internal auditor, a vice president of operations, a vice president of research and a senior portfolio manager, would have authority to hire and fire employees, managers, custodians, advisers, consultants, legal counsel and service vendors, procure equipment facilities and supplies, and enforce contracts and agreements. Management would also be responsible for preparing various reports, analyses and records that would be provided to the Board. Financial records of the Trust Company would be audited annually by an independent certified public accounting firm.

The investment policies to be undertaken by the Trust Company would be determined, under the Commissioner's proposal, by a committee that would be chaired by the Trust Company's chief investment officer and that would include the Trust Company's chief executive officer, vice president of research, senior portfolio manager and three out-of-state and unrelated investment management professionals recommended by the chief investment officer and appointed by the chief executive officer, who are well-regarded and have established records as managers of comparable private funds. Investment policies of the Trust Company would be executed free of any statutory restrictions other than a prudent expert rule. Thus, in the

establishment of its policies and its general operations, the Trust Company would operate in a manner similar to investment management and trust operations in the private sector, except that all personnel at decision levels would be required to be professionally accredited.

The proposal to create the Trust Company reflects an attempt to deal with perhaps the most significant problem involved in the investment management of public plans; those officials responsible for that management face a conflict of interest because they "are generally appointed by, and answer to, the political process rather than plan participants."<sup>158</sup> As the Commissioner has himself noted, formation of the Trust Company would, among other things, "substitute a professional corporation for the state as trustee, thus reducing the chance of political or administrative factors interfering with investment policy. . ."<sup>159</sup>

In seeking to deal with the conflicts of interest involved in the investment management of the Funds, the Commissioner is proposing a fundamental change in the structure of the Funds' operations. Two basic structures for the control of public enterprises have been identified by commentators: the

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<sup>158</sup> Public Pension Funds, supra note 12, at 213.

<sup>159</sup> Memorandum from Hugh Malone, Commissioner of Revenue, to Robert A. Evans, Legislative Liaison, Office of the Governor (August 14, 1987).

government department form and the public corporation form.<sup>160</sup>  
Investment management of the Funds currently takes the  
government department form, which is generally characterized by

direct responsibility on all matters devolv[ing]  
on the director of the department and ultimately  
on the chief executive of the government. Direct  
government control of operations is exercised by  
executive order and legislative review.  
Personnel are usually subject to civil service  
regulation. The enterprise is financed by annual  
appropriations and is subject to the budget,  
accounting, and audit controls applicable to  
other government activities. The enterprise  
frequently possesses the sovereign immunity of  
the state.<sup>161</sup>

The public corporation form, which form the Trust Company would  
take, is generally characterized by its own board of directors,  
financing, budget accounting and auditing procedures, as well  
as the ability to sue and be sued in its own name.<sup>162</sup>

Each of the government department and the public  
corporation forms suffers from operational problems. Due to  
pressures to conform to standard government regulations and  
procedures, the government department form is characterized by  
a lack of information, an inability to respond quickly and a  
high degree of operating difficulty.<sup>163</sup> Although the public

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160 N. Hamilton & P. Hamilton, Governance of Public  
Enterprise 78 (1981); United Nations Technical Assistance  
Administration, Some Problems in the Organization and  
Administration of Public Enterprises in the Industrial  
Field, U.N. Doc. ST/TAA/M/7 (1954).

161 N. Hamilton and P. Hamilton, supra note 160, at 72.

162 Id. at 75-84.

163 Id. at 73-75.

corporation form deals with these problems by being autonomous, it is often characterized by a lack of a consistent pattern or coherent theory addressing the issues of policy formation and efficient operation.<sup>164</sup> The Trust Company's proposed investment committee would appear to represent a reasonable solution to this problem of the public corporation form.

In general, public plans in the United States take the government department form.<sup>165</sup> Some precedent does exist, however, for the format offered by the Commissioner in proposing the Trust Company. Under the laws of the State of Minnesota, for example, public retirement systems are operated by retirement boards, but investment responsibility for the systems is delegated to the State Board of Investment, which includes five constitutional officers.<sup>166</sup> An executive director, who must be an experienced investment professional, is appointed by the State Board of Investments and is responsible for planning, directing, coordinating and executing administrative and investment functions in accordance with the

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<sup>164</sup> Id. at 78.

<sup>165</sup> See Task Force Report at 65.

<sup>166</sup> Minn. Stat. Ann. §§ 11A.03-.04 (West 1988). The five officers include the governor, state auditor, state treasurer, secretary of state and attorney general. The Minnesota retirement system is described and analyzed at some length in Murphy, Regulating Public Employee Retirement Systems for Portfolio Efficiency, 67 Minn. L. Rev. 211 (1982).

policies and directives of the State Board.<sup>167</sup> Both the executive director and the State Board of Investments are in turn advised by a statutorily created Investment Advisory Council composed of seventeen members, ten of whom must be individuals experienced in general investment matters.<sup>168</sup> The operational framework reflected in the Minnesota statutes, like the Commissioner's Trust Company proposal, reflects an attempt at reducing the local political pressures inherent in many public employee plans.<sup>169</sup>

A second precedent for the proposed structure of the Trust Company is one well-known to the Commissioner, the Permanent Fund. The Permanent Fund, which has a legal existence independent of, and separate from, the State, is operated under the direction of a six-person board of trustees appointed by the Governor that includes the Commissioner, two other State commissioners and three public members.<sup>170</sup> The public members, who must be confirmed by the Legislature, may not hold any other State or federal office or employment and must have recognized competence and wide experience in finance, investments or other business management-related fields.<sup>171</sup>

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167 Minn. Stat. Ann. § 11A.07 (West 1988).

168 Minn. Stat. Ann. § 11A.08 (West 1988).

169 Murphy, supra note 166, at 212 n.3.

170 Alaska Stat. §37.13.050 (1983).

171 Alaska Stat. §37.13.050 (1983).

Confirmation of the public members of the Permanent Fund's board reflects a legislative intent somewhat different from that implicit in the Trust Company proposal; as noted in the legislative history of the Permanent Fund, the aim of the Legislature was "to establish a management system for the Alaska Permanent Fund which would be protected from political influence but, at the same time, responsive to changes in state policy and accountable to the people through their elected officials. In short, the aim was insulation without isolation."<sup>172</sup>

Additional precedential support for the Commissioner's Trust Company proposal may be found in actions taken by the State of Connecticut in the early 1970s to reform its public pension systems.<sup>173</sup> In 1972, the assets of five state trust funds, which were centrally managed under the authority of the state treasurer, were organized for investment purposes into a fixed-income, a common stock and a mortgage fund. The treasurer also appointed an investment advisory council, composed principally of insurance company executives and others with investment experience, that assisted the treasurer to select an in-house staff and outside investment advisers. As a further measure, the treasurer established Connecticut Nutmeg

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<sup>172</sup> Alaska State Legislature, Free Conference Committee Report, FCCS For SB 161 (April 2, 1980) (emphasis added).

<sup>173</sup> The reforms are described in detail in Kohlmeier, supra note 19, at 878.

Securities, Inc., which remains operational at present, and which was the first brokerage firm owned and operated by a governmental unit to execute stock transactions. The elements of Connecticut's reforms--separation and centralization of functions and the use of experts--are generally similar to those underlying the Trust Company proposal.

The notion of separation of functions as a means of resolving conflicts of interest is one that is used not only by public pension plans, but by other financial institutions. Banks, for example, have for some time made use of a procedure, typically referred to as a "Chinese Wall," that is designed to limit, or in some instances completely block, the flow of information between trust and commercial departments. Although the use of Chinese Walls by banks was promoted in the 1960s as a means of preventing the inappropriate use of "inside information" that could potentially expose banks to liability under the federal securities laws,<sup>174</sup> the segregation of

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<sup>174</sup> The concept of the Chinese Wall as a device designed to deal with potential liability under the federal securities laws was first endorsed in a late 1960s settlement of a case involving the selective "leaking" by Merrill, Lynch, Pierce, Fenner & Smith Incorporated ("Merrill") of negative news its underwriting division had learned about Douglas Aircraft Co., Inc. In settling the case with the SEC, Merrill's underwriting division agreed not to disclose material, non-public (that is, "inside") information to Merrill's other divisions. Exchange Act Release No. 8,459 [1967-1969 Dec.] Fed. Sec. L. Rep. (CCH) ¶ 77,629 (Nov. 25, 1968). The use of a Chinese Wall to ensure the compliance with federal securities laws has since been supported by the SEC, in adopting Rule 14e-3, 17 C.F.R. § 240.14e-3 (1987), and by  
(Footnote Continued)

functions between a bank trust and commercial departments has proven to be useful in preventing the use of trust assets to further policies or goals of the commercial departments and their corporate clients.<sup>175</sup>

Among the conflicts of interest that banks have had to resolve in operating both commercial and trust departments are: (1) the exertion of pressure by the commercial side upon the trust department to service the needs of commercial customers that maintain large commercial deposits through the use of trust assets, possibly to the detriment of trust beneficiaries; (2) the allocation of brokerage commissions from trust account trades to brokers that maintain large demand deposits with, or provide research services to, the commercial side; and (3) the placement of uninvested trust cash in low-interest or non-interest bearing time deposit accounts on the commercial side of the bank, thereby limiting the productivity of trust assets.<sup>176</sup>

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- (Footnote Continued)
- 174 the Comptroller of Currency, in regulating the conduct of national banks, 12 C.F.R. § 9.7(d) (1987).
- 175 See Mendez-Penate, The Bank "Chinese Wall": Resolving and Contending with Conflicts of Duties, 93 Bank. L.J. 674, 689 (1976). See also Lybecker, Regulation of Bank Trust Department Investment Activities, 82 Yale L.J. 977 (1973).
- 176 See Mendez-Penate, supra note 175, at 689; Herman, Conflicts of Interest: Commercial Bank Trust Departments, 45-56, 108-114 (1975); Lybecker, supra note 175, at 981-992. Note that, although the commercial side of a bank may have the ability to influence investment decisions by the trust department, the commingling of
- (Footnote Continued)

Although some of the conflicts faced by banks have been addressed by specific state and federal banking regulations limiting certain practices,<sup>177</sup> many commentators have endorsed the use of a self-imposed separation of the commercial and trust departments to help assure that the interests of trust beneficiaries in maximizing investment performance is not subordinated to the bank's interest in maximizing profits from its commercial operations.<sup>178</sup> Most commentators have suggested the use of an "impermeable" or a "semi-impermeable" Chinese Wall between the trust and commercial sides of the bank to block the flow of certain types of information between the departments. Other commentators, however, have suggested the separate incorporation of the trust department outside the bank complex--that is, the complete divorce of the trust business from the commercial bank--in

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- (Footnote Continued)
- 176 trust assets with other accounts in the bank is expressly prohibited by most state and federal banking law statutes. See 12 C.F.R. § 9.13 (1987) (expressly mandating the separation of trust assets from bank assets).
- 177 See 12 C.F.R. §§ 9.7, 9.10, 9.12 (1987) (Comptroller of Currency National Bank regulations concerning the administration of fiduciary duties, the allocation of uninvested trust cash, and bank self-dealing).
- 178 See, Mendez-Penate, supra note 175, at 689-710; Lybecker, supra note 175, at 981-984.

order to alleviate completely the many conflicts of interest that exist between the two sides.<sup>179</sup>

The Chinese Wall approach suggested by the banking industry is instructive in analyzing the Trust Company proposal; the Commissioner, in managing the investment of the Funds, is faced with conflicts of interest somewhat analogous to those faced by banks. State officials, for example, may wish to exert pressure on Fund administrators to invest Fund assets in the securities of Alaska issuers to promote regional economic vitality, or other social policies. State officials may also desire that the Funds use local service providers in managing Fund assets, even though better, lower-cost services may be available out of state.<sup>180</sup> The Chinese Wall procedure established by Banks suggests that the separation of the State's political policy-making function from the Funds' investment operations might help assure that political pressure will not influence the administration and investment of Fund

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179 See Lybecker, Regulation of Bank Trust Department Investment Activities: Seven Gaps, Eight Remedies: Part II, 2 Sec. Reg. L. J. 225, 262-265 (1974); Lybecker, supra note 175, at 1001; Mendez-Penate, supra note 175, at 705-709. The proposals to divorce the trust business from commercial banking completely have been severely criticized as economically unfeasible and impractical because of the economic interdependencies of the two departments. The general consensus among commentators has been that independent trust companies would be unable to survive on their own resources; this concern would not necessarily be a problem for the proposed Trust Company. Id.

180 See, generally, L. Kohlmeier, supra note 19.

monies, and that investments on behalf of the Funds will be made in a manner consistent with the interests of Fund beneficiaries.

Of the various precedents described above supporting the establishment of the Trust Company, the one most closely resembling the Trust Company is the State of Minnesota public retirement systems. Those systems were the subject of a detailed scholarly study in 1982.<sup>181</sup> The shortcomings of the Minnesota systems noted in that study provide a means of evaluating the Trust Company proposal.

The most significant deficiency observed in the operation of the Minnesota retirement systems was a lack of knowledge or expertise in investment, banking and finance on the part of the members of the State Board of Investment.<sup>182</sup> Exacerbating this fundamental problem were the time and political demands placed on State Board members, many of whom were elected government officials whose election to office was often unrelated to State Board policies.<sup>183</sup> Those demands, when combined with the State Board's lack of knowledge and expertise, resulted in a number of inefficiencies in the internal operation of the Minnesota retirement systems, including: (1) difficulty in formulating investment policies;

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181 Murphy, supra note 166.

182 Id. at 230.

183 Id. at 231-32. See supra note 166 and accompanying text.

(2) difficulty in delineating powers and duties among the State Board of Investment, the executive director of the systems and the Investment Advisory Council; (3) difficulty in establishing adequate communication and reporting among the various participants in the investment process; and (4) difficulty in the establishment of appropriate investment performance measurements and staff evaluation procedures.<sup>184</sup> Compounding these internal inefficiencies were legal list requirements limiting investment by the Minnesota retirement systems to specified categories.<sup>185</sup>

The Trust Company, if operated as proposed, should be able to avoid the problems faced by the Minnesota retirement systems. The Trust Company will not be operated under the direction of unknowledgeable and inexperienced personnel; the three outside Board members, the three out-of-state members of the investment policy committee and the members of the Trust Company's staff are all proposed to be seasoned professionals with money management experience. Those individuals responsible for the operation of the Trust Company should not face the time and political pressures experienced by their Minnesota counterparts, because only a minority of the Board will be political appointees and elected office holders. The investment policy committee, and the auditing, accounting and

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<sup>184</sup> Id. at 232-35, 237.

<sup>185</sup> Id. at 235. Authorized investments are set out in Minn. Stat. Ann. § 11A.24 (West 1988).

reporting procedures to be applicable to the Trust Company, should serve to enable the Trust Company to avoid most, if not all, of the operational inefficiencies that has characterized the Minnesota retirement systems. Finally, in operating the Trust Company, management will be subject only to a prudent expert rule and will not face the limitations of any legal lists.

Although we believe that the Trust Company proposal represents a significant improvement over the Minnesota structure, we wish to emphasize that we are expressing no view of the merits of the proposal from a policy perspective; both the Commissioner and the Legislature are in a far better position than we to assess the problems currently presented in the investment operations of the Funds, and the benefits that would be provided to the Funds and their beneficiaries if the proposal were adopted. In addition, we express no view as to matters of Alaska law bearing on the Trust Company proposal such as the ability of the Legislature to establish an independent corporation and the legal status of such a corporation under Alaska law.

Acknowledging the improvements over the Minnesota statutory framework reflected in the Trust Company proposal, we nonetheless believe that the Commissioner may wish to consider adding two kinds of provisions to the proposal, each of which is designed to strengthen accountability of those individuals responsible for managing the assets of the Funds. The first of

the provisions would specify clearly the parties who are potentially liable for breaches of their statutory obligations to the participants and beneficiaries of the Funds having assets administered by the Trust Company. Each potentially liable party could be designated as a fiduciary of the assets held by the Trust Company. The term "fiduciary" could in turn be defined functionally as it is under ERISA. Under such a definition, the Commissioner would not be potentially liable for actual investments made by Trust Company personnel on behalf of the Funds; the Trust Company proposal contemplates that responsibility for investment policies undertaken for the Funds rests with the Trust Company's investment committee and management and not with the Commissioner. The Commissioner and the other members of the Board would be potentially liable, on a co-fiduciary theory, if they did not undertake their oversight responsibility prudently.<sup>186</sup>

A second kind of provision that the Commissioner might consider adding to the Trust Company proposal is one specifically authorizing the participants and beneficiaries of the Funds having assets administered by the Trust Company to institute appropriate legal actions against the Company.<sup>187</sup>

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<sup>186</sup> See the discussion of co-fiduciary liability included in Section II.B(1)[B] of this Memorandum.

<sup>187</sup> An example of this sort of provision is Section 502 of ERISA, which designates the parties who may sue and the action that may be brought to enforce the provisions of ERISA.

The attorney general might also be given standing to commence an action against the Trust Company on behalf of Fund participants and beneficiaries.<sup>188</sup> Expressly authorizing the parties that may bring actions in connection with the investment operations of the Funds could only serve to help to ensure effective management of the Funds and compliance with fiduciary standards imposed under Alaska law.

#### Conclusion

The Bill, if adopted, should serve to remedy the practical problems currently faced by the Commissioner in investing on behalf of the Funds. In general, the Bill's proposals would increase the amount of the Commissioner's investment flexibility. At the same time, however, the Bill's proposals would increase the Commissioner's responsibility and accountability with respect to the Fund's investments.

The Trust Company proposal reflects a more dramatic form, than does the Bill, of changing current Alaska law regarding the Funds' investment operations. Although it contemplates a fundamental change in the structure of those operations, the Trust Company proposal is not without some precedent. Moreover, the proposal appears to reflect a significant improvement over similar structures now in place outside Alaska.

WILLKIE FARR & GALLAGHER

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<sup>188</sup> Under Section 502 of ERISA, the Department of Labor is authorized to bring certain suits.

State of Alaska  
Department of Revenue

# General Investment Policies



Treasury Division  
January 1988

State of Alaska  
Department of Revenue  
Treasury Division

Memorandum Concerning  
General Investment Policies

A review of the bases for  
the policies, including relevant  
objectives, factors, and standards,  
as well as responsibilities,  
authorizations, and limitations.

Prepared by  
Treasury Division  
January 1988

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The purpose of this memorandum is to summarize and explain the bases for the Department of Revenue's investment policies, the standards utilized in implementing the policies, and the authorities under which the investment policies and investments are made.

## I. APPLICABILITY

This memorandum covers the following listed separately invested funds:

- State of Alaska General Investment Fund
- AHFC Pledged Fund
- International Airports Construction Fund
- International Airports Revenue Fund  
(including the Repair and Replacement Reserve Account)
- State Mortgage Insurance Fund
- Public Employees Retirement Fund
- Teachers Retirement Fund
- Judicial Retirement Fund
- Alaska National Guard and Alaska Naval Militia Retirement Fund
- Public School Fund
- University of Alaska Fund

Within the General Investment Fund are the General Fund, special revenue funds, debt service funds, capital projects funds, enterprise funds, intra-governmental service funds, and other funds which are commingled for investment purposes. The International Airports Funds are the only separately invested enterprise funds. All trust funds are separately invested.

For separately invested funds, the income accrues to the fund which earned it. The income of all funds in the General Investment Fund accrues to the General Fund. The only exceptions are the Student Loan Fund, Alaska Clean Water Fund, Fish and Game Fund, Power Development Revolving Loan Fund, and trust funds or accounts--the most significant of which is the Permanent Fund Dividend Trust Account--all of which receive their pro-rata share of monthly General Investment Fund income, pursuant to Attorney General's opinions dated September 10, 1984 and July 19, 1985. Appendix A contains a Memorandum of Understanding between the Departments of Revenue and Administration that provides for the crediting of General Investment Fund income to funds or accounts other than the General Fund.

## II. COMMISSIONER OF REVENUE'S AUTHORITY

The Commissioner of Revenue has the general authority to invest all State funds, under AS 44.25.010 and AS 44.25.-020(2), and has either the primary or secondary authority to invest all monies deposited or held in the applicable funds under the sources cited below. These authorities are partly limited by relevant laws.

### A. Sources of Authority

The source of the Commissioner's authority for each of the applicable funds is:

1. State of Alaska General Investment Fund, under AS 37.10.070;
2. AHFC Pledged Fund, under Section 508 of the General Housing Mortgage Bond Resolution of the Alaska Housing Finance Corporation;
3. International Airports Construction Fund, under Section 3.02 of Resolution No. 68-4 of the State Bond Committee of the State of Alaska and AS 37.15.420;
4. International Airports Revenue Fund, under Section 5.02 of Resolution No. 68-4 of the State Bond Committee of the State of Alaska (the requirement to separately invest the Repair and Replacement Account is specified in this Resolution) and AS 37.15.430;
5. State Mortgage Insurance Fund, under AS 18.56.095;
6. Public Employees Retirement Fund, under AS 39.35.110;
7. Teachers Retirement Fund, under AS 14.25.180;
8. Judicial Retirement Fund, under AS 22.25.048(c);
9. Alaska National Guard and Alaska Naval Militia Retirement Fund, under AS 26.05.228(c);
10. Public School Fund, under AS 37.14.170 and subsequent delegation by the Public School Fund Advisory Board (see Appendix B);
11. University of Alaska Fund, under AS 14.40.400 and subsequent delegation by the Governor (see Appendix C).

## B. Limitations of Authority

The Commissioner's authority is limited in the various funds to specific types of investment instruments, and in certain funds the maximum percentage which can be held in some classes of investments is also specified.

### 1. Permissible Investment Instruments

The instrument limitations are prescribed by Alaska Statutes for the various funds as follows:

- a. General Investment Fund, AS 37.10.070 (see Appendix D);
- b. AHFC Pledged Fund (see Appendix E);
- c. International Airports Funds, State Bond Committee Resolution No. 684 (see Appendix F);
- d. State Mortgage Insurance Fund, AS 18.56.-095(b) and AS 37.10.070(a), the General Fund (see Appendix G);
- e. Public Employees Retirement Fund, AS 39.35.110;  
Teachers Retirement Fund, AS 14.25.180;  
Judicial Retirement Fund, AS 22.25.048(c);  
Alaska National Guard and Alaska Naval Militia Retirement Fund, AS 26.05.228(c);  
Public School Fund, AS 37.14.170 (see Appendix H);
- f. University of Alaska Fund, AS 14.40.400 (see Appendix C).

Although not expressly stated in the statutes, the Attorney General has ruled in an opinion dated November 28, 1978 that the Commissioner has authority to enter into reverse repurchase agreements.

### 2. Percentage Allocations Within a Fund

Certain funds have maximum percentage allocations or dollar limitations for some investments as prescribed by Alaska Statutes or the Alaska Administrative Code. The funds are the Public Employees Retirement and the Teachers Retire-

ment. The Judicial Retirement Fund, Alaska National Guard and Alaska Naval Militia Retirement Fund, and Public School Fund are also subject to the maximums because Alaska Statutes place them under the same investment limitations as the retirement funds.

a. Statutes

- (1) corporate stock and debt securities may not exceed 50 percent of the fund (AS 14.25.180(c) and AS 39.35.110(c));
- (2) no more than 5 percent of the voting stock of a corporation may be owned (AS 14.25.180(c) and AS 39.35.110(c));
- (3) foreign securities may not exceed 10 percent of the fund (AS 14.25.180-(b)(23) and AS 39.35.110(a)(23)); and
- (4) foreign time deposits may not exceed 20 percent of the fund (AS 14.25.180-(b)(24) and AS 39.35.110(a)(24)).

b. Administrative Code

For real estate mortgage loan investments

- (1) a single loan may not exceed \$1,000,000 (15 AAC 114.050(e) and 15 AAC 139.050(e)); and
- (2) loans may not exceed 20 percent of the portfolio measured at cost at the time of purchase of any loan (15 AAC 114.-050(f) and 15 AAC 139.050(f)).

III. COMMISSIONER OF REVENUE'S RESPONSIBILITY

The Commissioner is solely responsible for the realized investment results on the entirety of each of the funds, except to the extent that statutory law by prescribing or proscribing particular investments or allocations may effectively prevent the Commissioner from fully discharging that responsibility. The responsibility is amplified and limited by both laws and practical considerations.

A. Rule of Prudence

A rule of law concerning a trustee's degree of care in managing investments for a trustor or trust beneficiary has developed over a long period of years in

U.S. jurisprudence and it has commonly been referred to as the "prudent man rule." The rule held fiduciaries to a standard of care comparable to that which a person of ordinary prudence would use in managing his own investments. With regard to the Commissioner's responsibility for the investment of trust funds, the Alaska Statutes (previously cited) have held the Commissioner to the higher and more demanding standard of care required of an institutional investor managing large investments under a trust relationship. The standard presumes the institution is a sophisticated professional investor whose knowledge and ability to evaluate alternative investments is substantially greater than that expected of an ordinarily prudent layman. Conformance with the standard may be evidenced by comparison with funds managed under similar, if not identical, standards. The trust funds covered by the statutes are the Public Employees Retirement Fund, the Teachers Retirement Fund, the Judicial Retirement Fund, the Alaska National Guard and Alaska Naval Militia Retirement Fund, and the Public School Fund. The statutes do not apply the "prudent institutional investor" standard to the University of Alaska Fund, but the 1963 Opinion No. 13 of the Attorney General held that the "prudent man rule" is the proper rule for guiding the investment of that fund and the Governor's delegation to the Commissioner (see Appendix C) imposed the "prudent institutional investor" as the applicable standard. The statutes do not impose either the "prudent man rule" or the "prudent institutional investor" rule on the Commissioner in investing the monies of the International Airports Revenue Fund or the State Mortgage Insurance Fund. The General Investment Fund, which is not in itself a trust fund, although it may include some commingled trusts, is also required by AS 37.10.070(b) to be invested under the "prudent institutional investor" rule, even though that would not be required necessarily under prevalent trust law. There are no statutory standards for the AHFC Pledged Fund or the International Airports Construction Fund.

#### B. Fiduciary Law

The extant body of fiduciary laws in U.S. jurisprudence (one of which is the "prudent man rule") impose additional criteria on the actions of investment managers of funds held in trust. The primary focus of the laws is to require the trustee to act independently and only in the best objective interests

of the beneficiaries of the trust, ignoring all considerations relating to the interests of others or the trustee's own self-interest, and avoiding all self-dealing and all conflicts of interest between the trustee and either the trustor or the trust beneficiaries. Similar obligations have been imposed by numerous federal and state laws (Securities and Exchange Commission, Investment Advisors Act, banking trust laws, etc.) and by professional self-regulatory bodies (Financial Analysts Federation, National Association of Securities Dealers, and others). These requirements are directly applicable to all but four of the eleven funds covered by this memorandum. The Commissioner and the staff of the Revenue department involved in the process of investment policy or investment selection decisions, or implementing, recording, or administering those decisions, are held accountable for compliance with the substance of the relevant laws. There is a significant risk that the statutory limitations on investment instruments and on allocations may be in conflict from time to time with the Commissioner's duties under the "prudent institutional investor" rule and the other fiduciary standards, to the extent that the limitations prevent investments that would be considered prudent.

### C. Practical Considerations

The Commissioner's general responsibility is also partly constrained by a number of practical considerations.

#### 1. Nature of the Funds

The size of the funds and their purposes can act to exclude or include various investments as part of a particular fund's portfolio.

#### 2. Personnel

The number of qualified staff members affects the amount of time which can be expended in managing the investments of the funds.

#### 3. Data

The adequacy of the content and the timeliness of the financial information available, whether internal or external, can also act to limit or extend the investment opportunities.

4. Budgets

Budgetary constraints can limit both the personnel and data requirements available to the Commissioner.

5. Administration

Required administrative procedures can act to impede some investment activity, which may obviate some opportunities and limit the investment results.

D. Personnel Standards

The Commissioner depends on the staff of the Treasury Division of the Department of Revenue in fulfilling the investment responsibility. In order to assure their compliance with the appropriate standards of conduct, the following requirements have been established:

1. Treasury Staff

All employees of the Treasury Division are required, as a condition of employment, to acknowledge and abide by the rules of conduct contained in the statement attached hereto as Appendix I.

In addition, all Treasury staff are subject to AS 39.52, the Alaska Executive Branch Ethics Act.

2. Treasury Officers

a. All officers of the Treasury Division are additionally required to conform to the applicable substantive provisions of "The Code of Ethics and the Standards of Professional Conduct" of the Financial Analysts Federation, attached hereto as Appendix J, with the exception of Part VI (c) which is superseded by the more restrictive AS 39.52-170(a) which prohibits any outside employment or service that is incompatible or in conflict with official duties.

b. In order to better ensure professional levels of knowledge, ability, and experience investment officers involved in marketable securities are required to be

Fellows of the Financial Analysts Federation  
or Chartered Financial Analysts.

IV. THE INVESTMENT OBJECTIVE

The general objective of all financial investments is "to increase the amount of monies available for some purpose over some span of time." The specific objectives applicable to a certain fund depend primarily upon the nature of the fund. Derived from the general objective are a number of important considerations which are involved both in determining specific objectives and in developing specific investment policies.

A. The Amount of Monies

The amount of monies concerned in a particular fund's objective or policy may represent only the principal of the fund, or its income if it has not been distributed, or they may represent some combination of both principal and income--either separately or combined.

B. Increasing the Amount

1. Capital Preservation

Whether the concern is for the principal or the income, or some combination of them, increasing the amount of monies usually requires that at least the capital of the fund (principal contributions) will not be reduced. Funds whose capital is supposed to be consumed are, of course, an exception. This objective of preserving the capital relates to the following investment characteristics which are important in determining investment policy:

a. Credit Risk

Credit risk involves the investment issuer's willingness and ability to pay the income and principal of a fixed amount obligation as it becomes due and payable. Credit risks vary greatly from issuer to issuer and usually reflect the relative certainty of the issuer's ability to pay. Low credit risks imply a high degree of certainty that the obligations will be paid in full and on time. High credit risks for classes of investment or individual investment selections are accommodated in investment policy

by diversifying those investments among enough different issuers to reduce the fund's exposure to any single issuer's default, by holding marketable issues which can be sold if the issuer's credit risk rises substantially, and by continuing staff surveillance of the issuer's ability to pay.

b. Residual Risk

Equity investments are not fixed amount obligations. They are percentage ownerships of net income (after taxes) and the residue of assets remaining after retirement of all outstanding liabilities. The risk on equity investments is related to the future profitability of an enterprise and/or to its current or future liquidation value. Equities are usually diversified in order to reduce the fund's exposure.

c. Exchange Rate Risk

Exchange rate risk involves the fluctuations in the relative exchange rates between foreign currencies and the U.S. dollar and they are only involved when investments payable or valued in foreign currencies are held in a domestic portfolio. Exchange rates vary daily and reflect a number of factors. In the long run they are primarily determined by relative measures of economic productivity and prices, and trade and financial flows among countries. The risk to a fund is reduced by limiting the percentage exposure to the exchange rate, by diversifying the holdings among several foreign currencies, or by hedging the currency positions in the futures markets.

d. Market Risk

Market risk involves the market's valuation of an investment when it is voluntarily or involuntarily liquidated by the holder before its scheduled maturity date (in the case of fixed amount obligations) or at any time (in the case of equities). The valuation for a fixed amount obligation will reflect the market's perception of the credit risk (and exchange rate risk, if appropriate), the remaining time before

maturity of the issue, the fixed rate of pay on the issue, and the then current interest rate at which similar obligations are being purchased (sometimes referred to as the interest rate level risk). The valuation for an equity obligation will reflect the market's perception of the current and future profitability of the enterprise, the annual rate of income remittance (dividends), the liquidation value of the enterprise, the future expected price for the equity, the exchange rate risk when appropriate, and its probable return relative to alternative investments. Because market valuations change daily and only reflect the market's perceptions, they do not necessarily reflect the true relative value of alternative investments, nor do they reflect the historical returns for held investments, but they do reflect the probable price at which investments can be bought or sold at that time. Because investments are made to achieve realized returns rather than transitory perceived returns, the market valuation is not particularly relevant to held investments if they are not going to be imminently liquidated, but it is important in making new investments because it affects the probable returns that can be made on them in the future.

## 2. Returns on Investments

The return on an investment is not definite until the investment is terminated. The return is the difference in the amount of monies received from an investment as compared to the amount of monies invested in it. Returns may be divided into principal returns, or income returns, or some combination of income and principal returns, depending on the nature of the funds, the purpose of the investment, legal requirements, and accounting conventions. Investments are made based upon an expected level of return over a future time period. Calculating an imputed return based on the market valuation of a held investment which is not going to be imminently liquidated is not necessarily meaningful because it reflects neither the expected return basis on which the investment was made nor the return which will be realized when the investment is terminated.

The rate-of-return on investments is a comparative measure of annual returns among alternative investments. It is the percentage rate which mathematically represents the amount of annual increase or decrease in monies as compared to the amount invested. It is always stated as an annual rate regardless of whether the time period is a fraction of a year or a multiple number of years. Rates-of-return may reflect only income, or principal, or a combination of income and principal, and they may be expectational, imputed, or realized. They are used in investment management as a basis for reallocating the relative percentages of classes of investments in a fund and as a basis for selecting particular investments from among many alternatives. They are also used on an imputed or realized basis to compare the relative performances of various investments or classes of investments within a fund or among funds. The usual objective of portfolio management is to achieve a relatively high rate-of-return over a time period appropriate to the nature of the fund.

C. Availability

Availability is a restriction on the general objective. Increasing the amount of monies is useless if the monies are not available when they are needed for the purposes of the fund. The amount and timing of the need for monies depends mostly on the nature of the fund and varies greatly among funds. Known amounts at known times can be readily accommodated by either specific maturities or liquidations of unmatured or non-maturing issues. Unknown amounts or unexpected timing can only be accommodated by liquidations. Liquidating investments means selling them at the going market price to another investor. The ability to liquidate an investment will depend on its marketability. Securities in which ongoing secondary markets are maintained are readily marketable, and those rated as having either low credit or residual risks are highly marketable. Securities which do not have ongoing secondary markets and privately-placed non-security investments have either a very low degree of marketability or none at all. Marketability is also affected by the amount of the investment. Secondary markets presume certain ranges of amounts. Liquidating investments which are substantially larger or smaller than those ranges will

reduce both the marketability and the price. The ability of investment management to terminate some investments, procure others, realize returns, reallocate the fund's investments, and achieve high rates-of-return would be severely reduced if a fund was substantially invested in unmarketable investments.

#### D. For Some Purpose Over Some Span of Time

Both the purposes which are to be served and time over which they are to be served will vary greatly depending on the nature of the funds. Endowment type funds with a perpetual lifetime and no permissible withdrawals of principal are substantially different in purpose and time span than funds whose principal is committed to consumption within a near term period. The purpose and the time span are crucial factors in establishing the specific investment objectives and policies for a particular fund. They act to amplify or limit the classes of investments which can be considered and affect all of the characteristics previously mentioned, i.e., credit risk, residual risk, market risk, rates-of-return, and marketability.

### V. THE NATURE OF INVESTMENT POLICIES

The strategic plan for achieving a particular fund's investment objectives is the fund's general investment policy. It is primarily concerned with the relative allocation of the classes of investments within the fund, but it can also be concerned with the structure or selections within a class of investments. Within the limits imposed by the nature of the fund, its investment objectives, and the constraints imposed by laws and practical considerations, the investment policy is designed to achieve a relatively high probable rate-of-return on the fund over some future time period. Although the imposed limits and constraints may be fairly static for long periods of time, the financial markets in which returns are realized are very dynamic. No matter how suitable and productive an investment policy may be at any point in time, subsequent changes in the financial markets can rapidly invalidate it. Consequently, investment policies have to be sufficiently flexible to quickly adapt to the dynamics of the marketplace if the desired rates-of-return are going to be achieved. The process of keeping the policies attuned to the probable future markets involves continuing reappraisals.

Investment policies are comprehensive derived strategies which represent evaluations of all of the significant factors utilized in selecting and managing investments. The most important of these factors is the probable rates-of-return which may be earned on particular investments between now and a future date. Those probabilities together with their relative degree of certainty and the risks associated with those investments are the essential considerations involved in determining the allocation of the fund among the potential classes of investments. The allocations are balanced within the policy with the intention of maximizing the fund's probable forward rate-of-return without permitting its probable risks to rise to an unacceptable level. Because investment policies are based on expected future events, their effectiveness in achieving the objectives can only be ascertained on an after-the-fact basis.

## VI. THE FUNDS AND THEIR INVESTMENT POLICIES

The application of the general investment objective to specific funds or types of funds results in the development of specific investment policies for each fund. A summary of the nature of each fund and its investment policy follows:

### A. The General Investment Fund

This does not include the unmarketable loans made under former State programs--all but one of which are no longer active.

#### 1. Nature

The General Investment Fund is a reservoir which holds State revenues until they are disbursed. It contains five broad categories of monies:

- a. revenues which will only temporarily be in the fund because they are subject to imminent disbursement in order to satisfy operating budget expenses;
- b. revenue receipts in excess of appropriations, which are usually in the fund for less than a year because they are subsequently appropriated and disbursed;
- c. revenues appropriated for capital budget projects, which may be in the fund for several years as monies are disbursed on an as needed basis;

- d. past revenues not appropriated for specific expenditures but held in reserve for emergency purposes, e.g. budget reserve fund;
- e. special revenue, reserve, operating, and trust funds which are commingled in the General Investment Fund but are separately accountable. These monies have mixed characteristics, are usually continuing in duration, and are a small percentage of the total fund.

The purpose of the fund is to combine these money flows into a pool where disparate inflows and outflows will frequently be offsetting and, consequently, the more stable pool will be more readily investible. The reduction through the use of a pool of the number of accounts which need to be invested also increases the size of the investments, reduces the number of investments, and minimizes the transaction and personnel costs. The fund is invested with the intent of earning income on the principal monies until the time of their disbursement. The income earnings constitute an additional source of revenues which are available for appropriation.

## 2. Policy

Because the principal of the fund has been appropriated and any realized losses would lead to curtailment of intended expenditures, preservation of principal is the most important determinant of investment policy. Because the expenditures are frequently large and their exact dates of disbursement are unknown, the policy has to allow for very high liquidity. Because the \$1 billion to \$2 billion size of the fund is very large, investments have to be limited to classes of investments which have secondary markets that can readily accommodate large holdings. Because the projected income from the investments is also appropriated before it is received, the projected income for any fiscal year should be relatively stable and certain. These characteristics denote an investment policy which avoids residual risks, has low credit and market risks, avoids substantial exchange risks, concentrates on large yet very marketable issues, and seeks to achieve a relatively high but non-volatile investment return within a fiscal year.

The current investment policy limits the investment selections to non-residual, fixed amount obligations. The vast majority of holdings consist of U.S. Treasury issues, which have the lowest credit risks, the highest marketability, and the best secondary markets for large holdings. The remaining holdings consist of short-term commercial or bank paper issues which have exceptionally low credit risks although they yield more income than U.S. Treasuries. The daily volatility in fund balances is handled through overnight repurchase agreements with the limited number of prime dealers with whom the Treasury Division has binding written agreements. The repurchase agreements have almost no risk because they are fully collateralized by delivered U.S. Treasury securities. The maturity structure of the fund is designed to provide cash through maturities at the probable dates it will be needed. The estimating of probable cash outflows is a continuing process and the maturity structure is constantly being altered to match the probable outflows. The particular investment selections and the maturity structure are also designed to maximize the income flow and, consequently, the current structure of interest rates and the future expected structure of those rates are important determinants of investment selections and maturity structure. In order to keep the income relatively certain, issues are usually held to their maturity date, unless the maturity schedule needs to be restructured. Currently, about 62 percent of the fund is scheduled to mature within the following 12 months and the remainder within three years.

## B. AHFC Pledged Fund

### 1. Nature

The monies held in this fund are State funds which were required under the terms of an outstanding AHFC bond issue. The amount required depends upon standards and certifications stated in the bond indenture and any excess can be withdrawn on November 30 of each year. Excess amounts have been withdrawn each year so the monies currently held are less than \$10 million. The indenture restricts the investment maturities to six months or less and limits the choices to the instruments noted in Appendix D.

## 2. Policy

The stringent maturity and instrument limitations leave little room for discretionary policy. Preservation of principal is the most important characteristic and it is being served by keeping the fund invested in U.S. Treasury obligations. The maturity restriction avoids any market risk. The current investment policy is to purchase issues maturing on either the indenture's semi-annual interest pay dates of May 30 and November 30 or the nearest practical date preceding those days.

### C. International Airports Construction Fund

#### 1. Nature

The construction fund holds the proceeds of construction bonds as well as monies appropriated for the same purposes. The monies are withdrawn as needed to repay contractors for construction expenses. Consequently, it is a declining fund which eventually pays out all of its principal and income.

#### 2. Policy

The objective of the investment policy is to maximize the return on the monies while they are held in the fund without risking the principal or the presumed interest income. The investment restrictions (Appendix E) virtually eliminate credit risks, and market risks are minimized by attempting to match the schedule of maturities to the timing and amounts of anticipated withdrawals. The schedules of withdrawals are estimated by the architects or engineers involved in the projects. Section 3.03(c) of State Bond Committee Resolution No. 68-4 restricts maturities to no more than six months after the estimated dates on which the monies will be needed.

### D. International Airports Revenue Fund

#### 1. Nature

The Revenue Fund receives all of the revenues from the ongoing operations of the international airports. The monies are utilized to pay the continuing expenses of airport operations and

the principal and interest payments on outstanding airport revenue bonds. Although the bond payments are known amounts which are scheduled for the life of the issues, the revenue receipts and other expenditures are erratic in timing and highly variable in amount. Investment earnings are retained by the fund as an additional revenue.

## 2. Policy

The irregular, unforecasted cash flows out of the fund impose high liquidity and low risk requirements on its investments. These characteristics are met by investing solely in U.S. Treasury or money market issues due within no more than one year. The short maturities ensure minimal market risks, the issuers have very low credit risks, and the high marketability assures the availability of monies even if there are unexpected outflows. The separately invested Repair and Replacement Reserve Account, required under the terms of a bond indenture and subject to Section 5.04 of Resolution No. 68.4 of the State Bond Committee, is less subject to erratic flows and therefore may use maturities of up to five years duration. These stringent requirements effectively preclude maximizing the return on the investments. If reliable forecasts of probable cash flows were available, maturities might be lengthened and timed to take advantage of changing interest rate levels so a higher rate-of-return could be earned.

## E. State Mortgage Insurance (Trust) Fund

### 1. Nature

The monies in this fund constitute a State insurance reserve supporting holders of AHFC Insured Mortgage Bonds. The amounts required to be held in the fund are specified in AS 18.-56.095. Monies may be withdrawn from the funds as needed to effectuate the mortgage insurance programs, and the fund may receive monies from either special mortgage loan commitment fees or special mortgage loan defaults which were charged against the fund or appropriations by the legislature to meet the fund's size requirements. The fund has an unknown duration, it may vary in size perpetually, or it may decline to

zero at some future date when all Insured Mortgage Bonds are retired.

## 2. Policy

Fund investments have to have the characteristics of safety of principal from credit risks because the monies are an insuring guarantee and of high marketability because money may be withdrawn at any time. These characteristics are served under the Mortgage Insurance Agreement of December 6, 1975 between the State and AHFC which limited the investments to highly marketable and low credit risk U.S. Treasury or money market investments (see Appendix F). Subject to that restriction, the Commissioner of Revenue delegated investment management of the fund to the National Bank of Alaska under the terms of a Custody and Investment Agreement dated July 30, 1976.

## F. Retirement (Trust) Funds

This comprises the Public Employees Retirement Fund, the Teachers Retirement Fund, the Judicial Retirement Fund, and the Alaska National Guard and Alaska Naval Militia Retirement Fund, which are separately accounted and invested. Their natures are sufficiently similar to give them the same general investment policy. However, the two minor funds, the Judicial and the Alaska National Guard and Alaska Naval Militia, are too small to directly participate in equity and certain fixed amount investments. The Treasury Division has established a pooled account for domestic common stock investments of all the retirement and endowment funds to make participation by the minor funds practical. In the future, the Division may establish additional pools for other types of investments.

### 1. Nature

The retirement plans are defined benefit plans whose payment amounts for each enrolled employee are determined by their length of employment and their salary levels. They are joint contributory plans under which both the employee and the employer are required to make continuing contributions, with the exception of the Alaska National Guard and Alaska Naval Militia plan which is funded solely by employer contribu-

tions. According to law, the benefits payable under the retirement plans are contractual, deferred compensation arrangements which must be honored by the employers, who are Constitutionally prohibited from diminishing or impairing the accrued benefits. The employers are the effective guarantors of the benefits and they assume all of the financial risks concerning the adequacy of the contributions and the returns on the investments. Employees have a legal right to benefits immediately upon enrollment in the system, although their right to the employer's contributions is dependent on certain vesting requirements such as a minimum term of employment and the status of that employment (full-time, part-time, temporary, etc.). The plans are considered as being perpetual in nature because they apply to both current and future employees and the employers have the characteristics of perpetual existence.

The funds' invested assets are impounded monies dedicated to the payment of future benefits and are not subject to reversion to or use by the contributors, except when paid to beneficiaries under the terms of the plans. They are fiduciary trusts whose monies are held and invested only for the benefit of current and future retirees.

The investments represent the accumulated excess of contributions and realized income over benefits paid during the years since the plans' inceptions. The amount of additional monies contributed each year by the employees and employers are determined by consulting actuaries and are based on the expected future payments to current and future retirees, the amounts of the funds, and the expected future returns on investments. In order to determine the amounts of the funds, the actuaries annually value the funds' investments by utilizing a three year moving average of the ratios of total actuarial value to total book value, where total actuarial value is composed of market values for equities and book values for fixed amount obligations. This methodology decreases the annual volatility of both the valuations and the resultant levels of contributions. The actuarial method being utilized--projected unit credit method--requires contributions in the early years that exceed the accrual of benefits.

Cash inflows into the funds substantially exceed the current amounts of benefits payments and that condition is expected to continue for many years into the future. The net inflow is a typical situation for retirement plans who have a relatively low percentage of retired members. This is illustrated by the following statistics concerning the two major plans:

	<u>Public Employees Retirement System</u> (1)	<u>Teachers Retirement System</u> (1)	<u>Mean of U.S. Public Pension Funds</u> (2)
Average Age of Active Members	39.21	40.48	40.9
Average Years of Credited Service	5.96	9.81	11.6
% of Total Members Retired	14.4%	19.2%	29.3%
% of Active Members Vested	44.6%	48.0%	47.7%
Period in Years to Amortize Unfunded Accrued Benefits	25	25	30.1
% of Pension Obligation Funded	102.0%	93.2%	72.4%
Excess of Actuarial Interest Rate Assumption Over Salary Increase Assumption	2.8% (3) estimate	2.8% (3) estimate	1.8%

(1) "Actuarial Valuation as of June 30, 1986," William M. Mercer-Meidinger, Inc.

(2) "Public Pension Funds 1987," Greenwich Research Associates, Greenwich, Connecticut

(3) 2.5% for the first five years of an employee's service and 3.5% per year thereafter.

## 2. Policy

The most important characteristic of the funds for investment policy purposes is their perpetual nature and the long number of years before they will encounter any net outflows

(probably 15 to 20 years). The long time span accommodates investments which should enjoy higher returns over the long-run, although they may be slow to materialize, or be erratic in the short-run, and it allows greater use of investments which may have substantial market valuation risks. This characteristic expands the universe of investment possibilities and increases the potential for achieving higher returns on the investments.

The primary objective of the investment policy is to maximize the returns on the funds' total investments over a long time span without undertaking an unreasonable degree of risk of reducing the principal of the funds or of realizing the lower returns which would necessitate raising the contribution levels. Higher investment returns over the years mean a larger fund, and a larger fund size relative to a retirement system's liability for future benefit payments is the beneficiaries' best security that the pensions will be paid when they are due. Returns which average higher than the actuarially assumed returns (currently 9 percent for the two major retirement plans) can lead to either increases in pension benefits or decreases in the amounts of annual contributions. The time span over which the objective seeks to maximize returns is highly variable but usually falls in the range of between three to eight years. The time span cannot be precise because both the separate investment markets and the economy experience independent fluctuations in price and performance. Economic cycles usually range between three to six years, stock market cycles from two to four years, interest rate cycles from three to seven years, exchange rate cycles from four to eight years, and real estate cycles from four to ten years. Investment risks are related to the entire portfolio of a fund's investments rather than to the classes of investments which are components of the portfolio. All investments bear some degree of risk and the risks vary not only with the class of an investment and the stage of its related cycle but with the alternative investments within each class. Investments having higher expected future returns usually contain a greater risk of disappointment (lower returns) than those expected to have lower future

returns. The reasonableness of risk for a fund's investment portfolio is a judgment concerning the greater probability of achieving the expected higher future returns than the probability of realizing lower than average future returns.

Because investment markets are constantly fluctuating, the ratio of probable rewards (higher returns) to probable risks (lower returns) for an investment, or class of investments, or a fund is also constantly changing. In order to achieve the primary objective of the retirement funds, the funds' investments need to be continuously reallocated between classes of investments and among individual investments. The reallocating requires continuous reevaluations of the probable levels of future markets as compared to the levels of current markets. Consequently, the investment policy is the result of a dynamic and continuing evaluation process, rather than a static allocation of assets which ignores the changing markets and focuses on the past rather than the future.

The general investment policy of the two major retirement funds consists of ranges of allocations by investment classes. The ranges provide the flexibility needed to continually adapt the allocations to changing markets and expectations. The current range for equity investments runs from a low of 25 percent of the funds to a high of 50 percent, and the current level is about 40 percent. The longer term strategy of holding substantial percentages in equities reflects the probability that equities will continue to earn the highest relative returns on a long term basis, a condition which has been true for longer term periods in the past. Large public pension funds were recently holding about 44 percent in equities and corporate pension funds were holding about 60 percent in equities (the higher returns which corporate pension funds have historically earned have been basically due to their higher percentages of equities). Within the equity area, common stock investments may range from 21 percent to 46 percent of the funds (domestic commons at 17 percent to 42 percent and international commons at 4 percent to 10 percent). All common stock investments are being managed under discretionary contracts by external managers who were

competitively selected primarily on the basis of their investment performance. In order to limit the residual risk exposure of the retirement funds, the contracts require adequate diversification of holdings and prevent substantial investments in smaller, less seasoned business corporations.

Real estate equities may range from 4 percent to 10 percent of the fund but the variance is less susceptible to short-term changes because of the long lead time needed to increase real estate equity investments and to realize the returns on those investments. Real estate equities are also managed by external managers. Although gold bullion investments are statutorily permissible, they are rarely, if ever, considered as reasonable investments by professional managers. The supply and demand factors which determine the price of gold are highly variable, essentially speculative, and are not usually susceptible to reasonable analysis or reliable forecasting. Consequently, the market risks are too great for gold to be considered as a component of the current policy.

The current range for fixed amount investments runs from a low of 50 percent of the funds to a high of 75 percent and is the complement of the equity investment range. The percent currently held in fixed amount investments is about 60 percent. The higher income yields available from fixed investments has given greater stability and certainty to the portfolios' annual returns and has helped avoid unnecessary volatility in the annual contribution rates. The current income yield of 10.10 percent on the fixed portion of the two major funds helps assure that even if the equity percentage is maximized the overall portfolio income yields will still meet the actuarial assumption for those funds of 9 percent per annum. The heavier reliance on fixed investments also reduces the overall return risks of the investment portfolios because the credit risks are substantially less than the residual risks of the equities. Within the fixed amount area, mortgage investments may range from a low of 2 percent of the funds to a high of 10 percent. Although the mortgage holdings usually are the highest income yielding segment of the fixed investments, they are essentially unmarketable and thereby limit the ability to reallocate the

portfolio holdings toward maximizing future returns. The current amount of 8 percent in mortgages is expected to decline toward the lower end of its range over the next several years. The remainder of the fixed amount area consists of fixed income securities which usually range from a low of 40 percent of the funds to a high of 73 percent. The securities include U.S. Treasury bonds, foreign government bonds, corporate bonds, and short-term money market issues. Bond investment management is aimed at maximizing income yields over interest rate cycles by lengthening maturities at high interest rate peaks and shortening them at low interest rate troughs. Because the corporate bonds and money market issues may entail significant credit risks, they are diversified to reduce the risk of default by any single issuer. The high marketability of the bonds facilitates limiting market risks by changing either the selections or the maturities. Alternatively, the market risks can be offset by hedging the holdings through the financial futures markets.

G. Public School (Endowment Trust) Fund

The Public School Fund is an endowment trust fund, separately accounted and invested.

1. Nature

The principal of endowment trust funds, including all subsequent principal contributions and principal gains, is retained in perpetuity in the funds, but the earned income is used for the purposes for which the trusts were established. The total retention of principal is a firmly established requirement of fiduciary law aimed at assuring perpetual income benefits by preventing diminution of the corpus of the trust. Additional principal contributions to the Public School Fund are made from State mineral revenues as compensation for land grant properties expropriated by the State. The total amount of compensation has not as yet been determined, but it will be a limited amount and at some future date additional contributions will cease. Income from the Public School Fund is used only for financing public education programs. Income earned on the principal of the fund is set aside in

income subaccounts and reinvested pending appropriation by the legislature and subsequent expenditure. In conformance with fiduciary principles, the distinction between principal and income is strictly maintained through accrual accounting with amortization of bond premiums and discounts on a constant yield-to-maturity basis in order to prevent unwarranted conversions of principal to income or income to principal.

## 2. Policy

The most important characteristic of the fund for investment policy purposes is its perpetual nature and the restriction that its principal can never be expended. As in the case of the retirement funds, this expands the universe of investment possibilities and increases the potential for achieving higher returns on the investments over the long run. The primary objective of investment policy should be to continuously increase the principal of the fund without severely reducing the current income flow available for the purposes of the trust. It is the typical objective of other endowment funds in the nation. The larger corpus over time leads to larger income flows, which in turn permit increased support of the activities for which the endowment was established. If the corpus were not to grow after the original contributions cease, the annual dollar income flows would be limited to the prevailing range of interest rates and would not be able to assist in financing any expansion of the activities or any increasing costs of the activities. The need for continuing growth of the principal of the fund in order to increase the available income is evident from the fact that the current income from the Public School Fund constitutes only about 1 percent of the total annual appropriations for public school programs.

Although the Public School Fund can invest as broadly as the retirement funds, until recent years it has been too small to effectively use the equity markets at reasonable transaction costs and the Commissioner of Revenue did not have the necessary discretionary authority. With the delegation of the authority from the Public School Fund Advisory board, required by

AS 37.14.170(a) and granted in September 1986 (see Appendix B), domestic common stock investments were initiated for the fund. Currently, the fund holds about 30 percent of its assets in common stocks and the remainder in straight corporate or federal government debt issues. The percentage held in equities will rise toward the retirement fund levels as opportunities develop in the equity markets. The corporate debt is diversified to reduce the exposure to credit risks and the debt maturities are structured to maximize interest income over interest rate cycles. Liquidity and market risks are not important elements of the policy, except to the extent necessary to preserve the ability to reallocate the investments within the funds. The fund's investment policy has been to maximize the realized return on the investments over a 10 to 20 year time span. Reduction of the perpetual life of the fund to a shorter time horizon is a practical necessity of the investment decision process.

Under the discretionary authority delegated to the Commissioner, the investment policy will shift to a predominant reliance upon equity issues. Educational endowment funds in the nation typically hold about two-thirds of their assets in equities. Because of the 50 percent statutory limitation on corporate obligations the policy range for equities is 30 percent to 50 percent. The equities currently are confined to domestic common stocks, through the consolidated investment pool which also includes the retirement funds' domestic common stock investments. When the fund grows larger, or when suitable pooled accounts are established by the Treasury Division, it may include real estate or international equities in its portfolio. This policy seeks to maximize the future income of the fund by increasing the principal of the trust. The greater potential exposure to residual risks is ameliorated through adequate diversification.

H. University of Alaska (Endowment Trust) Fund

This is a land grant endowment trust created by Acts of Congress dated January 21, 1929 and February 28, 1891 and amended by subsequent Acts dated September 19, 1966 and March 4, 1915 in which lands were

donated to the University of Alaska (as beneficiary) for the support of the Agricultural College and the School of Mines. The trust fund holds revenues from the use of the granted lands, proceeds from the sale of those lands, and any monetary gifts, bequests, or endowments made to the University of Alaska for the same purposes as the land grant.

#### 1. Nature

The trust is a typical university endowment fund and has the same perpetual preservation of principal nature as the Public School Fund. The principal contributions to the trust are erratic in timing and amount, and they do not flow from legislated appropriations. Income is used by the University for the Agricultural College and the School of Mines. As in the case of the other endowment trusts, the distinction between principal and income is strictly maintained through appropriate accounting procedures.

#### 2. Policy

The investment policy for this fund should be the same as the policy for the other endowment trust fund (IV.G.2) and for the same reasons. Unfortunately, such a policy would not be legal. Although the nature and purpose of the trust fund would most appropriately be served through equity investments, AS 14.40.400(b) restricts the fund's investments to interest-bearing securities. Opinion No. 13 (1963) of the Attorney General says "The prudent man rule is the proper rule for guiding the Commissioner of Revenue in the investment of the University's fund" and "In investing the endowment funds of the University of Alaska, the Commissioner of Revenue can obtain some guidance through observing the type of investments made throughout the United States by those responsible for the investment of university endowment funds." Since the time of that opinion, the prudent man rule has been upgraded to the prudent institutional investor rule through subsequent statutes affecting almost all funds. Because the nature or purpose of the trust, the prudent institutional investor rule, and the investment allocations of other university endowment funds are in conflict with the statutory limitation, it is strongly recommended that AS 14.40.400(b)

be repealed in favor of a new requirement limiting investments to the prudent institutional investor rule.

Within the constraints imposed by the interest-bearing statutory limitation, the fund's investment policy has been to maximize the income flow from the investments over one or more interest rate cycles. The fund now holds all of its assets in straight corporate or federal government debt issues.

If the interest-bearing limitation was removed, the new investment policy would move in the direction of heavier reliance on equity investments--as in the other endowment trust--in order to maximize the future income of the fund by increasing the principal of the trust.

## VII. ADMINISTRATION OF INVESTMENT POLICY

As noted under the nature of investment policies (V, preceding), the strategic policies are comprehensive derived evaluations of all of the significant factors which may affect investment prices and yields over some future time period. Many of the factors involved have been specified in the foregoing presentation. The development and execution of dynamic investment policies aimed at achieving the investment objectives in a constantly changing marketplace requires continuing re-evaluations by the professional investment analysts and managers who are investment officers in the Treasury Division.

### A. Development

Development of suitable investment policies for the various funds is primarily the ongoing responsibility of the professional staff of the Treasury Division. It requires review of large amounts of complex data concerning probable cash inflows and outflows from the funds, actuarial extensions, domestic and international economic developments and financial flows, industry and company financial studies, financial market pricings, and statutory, regulatory and tax law changes. The staff collects, organizes, analyzes, and evaluates the data in order to forecast the probable future movements of investment prices. The forecasts are revised as necessary and are the keystone underlying the formulation of investment policy for the retirement and endowment trust funds. They can also be a factor in the policies for the other shorter-term funds.

## B. Execution

The authority to invest the State Mortgage Insurance Fund was delegated to the National Bank of Alaska by a Custody and Investment Agreement dated July 30, 1976. The authority to invest all other funds has been delegated to the investment officers of the Treasury Division of the Department of Revenue by the written delegations contained in Appendices K and L. The exceptions to the general authorization to the Treasury Division are the delegations of authority by contract to independent investment management firms of specific amounts for investment in domestic and international common stocks. The current contracts were initiated in the 1984 fiscal year through the competitive procedures required for State professional service contracts.

### 1. Equities

The amounts placed with the common stock management firms and the timing of those placements are determined by the applicable investment policies which look to both the probable long- and short-term benefits to the funds. The amounts so placed with the management firms are invested at their discretion but within the limitations imposed by the contracts. The amounts invested in real estate equity pools and the timing of those investments are also determined by the applicable investment policies. The selection of the particular real estate equity pools is made by the Real Estate Management Section of the Treasury Division.

### 2. Fixed Amount Obligations (Non-Equities)

All fixed amount investments are selected, executed, and managed by the Treasury Division in conformance with the appropriate investment policies and under established operating standards and procedures. Real estate mortgages are the responsibility of the Real Estate Management Section and all securities are the responsibility of the Portfolio Management Section. The only exceptions to these responsibilities are:

- a. unexpected daily cash surpluses which may arise at the master custodian bank and which are invested by it for an overnight period under the terms of our contract with the bank;

- b. privately-placed and unmarketable Alaska securities previously acquired under former State loan programs which are being held in the General Investment Fund until they mature.

C. Operating Standards and Policies

The Treasury Division has established a number of policies and standards relating to the selection and execution of investment purchases and sales.

1. Pricing

Transaction methods are aimed at achieving the highest sale prices and lowest purchase prices, or the prevailing rates for non-priced securities.

- a. All U.S. Treasury and federal agency issue transactions are executed in the national markets using competitive auction procedures with large U.S. primary dealers.
- b. Corporate debt issue transactions are also executed in the national markets using competitive auction procedures with large, well-established broker-dealers, except when the procedure is impractical because the secondary market debt issue being purchased is only available from one dealer.
- c. Common stock transactions are executed in national stock exchange auction markets or over-the-counter markets by the external contracted managers. The trades may alternatively be executed at the discretion of the managers in the block trade market when size of the transaction, greater speed of execution, better prices, or lower commission costs are relevant factors.
- d. Other investments such as repurchase agreements, commercial paper, marketable bank paper, futures, foreign exchange, mortgages, and security lending arrangements are executed at prevalent national (or international) rates or prices through either limited auction or negotiation procedures.
- e. Foreign investments utilize a combination of the aforementioned procedures depending

upon the structure of the foreign market, the size of the transaction, and the limitation on trading because of time zone differences.

2. Deliveries

In order to prevent the risk in settling trades of releasing investments or cash without receiving the offsetting cash or investments, all investment transactions are limited to delivery against simultaneous payment. No payments are made nor investments delivered against "due bills" (I.O.U.'s).

3. Credit Standards

a. Securities

The potential credit risks on all debt securities are determined by the Portfolio Management Section through financial analysis of the issuer. The standards of selection for acceptable credits are more demanding than those required by the relevant statutes and are primarily professional judgments concerning the probable ability of the issuer to avoid defaulting on the obligation. Regular financial reports are required of all issuers in whose obligations we invest. The credit standards are formulated, monitored, and revised as necessary by the analysts in the Portfolio Management Section.

b. Mortgages

In addition to statutory and regulatory requirements, all real estate mortgage loans must meet the standards contained in Appendix M. These standards are developed and revised by the Real Estate Management Section.

4. Underlying Agreements

Certain transactions are limited to and by the terms of underlying and binding agreements entered into between the Treasury Division and other parties.

a. Repurchase Agreements

Repurchase Agreements (Repo's) are only transacted with non-bank primary dealers who have signed our repurchase agreement, which protects each party's right to the collateral in the event the other party defaults or goes bankrupt. The agreement limits acceptable collateral to U.S. Treasury obligations and requires a 102 percent ratio of the collateral's market value to the loan amount. The agreements are revised as necessary by the Portfolio Management Section.

b. Lending Agreements

Lending agreements similar in protective provisions to the repurchase agreements but covering the lending of owned debt securities against acceptable collateral and at the prevailing percentage rate and margin may be entered into with broker-dealers. The agreements are developed and revised by the Portfolio Management Section.

c. Master Demand Note Agreements

Lending agreements with major, prime-rated, non-bank, commercial paper issuers covering day-to-day loans of variable amounts of money to the corporate issuer and evidenced by annotation to master notes held by our custodian bank. Rates on the notes may vary daily in response to market rates. The agreements are developed and revised by the Portfolio Management Section.

d. Mortgages

Mortgage loan sales and servicing agreements are required of all sellers from whom the Treasury Division purchases mortgages. The agreements are revised as necessary by the Real Estate Management Section.

e. Real Estate Equities

All investments in real estate equity pools require underlying negotiated agreements between the Treasury Division and the seller or manager of the properties. These agree-

ments are developed by the Real Estate Management Section and reviewed by the Attorney General.

5. Consolidated Investment Pools

The Treasury Division may establish pools for investment in particular types of assets by the various funds under management by the Division. The purpose of consolidated investment pools is to simplify administration, reduce costs, and provide a vehicle for diversified investment in these types of assets by smaller funds. Without such pools, small funds would be unable to invest in certain types of investments and would not be adequately diversified.

Currently, the Treasury Division maintains a domestic common stock consolidated investment pool. All domestic common stock holdings of the pension and endowment trust funds are represented by shares in this pool.

Each share is entitled to an equal portion of the pool's principal, realized gains or losses, and income. The pool shares, and therefore each fund's total holdings, are valued at the market value of the pool's principal at the end of each month. Contributions to, or withdrawals from, the pool (i.e., purchases or sales of pool shares) by a fund may be made at the end of each month at the pool shares' market value. Realized gains or losses are accounted for as a change in the book value of each fund's shares but are not distributed in cash. Income received is distributed in cash each month, first, to accrued income allocated to any withdrawal, and second, in proportion to each fund's remaining accrued income.

VIII. ACCOUNTABILITY

A. Audits of Accounts

An annual financial audit is conducted each fiscal year by an independent Certified Public Accounting firm for the General and Segregated Funds, the Public Employees Retirement Fund, and the Teachers Retirement Fund. The scope of the audit includes a review of internal controls and of securities custody and safekeeping practices and procedures.

## B. Safekeeping of Assets

Marketable securities are held by custodial banks under contracts with the Treasury Division. A small amount of securities or cash may be held from time to time at a futures broker under the requirements and supervision of the exchange on which the futures are traded. Cash held at clearing or custodial banks is kept at minimal operating levels. Non-marketable securities, mortgages, and unmarketable privately-placed loans are held in a vault in the Treasury Division.

## C. Reporting

### 1. Investment Status and Activity

The Comptroller of the Treasury Division prepares separate monthly financial reports for the General Investment Fund, Public Employees Retirement Fund, Teachers Retirement Fund, Public School Fund, and University of Alaska Fund. The reports consist of asset statements, income statements on the accrual basis of accounting, and sources and uses statements.

### 2. Performance Reviews

Under contract with the Treasury Division independent organizations perform comparative investment performance reviews of the Public Employees Retirement Fund, the Teachers Retirement Fund, and the Public School Fund. The reviews currently cover the portions of each fund which are managed by outside firms under contracts with the Treasury Division and the portions of each fund which are managed by the Treasury Division, excepting mortgage holdings. The reviews compare the investment performance against market indices and funds of a similar nature or against other managers.

APPENDIX A

State of Alaska  
Memorandum of Understanding  
between  
Department of Revenue  
and  
Department of Administration

WHEREAS, Attorney General's opinions, file nos. 366-103-85 and 366-171-85, authorize the crediting of investment income to trust funds or accounts managed by the State, the fish and game fund, and the power development revolving loan fund (hereinafter, "Funds"); and

WHEREAS, these Funds are commingled for investment purposes with the State general fund and other funds in the General Investment Fund; and

WHEREAS, the Department of Revenue and the Department of Administration desire to formalize their agreement as to

- a. their respective responsibilities for crediting investment income of the General Investment Fund to these Funds; and
- b. the valuation of assets of these Funds in the event of their transfer from the General Investment Fund;

NOW, THEREFORE, BE IT RESOLVED BY the Department of Revenue and the Department of Administration that:

1. The Department of Revenue, Treasury Division will determine monthly the figures for:
  - (a) the book value at the end of the month of the marketable securities portfolio of the General Investment Fund; and
  - (b) the income during the month on the marketable securities portfolio of the General Investment Fund, including realized and accrued income, amortization of premiums, and accretion of discounts but excluding unrealized gains or losses attributable to changes in market values of securities.
2. The Department of Revenue, Treasury Division will calculate the amount of monthly investment income to be

credited to each Fund and the end of month balance for each Fund by:

- (a) calculating the pro rata share of each Fund by dividing
  - (i) the preliminary balance of the Fund at the end of the month by
  - (ii) the General Investment Fund balance for that month as reported under 1.(a) of this agreement less the income during the month on the General Investment Fund as reported under 1.(b) of this agreement;

the preliminary balance shall be the balance as of the end of the month as recorded on the State's automated accounting system (AKSAS) on the tenth business day following the end of the month, excluding the credit calculated in this agreement;

- (b) calculating the credit to each Fund for the month by multiplying each Fund's pro rata share as calculated in 2.(a) of this agreement by the General Investment Fund marketable securities portfolio income as reported under 1.(b) of this agreement; and
- (c) calculating the balance of each Fund at the end of each month by adding the credit calculated in 2.(b) of this agreement to the preliminary balance at end of the month.

The Department of Revenue, Treasury Division will provide documentation showing the amounts and calculations determined under 1 and 2 of this agreement to agencies desiring to verify the calculations as listed in Attachment A.

- 3. The Department of Administration, Division of Finance at the end of each fiscal year will record in the State's annual financial report, AKSAS, and any other books or accounts of record:
  - (a) the total investment income credited to each Fund (and debited to the general fund), which shall be the total of the credits calculated for each month during the fiscal year; and
  - (b) the balance of each Fund at the end of the fiscal year.

4. The Department of Administration, Division of Finance may delegate its responsibilities under this agreement to a State agency. The Division of Finance may record, or permit a delegated agency to record, credits, debits, and balances at a more frequent interval than annually.
  
5. In the event any assets of any Fund are transferred from the general fund to another State fund or in liquidation or partial liquidation of the Fund, the amount of cash transferred shall be the market value of the assets. The market value of the assets transferred shall be determined by multiplying the market value of the marketable securities portfolio of the General Investment Fund by the ratio of the Fund balance or portion of Fund balance being transferred, to the General Investment Fund balance as reported under 1.(a) of this agreement. Balances used in this calculation shall be as of the end of the month in which the transfer is made and shall include all credits to the Funds due under this agreement as of the date of transfer.
  
6. The funds listed on Attachment A are subject to this agreement. Other funds may become subject to this agreement upon the approval of the Attorney General. Funds which are clearly trust funds or clearly contain a statutory dedication of investment income will become subject to this agreement automatically.

This agreement takes effect July 1, 1986.

Department of Administration  
Eleanor L. Andrews, Commissioner

Department of Revenue  
Mary A. Nordale, Commissioner

          /s/ Eleanor Andrews            
(Signature)

          /s/ Mary A. Nordale            
(Signature)

          July 30, 1986            
(Date)

          August 8, 1986            
(Date)

## Attachment A

Funds and Accounts With Dedicated Earnings  
Revised as of January 29, 1988

<u>Fund or Account</u>	<u>Statutory Citation</u>	<u>Agency Verifying Credit Calculation</u>	<u>Frequency of Verification</u>	<u>Agency Responsible for AKSAS Entry</u>	<u>Frequency of Recordation</u>
Student Loan Fund	AS 14.42.210	Alaska Student Loan Corp.	Annually	Administration (Finance)	Annually
Alaska Clean Water Fund (exclusive of non-matching funds)(effective July 1, 1987)	AS 46.03.032	Administration (Finance)	Annually	Administration (Finance)	Annually
Fish and Game Fund	AS 16.05.110	Administration (Finance)	Annually	Administration (Finance)	Annually
Power Development Revolving Loan Fund	AS 44.33.600	Administration (Finance)	Annually	Administration (Finance)	Annually
Mental Health Trust Income Account	Ch. 132 SLA 1986 and AS 37.14.011(a)	Administration (Finance)	Annually	Administration (Finance)	Annually
Permanent Fund Dividend Trust Accounts	AS 43.23.105(e)	Revenue (Fiscal)	Quarterly	Administration (Finance)	Annually
Miscellaneous Trust Account (Department of Law)		Revenue (Fiscal)	Monthly	Administration (Finance)	Annually
Unlicensed Vessel Personnel Annuity Retirement Fund		Administration (Retirement & Benefits)	Semi-annually	Administration (Finance)	Annually
Warner Trust Fund		Community & Regional Affairs	Quarterly	Administration (Finance)	Annually
Exxon Trust Fund		Community & Regional Affairs	Quarterly	Administration (Finance)	Annually
Railbelt Energy Fund <sup>1/</sup>	AS 37.05.153	Administration (Finance)	Annually	Administration (Finance)	Annually
Budget Reserve Fund <sup>1/</sup>	AS 37.05.156(d)	Administration (Finance)	Annually	Administration (Finance)	Annually

<sup>1/</sup> Income is only to be calculated (step 2.(c) of the agreement is to be omitted) unless the legislature appropriates the income to the fund, in which case it will be credited. As a result interest will be compounded annually at best.

APPENDIX B

Public School Fund Advisory Board  
Resolution No. \_\_\_\_\_

Providing for the Authorization of the  
Commissioner of Revenue to Invest  
the Public School Fund in the Manner  
Specified in AS 39.35.110.

WHEREAS, AS 37.14.170 authorizes the Commissioner of Revenue, with the approval of the Public School Fund Advisory Board, to invest the principal of the Public School Fund in the manner specified in AS 39.35.110 for the Public Employees Retirement Fund;

WHEREAS, the Department of Revenue has provided to the Board of Education its General Investment Policies dated January 1986 which sets forth the authority, objectives, and investment policies for each fund which is invested by the Commissioner of Revenue;

NOW, THEREFORE, BE IT RESOLVED that the Public School Fund Advisory Board hereby concurs with the objectives and investment policies proposed for the Public School Fund by the Department of Revenue in its General Investment Policies; and

BE IT FURTHER RESOLVED that the Public School Fund Advisory Board hereby authorizes the Commissioner of Revenue to invest the Public School Fund in the manner specified in AS 39.35.110.

BY: /s/ Ernestine Griffin  
Chairman, Public School Fund  
Advisory Board  
DATE: September 26, 1986

ATTEST:

/s/ Marshall L. Lind  
Commissioner, Department of Education

APPENDIX C

State of Alaska  
Office of the Governor  
Delegation of Investment Authority  
University of Alaska Fund

WHEREAS, AS 14.40.400 requires the University of Alaska Trust Fund to be invested in interest-bearing securities as approved by the Governor;

WHEREAS, the 1963 Opinion No. 13 of the Attorney General holds that the prudent-man rule is the proper rule for guiding the investment of the Fund; and

WHEREAS, AS 44.25.020(2) requires the Department of Revenue to invest all State funds,

I, BILL SHEFFIELD, GOVERNOR OF THE STATE OF ALASKA, do hereby delegate the authority vested in me by the Alaska Statutes to approve investments of the University of Alaska Trust Fund in interest-bearing securities to the Commissioner of Revenue subject to adherence by the Commissioner to the following standard of prudence:

In making investments, the Commissioner of Revenue or the delegate of the Commissioner shall exercise the judgment and care under the circumstances then prevailing which an institutional investor of ordinary prudence, discretion, and intelligence exercises in the management of large investments entrusted to it not in regard to speculation but in regard to the permanent disposition of funds, considering probable safety of capital as well as probable income.

This delegation is effective July 1, 1985 and shall continue in force until amended or revoked in writing by me or my successor.

Signed:           /s/ Bill Sheffield            
Bill Sheffield  
Governor

## APPENDIX D

### The General Investment Fund Permissible Investment Instruments (AS 37.10.070)

#### Investments limited to:

1. obligations of, or obligations insured or guaranteed by, the United States or agencies or instrumentalities of the United States;
2. obligations secured by reserves paid in by the United States or agencies or instrumentalities of the United States or obligations of corporations in which the United States is a shareholder or member;
3. certificates of deposit issued by United States domestic banks which are members of the Federal Deposit Insurance Corporation for which a generally recognized secondary market exists or which are secured fully at all times as to the payment of principal and interest in accordance with Alaska law;
4. corporate debt securities with a minimum rating of "BAA" or the equivalent by a nationally recognized rating organization and the preferred and common stocks of companies which have paid dividends continuously for the last three years;
5. commercial paper bearing the highest rating of a nationally recognized rating organization;
6. securities of foreign governments, foreign governmental agencies, and foreign corporations the principal, interest, or dividends of which are payable in either United States dollars or foreign currencies;
7. bankers acceptances drawn on and accepted by banks with a combined capital and surplus aggregating at least \$200,000,000;
8. shares of federally chartered savings and loan associations in Alaska which are fully secured at all times as to the payment of principal and interest in accordance with Alaska law;
9. savings certificates issued by state-chartered savings and loan associations in Alaska which are fully secured at all times as to the payment of principal

and interest in accordance with Alaska law;

10. deposits with mutual savings banks in Alaska which are fully secured at all times as to the payment of principal and interest in accordance with Alaska law;
11. fixed-term certificates of indebtedness of federally insured credit unions in Alaska which are fully secured at all times to the payment of principal and interest in accordance with Alaska law;
12. foreign time deposits of both United States-owned and foreign-owned banks and trust companies denominated in either United States dollars or foreign currencies;
13. mortgages of the Alaska Rural Rehabilitation Corporation which secure agricultural loans, agricultural business loans, and agricultural processing loans;
14. futures contracts for the sale of investments only for the purpose of hedging an existing equivalent ownership position in investments of the types described above.

## APPENDIX E

### AHFC Pledged Fund Permissible Investment Instruments (Section 508 of AHFC General Housing Mortgage Bond Resolution)

#### Investments limited to:

1. direct obligations of or obligations guaranteed by the United States of America;
2. deposits in interest-bearing time deposits or certificates of deposit secured by obligations of, or unconditionally guaranteed by, the United States of America or by obligations described in 1 or 3 hereof;
3. bonds, debentures, notes, or participation certificates issued by any of the following Federal agencies: Bank for Cooperatives, Federal Intermediate Credit Banks, Federal Home Loan Banks System, Federal Land Banks, Export-Import Bank, Tennessee Valley Authority, Government National Mortgage Association, and Farmers Home Administration;
4. Public Housing Bonds issued by Public Housing Authorities and fully secured as to the payment of both principal and interest by a pledge of annual contributions under an annual contribution contract or contracts with the United States of America, or Temporary Notes issued by Public Housing Authorities or Preliminary Loan Notes issued by Local Public Agencies, in each case, fully secured as to the payment of both principal and interest by a requisition or payment agreement with the United States of America;
5. direct and general obligations of or obligations guaranteed by the State to the payment of the principal of and interest on which the full faith and credit of the State is pledged;
6. deposits in interest-bearing time deposit or certificates of deposit secured by obligations of or guaranteed by the State;
7. bankers acceptances drawn on and accepted by banks with a combined capital and surplus of at least \$200,000,000;

8. corporate obligations of prime or equivalent quality as rated by a nationally recognized rating agency; and
9. bank certificates of deposit which are secured as to payment of principal and interest in accordance with Alaska law.

## APPENDIX F

### International Airports Funds Permissible Investment Instruments (State Bond Committee Resolution No. 68-4)

Instruments for the Construction Fund, the Revenue Trust Fund, and the Repair and Replacement Reserve Account are limited to:

1. time or demand deposits in any bank or trust company authorized to accept deposits of public funds and secured at all times by such obligations as are required by law and to the fullest extent required by law;
2. direct obligations of the United States of America, obligations the principal of and interest on which are guaranteed by the United States of America;
3. obligations issued by federal land banks or federal intermediate credit banks established under the Federal Farm Loan Act, as amended;
4. bonds or debentures of the Federal Home Loan Bank Board or of any federal home loan bank established under the Federal Home Loan Bank Act;
5. obligations of the Federal National Mortgage Association established under the National Housing Act, as amended; and
6. debentures and consolidated debentures issued by the Central Bank for Cooperatives or banks for cooperatives established under the Farm Credit Act of 1933, as amended.

## APPENDIX G

### State Mortgage Insurance Fund Permissible Investment Instruments (AS 18.56.095(b) and AS 37.10.070(a))

Although the permissible instruments include all of those specified for the General Fund (Appendix E), the Mortgage Insurance Agreement dated December 6, 1975 between the State and AHFC has further limited investments to:

1. direct obligations of, or obligations insured or guaranteed by, the United States of America or agencies or instrumentalities of the United States;
2. bankers acceptances drawn on and accepted by banks and certificates of deposit of banks, with a combined capital and surplus aggregating at least \$200,000,000; or
3. interest bearing time deposits or certificates of deposit of a bank or trust company continuously secured and collateralized by obligations of the type described in paragraph 1 or by obligations of the State having a market value at least equal at all times to the amount of such deposit or certificate, to the extent such deposit or certificate is not insured by the Federal Deposit Insurance Corporation or the Federal Savings and Loan Insurance Corporation, or any successors thereto.

## APPENDIX H

Public Employees Retirement Fund  
Teachers Retirement Fund  
Judicial Retirement Fund  
Alaska National Guard and Alaska Naval Militia Retirement Fund  
Public School Fund  
Permissible Investment Instruments  
(AS 39.35.110, AS 14.25.180, AS 37.14.170,  
AS 22.25.048(c), AS 26.05.228(c))

1. shares of federally chartered savings and loan associations in Alaska, to the extent that the investment is insured by the federal government or by an agency of the federal government;
2. deposits with mutual savings banks in Alaska, to the extent that the investment is insured by the federal government or an agency of the federal government;
3. deposits with state and national banks in Alaska to the extent that the investment is insured by the federal government or an agency of the federal government;
4. the guaranteed portion of Small Business Administration loans;
5. first lien real estate mortgages guaranteed by the federal Veterans Administration;
6. notes secured by mortgages of commercial or residential buildings if the mortgages are insured by a private mortgage insurance corporation which is authorized to do business in Alaska and has combined capital, surplus, and reserves aggregating at least \$20,000,000; however,
  - a. no mortgage insurance is necessary for commercial loans having loan-to-value ratios of less than 50 percent and the minimum coverage of other commercial loans shall be 10 percent for those having a loan-to-value ratio of 50-60 percent and 15 percent for those having a loan-to-value ratio greater than 60 percent but no more than 75 percent, and
  - b. no mortgage insurance is necessary for residential loans having a loan-to-value ratio of less than 70 percent and the minimum coverage of other residential loans shall be 10 percent for those having a

loan-to-value ratio greater than 70 percent but less than 90 percent and 20 percent for those having a loan-to-value ratio of 90 percent;

7. conventional residential mortgages if the originating financial institution retains at least 25 percent of the mortgage for a minimum of two years;
8. notes secured by mortgages of commercial buildings if the originating financial institution retains at least 25 percent of the mortgage until maturity;
9. FHA guaranteed portion of business and industrial loans made under the Rural Development Act of 1972;
10. bankers' acceptances which are eligible for discount at the Federal Reserve Bank and certificates of deposit issued by United States domestic banks which are members of the Federal Deposit Insurance Corporation if a generally recognized secondary market exists for the certificates of deposit;
11. obligations of, or obligations insured by or guaranteed by, the United States or agencies or instrumentalities of the United States;
12. obligations secured by reserves paid in by the United States or agencies or instrumentalities of the United States or obligations of corporations in which the United States is a shareholder or member;
13. corporate debt securities with a minimum rating of "A" or an equivalent rating by a nationally recognized rating organization;
14. preferred and common stock of companies which have paid dividends in each of the three years immediately preceding the investment; Stocks eligible for purchase are restricted to stocks which, except for bank stocks and insurance stocks, are listed upon an exchange registered with the Federal Securities and Exchange Commission;
15. commercial paper bearing the highest rating of a nationally recognized rating organization;
16. securities of foreign governments, foreign governmental agencies, and foreign corporations the principal, interest, or dividends on which are payable in either United States dollars or foreign currencies;

17. foreign time deposits of both United States-owned and foreign-owned banks and trust companies denominated in either United States dollars or foreign currencies;
18. gold bullion certified as to fineness of at least 99 1/2 percent;
19. futures contracts for the sale of investments only for the purpose of hedging an existing equivalent ownership position in investments of the types described above; and
20. a trust which is qualified under Sec. 401(a) of the Internal Revenue Code (26 U.S.C. Sec. 401(a)) and exempt from taxation under Sec. 501(a) of the Internal Revenue Code (26 U.S.C. Sec. 501(a)) and which is maintained as a medium for pooling a portion of the funds of pension and profit-sharing trusts for diversifying investments in real estate and interests in real estate.

APPENDIX I

State of Alaska  
Department of Revenue  
Treasury Division

Mandatory Agreement For All Treasury Personnel

The Treasury Division of the Department of Revenue is responsible for managing large amounts of investments and cash for either the State of Alaska or the beneficiaries of fiduciary trusts. The responsibility cannot be faithfully discharged if the integrity of the function is impaired through financial conflicts of interests or unnecessary dissemination of privileged information by the personnel of the Treasury Division. I voluntarily agree to adhere to the following behavioral standards as a condition of employment and with the understanding that any violations may constitute grounds both for dismissal and for any other penalties provided by law:

1. I will not engage in, nor recommend or suggest that others engage in, personal investment transactions which have an adverse effect upon the Treasury Division's investment transactions.
2. I may in the course of my employment obtain privileged information concerning recent, contemporaneous or impending Treasury Division investment transactions, or investment advice or counsel furnished to the Treasury Division, or tax payments, but I will not provide that information to others who do not have a functional need or a legal right to know it, nor will I utilize the information as a basis for making personal investments or for recommending or suggesting to other parties that they make investments whose returns are partly or wholly dependent upon similar or contrary investment transactions undertaken or to be undertaken by the Treasury Division. I understand that this restriction does not apply if the information has been disseminated to the public.
3. I will not accept from parties doing business with the Treasury Division any personal gifts or valuable considerations as a reward or inducement for any Treasury business done with them. The occasional unsolicited distribution by financial institutions of token gifts to their substantial customers, and meals or refreshments furnished while business is being transacted, may be accepted, subject to the reporting requirements of AS 39.52.130(b) if the gift or consideration exceeds \$50 and the recipient may take official action that affects the giver.

Acknowledged by:

\_\_\_\_\_  
Signature

\_\_\_\_\_  
Date

## APPENDIX J

1

### THE CODE OF ETHICS AND THE STANDARDS OF PROFESSIONAL CONDUCT

Adopted by The Federation of Financial Analysts and The Institute of Chartered Financial Analysts. Revised April 29, 1984.

#### THE FAF RESOLUTION

WHEREAS, the profession of financial analysis and investment management has evolved because of the increasing public need for competent, objective, and trustworthy advice with regard to investments and financial management; and

WHEREAS, those engaged in this profession have joined together in an organization known as The Financial Analysts Federation; and

WHEREAS, despite a wide diversity of interest among analysts employed by brokers and securities dealers, investment advisers, banks, insurance companies, investment companies and trusts, pension trusts, and other institutional investors and investment entities, there are nevertheless certain fundamental standards of conduct which should be common to all engaged in the profession of financial analysis and investment management and accepted and maintained by them; and

WHEREAS, the members of The Financial Analysts Federation adopted a Code of Ethics and Standards on May 20, 1962, which have been amended from time to time; and

WHEREAS, The Financial Analysts Federation provides for individual membership in it, requires that all of its member societies adopt its Code of Ethics and Standards of Professional Conduct, and requires that all individual members comply with them;

#### THE ICFA RESOLUTION

WHEREAS, the profession of financial analysis and investment management has evolved because of the increasing public need for competent, objective, and trustworthy advice with regard to investments and financial management; and

WHEREAS, The Institute of Chartered Financial Analysts was organized to establish educational standards in the field of financial analysis, to conduct examinations of financial analysts and to award the professional designation of Chartered Financial Analyst, among other objectives; and

WHEREAS, despite a wide diversity of interest among analysts employed by brokers and security dealers, investment advisers, banks, insurance companies, investment companies and trusts, pension trusts, and other institutional investors and investment entities, there are nevertheless certain fundamental standards of conduct which should be common to all engaged in the profession of financial analysis and investment management and accepted and maintained by them; and

WHEREAS, The Institute of Chartered Financial Analysts adopted a Code of Ethics and Standards on March 14, 1964, which have been amended from time to time;

NOW, THEREFORE, The Institute of Chartered Financial Analysts hereby adopts the following Code of Ethics and Standards of Professional Conduct:

NOW, THEREFORE, the following are the Code of Ethics and Standards of Professional Conduct of The Financial Analysts Federation:

*Members of The Financial Analysts Federation are obligated to conduct their professional activities in accordance with the following Code of Ethics and Standards of Professional Conduct. Disciplinary sanctions may be imposed for violations of the Code or Standards.*

*Members of The Institute of Chartered Financial Analysts are obligated to conduct their professional activities in accordance with the following Code of Ethics and Standards of Professional Conduct. Disciplinary sanctions may be imposed for violations of the Code or Standards.*

### THE CODE OF ETHICS

A financial analyst/Chartered Financial Analyst should conduct himself with integrity and dignity and act in an ethical manner in his dealings with the public, clients, customers, employers, employees, and fellow analysts.

A financial analyst/Chartered Financial Analyst should conduct himself and should encourage others to practice financial analysis in a professional and ethical manner that will reflect credit on himself and his profession.

A financial analyst/Chartered Financial Analyst should act with competence and should strive to maintain and improve his competence and that of others in the profession.

A financial analyst/Chartered Financial Analyst should use proper care and exercise independent professional judgment.

### THE STANDARDS OF PROFESSIONAL CONDUCT

#### I. Obligation to Inform Employer of Code and Standards.

The financial analyst/Chartered Financial Analyst shall inform his employer through his direct supervisor, that he is obligated to comply with the Code of Ethics and Standards of Professional Conduct, and is subject to disciplinary sanctions for violations thereof. He shall deliver a copy of the Code and Standards to his employer if the employer does not have a copy.

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\*Masculine pronouns, used throughout the Code and Standards, as well as throughout the Handbook, to simplify sentence structure, shall apply to all persons, regardless of sex.

## **II. Compliance with Governing Laws and Regulations and the Code and Standards.**

### **A. Required Knowledge and Compliance.**

The financial analyst/Chartered Financial Analyst shall maintain knowledge of and shall comply with all applicable laws, rules, and regulations of any government, governmental agency, and regulatory organization governing his professional, financial, or business activities, as well as with these Standards of Professional Conduct and the accompanying Code of Ethics.

### **B. Prohibition Against Assisting Legal and Ethical Violations.**

The financial analyst/Chartered Financial Analyst shall not knowingly participate in, or assist, any acts in violation of any applicable law, rule, or regulation of any government, governmental agency, or regulatory organization governing his professional, financial, or business activities, nor any act which would violate any provision of these Standards of Professional Conduct or the accompanying Code of Ethics.

### **C. Prohibition Against Use of Material Non-Public Information.**

The financial analyst/Chartered Financial Analyst shall comply with all laws and regulations relating to the use of material non-public information. (1) If the analyst acquires such information as a result of a special or confidential relationship with the issuer, he shall not communicate the information (other than within the relationship), or take investment action on the basis of such information, if it violates that relationship. (2) If the analyst is not in a special or confidential relationship with the issuer, he shall not communicate or act on material non-public information if he knows or should know that such information was disclosed to him in breach of a duty. If such a breach exists, the analyst shall make reasonable efforts to achieve public dissemination of such information.

### **D. Responsibilities of Supervisors.**

A financial analyst/Chartered Financial Analyst with supervisory responsibility shall exercise reasonable supervision over those subordinate employees subject to his control, to prevent any violation by such persons of applicable statutes, regulations, or provisions of the Code of Ethics or Standards of Professional Conduct. In so doing the financial analyst/Chartered Financial Analyst is entitled to rely upon reasonable procedures established by his employer.

**III. Research Reports, Investment Recommendations and Actions.**

**A. Reasonable Basis and Representations**

1. The financial analyst/Chartered Financial Analyst shall exercise diligence and thoroughness in making an investment recommendation to others or in taking an investment action for others.
2. The financial analyst/Chartered Financial Analyst shall have a reasonable and adequate basis for such recommendations and actions, supported by appropriate research and investigation.
3. The financial analyst/Chartered Financial Analyst shall make reasonable and diligent efforts to avoid any material misrepresentation in any research report or investment recommendation.
4. The financial analyst/Chartered Financial Analyst shall maintain appropriate records to support the reasonableness of such recommendations.

**B. Research Reports.**

1. The financial analyst/Chartered Financial Analyst shall use reasonable judgment as to the inclusion of relevant factors in research reports.
2. The financial analyst/Chartered Financial Analyst shall distinguish between facts and opinion in research reports.
3. The financial analyst/Chartered Financial Analyst shall indicate the basic characteristics of the investment involved when preparing for general public distribution a research report that is not directly related to a specific portfolio or client.

**C. Portfolio Investment Recommendations and Actions.**

The financial analyst/Chartered Financial Analyst shall, when making an investment recommendation or taking an investment action for a specific portfolio or client, consider its appropriateness and suitability for such portfolio or client. In considering such matters, the financial analyst/Chartered Financial Analyst shall take into account (1) the needs and circumstances of the client, (2) the basic characteristics of the investment involved, and (3) the basic characteristics of the total portfolio. The financial analyst/Chartered Financial Analyst shall use reasonable judgment to determine the applicable relevant factors. The financial analyst/Chartered Financial Analyst shall distinguish between facts and opinion in presentation of investment recommendations.

**D. Prohibition Against Plagiarism.**

The financial analyst/Chartered Financial Analyst shall not, when presenting material to his employer, associates, customers, clients, or the general public, copy or use in substantially the same form, material prepared by other persons without acknowledging its use and identifying the name of the author or publisher of such material. The analyst may, however, use without acknowledgment factual information published by recognized financial and statistical reporting services or similar sources.

**E. Prohibition Against Misrepresentation of Services.**

The financial analyst/Chartered Financial Analyst shall not make any statements, orally or in writing, which materially misrepresent (1) the services that the analyst or his firm is capable of performing for the client, (2) the qualifications of such analyst or his firm, (3) the investment performance that the analyst or his firm has accomplished or can reasonably be expected to achieve for the client, or (4) the expected performance of any investment. The financial analyst/Chartered Financial Analyst shall not make any unsupported oral or written statement that assures or guarantees any investment or its return either explicitly or implicitly.

**F. Fair Dealing With Customers and Clients.**

The financial analyst/Chartered Financial Analyst shall act in a manner consistent with his obligation to deal fairly with all customers and clients when (1) disseminating investment recommendations, (2) disseminating material changes in prior investment advice, and (3) taking investment action.

**IV. Priority of Transactions.**

The financial analyst/Chartered Financial Analyst shall conduct himself in such a manner that transactions for his customers, clients, and employer have priority over personal transactions, and so that his personal transactions do not operate adversely to their interests. If a financial analyst/Chartered Financial Analyst decides to make a recommendation about the purchase or sale of a security, he shall give his customers, clients, and employer adequate opportunity to act on this recommendation before acting on his own behalf.

**V. Disclosure of Conflicts.**

The financial analyst/Chartered Financial Analyst, when making investment recommendations, or taking investment actions, shall disclose

to his customers and clients any material conflict of interest relating to him and any material beneficial ownership of the securities involved which could reasonably be expected to impair his ability to render unbiased and objective advice.

The financial analyst/Chartered Financial Analyst shall disclose to his employer all matters which could reasonably be expected to interfere with his duty to the employer, or with his ability to render unbiased and objective advice.

The financial analyst/Chartered Financial Analyst shall also comply with all requirements as to disclosure of conflicts of interest imposed by law and by rules and regulations of organizations governing his activities and shall comply with any prohibitions on his activities if a conflict of interest exists.

## **VI. Compensation.**

### **A. Disclosure of Additional Compensation Arrangements.**

The financial analyst shall inform his customers, clients, and employer of compensation arrangements in connection with his services to them which are in addition to compensation from them for such services.

### **B. Disclosure of Referral Fees.**

The financial analyst shall make appropriate disclosure to a prospective client or customer of any consideration paid to others for recommending his services to that prospective client or customer.

### **C. Duty to Employer.**

The financial analyst shall not undertake independent practice for compensation in competition with his employer unless he has received written consent from both his employer and the person for whom he undertakes independent employment.

## **VII. Relationships with Others.**

### **A. Preservation of Confidentiality.**

A financial analyst shall preserve the confidentiality of information communicated by the client concerning matters within the scope of the confidential relationship, unless the financial analyst receives information concerning illegal activities on the part of the client.

**B. Maintenance of Independence and Objectivity.**

The financial analyst, in relationships and contacts with an issuer of securities, whether individually or as a member of a group, shall use particular care and good judgment to achieve and maintain independence and objectivity.

**C. Fiduciary Duties.**

The financial analyst, in relationships with clients, shall use particular care in determining applicable fiduciary duty and shall comply with such duty as to those persons and interests to whom it is owed.

**VIII. Use of Professional Designation.**

**FAF**

The qualified financial analyst may use the professional designation "Fellow of The Financial Analysts Federation," and is encouraged to do so, but only in a dignified and judicious manner. The use of the designation may be accompanied by an accurate explanation (1) of the requirements that have been met to obtain the designation and (2) of The Financial Analysts Federation.

**ICFA**

The Chartered Financial Analyst may use the professional designation Chartered Financial Analyst, or the abbreviation CFA, and is encouraged to do so, but only in a dignified and judicious manner. The use of the designation may be accompanied by an accurate explanation (1) of the requirements that have been met to obtain the designation and (2) of The Institute of Chartered Financial Analysts.

**IX. Professional Misconduct.**

The financial analyst shall not (1) commit a criminal act that upon conviction materially reflects adversely on his honesty, trustworthiness, or fitness as a financial analyst in other respects or (2) engage in conduct involving dishonesty, fraud, deceit, or misrepresentation.

APPENDIX K

State of Alaska  
Department of Revenue  
Delegation of Investment Authority

I, Milton B. Barker, Acting Commissioner of Revenue for the State of Alaska, do hereby delegate the authority vested in me by the Alaska Statutes and the Resolutions of various State boards and committees to invest and reinvest the assets of State funds to the state officers whose signatures appear below.

James R. Wilson  
State Investment Officer           /s/ James R. Wilson      

Kenneth L. Shaffer  
State Investment Officer           /s/ Kenneth L. Shaffer      

James A. Corrao  
State Investment Officer           /s/ James A. Corrao      

Steven C. Verschoor  
State Investment Officer           /s/ Steven C. Verschoor      

The officers designated above are authorized to open an account or accounts with one or more firms or banks for the purpose of engaging in transactions to purchase, sell, assign, transfer or otherwise enter into agreements, contracts, commitments or similar arrangements, for cash or forward settlement or future contracts relating to the investment of assets.

The designated officers are authorized to commit, bind, and obligate the State of Alaska for investment transactions, to execute those transactions, and in connection therewith to deliver securities and monies, to sign and deliver agreements, contracts, commitments and confirmations and other necessary, desirable or customary documents. Other parties to the transactions may rely and act upon any verbal or written orders and instructions from the designated officers in connection with such accounts and transactions.

This delegation is effective November 5, 1986 and shall continue in force until amended or revoked in writing by the Commissioner of Revenue.

      /s/ Milton B. Barker        
Milton B. Barker  
Acting Commissioner of Revenue  
November 5, 1986

APPENDIX L

State of Alaska  
Department of Revenue  
Delegation of Investment Authority

I, Milton B. Barker, Acting Commissioner of Revenue for the State of Alaska, do hereby delegate the authority vested in me by the Alaska Statutes to invest and reinvest the assets of the State of Alaska General and Segregated Funds, the Public Employees Retirement System and Fund, and the Teachers Retirement System and Fund to the state officers whose signatures appear below.

Martin W. Lentz  
State Investment Officer

/s/ Martin W. Lentz

OR

Karen Ann L. Carlson  
Loan Examiner

/s/ Karen Ann L. Carlson

The officers designated above are authorized to open an account or accounts with one or more firms or banks for the purpose of engaging in loan and mortgage transactions to purchase, sell, convey, assign, transfer or otherwise enter into agreements, contracts, commitments or similar arrangements, for cash or forward settlement or future contracts relating to the investment of the assets of the above funds. The officers designated above are also authorized to convey any and all real property acquired by the State of Alaska as a result of any of the above described transactions.

For all accounts authorized above, the designated officers are authorized to commit, bind and obligate the State of Alaska for conveyances of real property and loan and mortgage transactions, to execute such transactions, and in connection therewith to deliver securities and monies, to sign and deliver agreements, contracts, deeds, commitments, confirmations and other necessary, desirable or customary documents. Other parties to the transactions may rely and act upon any verbal or written orders and instructions from the designated officers in connection with such accounts and transactions.

This delegation is effective October 3, 1986 and shall continue in force until amended or revoked in writing by me or my successor.

/s/ Milton B. Barker  
Milton B. Barker  
Acting Commissioner of Revenue  
October 3, 1986

## APPENDIX M

### REAL ESTATE MORTGAGES REQUIREMENT & POLICIES

#### GENERAL INFORMATION

- \*\* Approved Seller/Serviceers cannot submit new loans when their 60 day delinquency ratio reaches more than 1/2 of 1% of the portfolio.
- \*\* No refinancings or interest rate reductions of an existing investment by a fund are allowed, except for bankruptcies, sale of properties acquired through foreclosure to a new borrower, or interest rate buydowns.
- \*\* Discounts for early payoff are not allowed.

#### COMMERCIAL LOANS

1. In addition to regular commercial real estate loans, anything non-owner occupied and of five or more units, whether owner-occupied or not, is considered a commercial loan.
2. Maximum loan-to-value ratio is 75 percent.
3. Maximum term is 25 years.
4. Loans must be secured by real estate improvements.
5. All loans must have private mortgage insurance down through 50 percent LTV or a minimum bank participation of 25 percent. An original participation certificate is required for each participation loan.
6. Commitments will be for six months with allowance for an additional six months.
7. Commitment fee of 1 percent (for six months) must be submitted with request for approval. Additional commitment of 1/6 of 1 percent for each month extension for a maximum of 2 percent for a total commitment period of one year.
8. No take-out refinances will be purchased except in the case of construction loans.
9. Minimum debt service coverage of 1.25 percent.

10. Banks must certify there is at least 75 percent occupancy prior to our funding.
11. All loans will be purchased at par.
12. After approval, final loan packages must be received by the 10th with disbursement made near the 25th of each month. The purchase date must be verified each month before preparing the delivery schedule.
13. Service charge will be  $\frac{3}{8}$  of 1 percent on loans under \$100,000;  $\frac{1}{4}$  of 1 percent on loans \$100,000 to \$299,000; and  $\frac{1}{8}$  of 1 percent on loans \$300,000 to a maximum of \$1,000,000.
14. All loans purchased will be serviced by seller from one office.
15. Participation in any one loan is a maximum of \$1,000,000.
16. Condo project take-out (AHFC approval):
 

1 of 3 or 4 units	4 of 9 through 12 units
2 of 5 or 6 units	5 of 13 through 20 units
3 of 7 or 8 units	maximum 10 units in any one project
17. Audited financial statements and tax returns as follows:
  - a. Total loan of \$500,000 to \$1,500,000 - at least one year financial statements and two years tax returns.
  - b. Total loan of \$1,500,000 or more - three years of financial statements and tax returns.

The audited financial statements requirement applies to companies only. The opinion must be unqualified unless it is the first audit or for some other reason no opinion has been rendered on the prior year. In this case the State will accept a qualified opinion. Tax returns will be required in the case of individuals in accordance with the above schedule. If the personal assets of individual owners have been pledged to secure a company loan, the State will further require tax returns of the owners covering the prior three calendar years for both categories above. In special cases, the State will consider a loan without audited financial statements provided the owners are pledging all of their personal assets to secure the loan and that the required tax returns are supplied. Records that reflect the life of the company if less than two years will be considered.

18. The State will not issue or repurchase:
  - a. Standby Commitments
  - b. Development Loans
  - c. Construction Loans

## DELINQUENCIES AND FORECLOSURES

### DELINQUENCIES

Each Seller/Servicer is required to take progressive actions against borrowers that are delinquent one or more payments and provide to the State a monthly written delinquency report. The actions and reports thereon are broken down into the following three categories:

- a. 30 day (1 payment) - These loans are reported to the State. The Seller/Servicer automatically issues late notices to the borrowers on the 16th day and demand notices on the 30th day. On the 45th day they send a notice of intent to foreclose.
- b. 60 day (2 payments) - Details of collection efforts are sent to the State. The Seller/Servicer issues to the borrower a second demand notice. When the loan reaches this level the Seller/Servicer contacts the borrower and if financially possible, a modification of the loan terms is considered and, if not, a "Request for Legal Action" form is sent to the State with the Seller/Servicer's recommendations on foreclosure. If applicable, an Assignment of Rents is put into effect at this time.
- c. 90 days (3 payments) - At this level the Seller/Servicer provides detailed reports and other correspondence. Loans are either on a Seller/Servicer or State approved workout, have a modification in process, have filed bankruptcy, or have a legal action pending. Each report details the activity that the Seller/Servicer is pursuing and if the loan is on an approved workout, the status of the payments on the workout.
- d. over 90 days (4 or more payments) - These loans have had some type of action finalized. Foreclosure has been initiated, bankruptcy has delayed collection, or a modification is in the final stages of approval. The Seller/Servicer has to follow very strict collection policies set down under the Federal Truth

in Lending Laws and the Fair Debt Collection Practices Act (P.L. 95-109) and their guidelines.

Each month Treasury investment staff consult with Seller/ Servicer personnel on resolution of delinquencies.

### BANKRUPTCIES

In the collection process the borrowers often file for protection under the United State bankruptcy laws and this stops all direct contact with the borrower. The Seller/Servicer then hires an attorney and proceeds under very rigid guidelines in the continuation of the collection process through the bankruptcy court. The State must evaluate the value of the collateral versus the debt and, when applicable, file for a relief from stay. This process is very time consuming and costly as the bankruptcy court requires a formal appraisal to verify the value in order to consider a relief from stay. The bankruptcy court must evaluate the State's claim to the asset as well as other creditors', secured or otherwise, and determine the best course of action for all parties concerned.

### FORECLOSURES

This process may take one of the following three forms:

- a. Deed in Lieu: The borrower offers their property back to the Seller/Servicer willingly without the time delays or the cost of a legal foreclosure. This process is only considered if the borrowers can give a title clear of any other obligations and the value of the collateral plus insurance is at least sufficient to cover the debt. The private mortgage insurance company must concur with this action, and the amount of the claim settlement is considered when evaluating possible loss in this transaction.
- b. Non-Judicial Foreclosure: This is also referred to as a summary foreclosure and allows the State to foreclose on the collateral. This eliminates all other liens following the State's first deed of trust position. This process takes a minimum of 120 days from the Notice of Intent to Foreclose and includes filing for foreclosure and the actual sale. This process is considered when the value of the collateral is at least sufficient to cover the debt but the title is encumbered. Private mortgage insurance on the loan is also taken into consideration and may cover any possible loss to the State.
- c. Judicial Foreclosure: This process allows the State to foreclose on the collateral and on any other

current or future assets that the borrower may have. This process takes one year to foreclose and then has a one year right of redemption for the borrower. A deficiency judgement is issued for any possible loss and filed against the other remaining assets of the borrower. This judgement is valid for 10 years. The costs to do this type of foreclosure are very high, and it is only considered when the loss level is extreme and the chance of recovery on the deficiency judgement exists. Again, private mortgage insurance will in some cases offset some of the losses, but they do not have to pay on the claim until given clear title which does not occur until the end of the second year.

Each loan is reviewed and analyzed for the proper procedure from the first 60 day notice through the delinquency and foreclosure process.

#### MODIFICATIONS

Each loan that is presented for modification to receive some type of temporary relief will be reviewed on a case by case basis. Each loan presented to the State for modification must have the following information and it is evaluated on the merits of that particular loan:

Two years tax returns on the individuals and the corporate entity, if applicable

Financial statements on all participants

Cashflow analysis for the past year on the subject property

Cashflow projection for at least the next six months to one year

Written analysis from the borrower explaining in detail their financial problems and their request for modification

A letter from the Seller/Service recommending a modification whether it conforms with the borrower's request or not.

These packages are thoroughly analyzed and, if feasible, a modification may be allowed. If the borrowers can subsidize the loan payment from other sources of income, the State will require this. Not every request is approved. Some are rejected and the borrower told to resume regular payments, whereas others are changed to meet a minimum level of modification that the State will allow.

Some modifications call for a permanent rate reduction and if the borrower or the individuals assuming the loan can afford the process, the State will allow the interest rate to be bought down under the following guidelines.

#### BUYDOWN POLICY

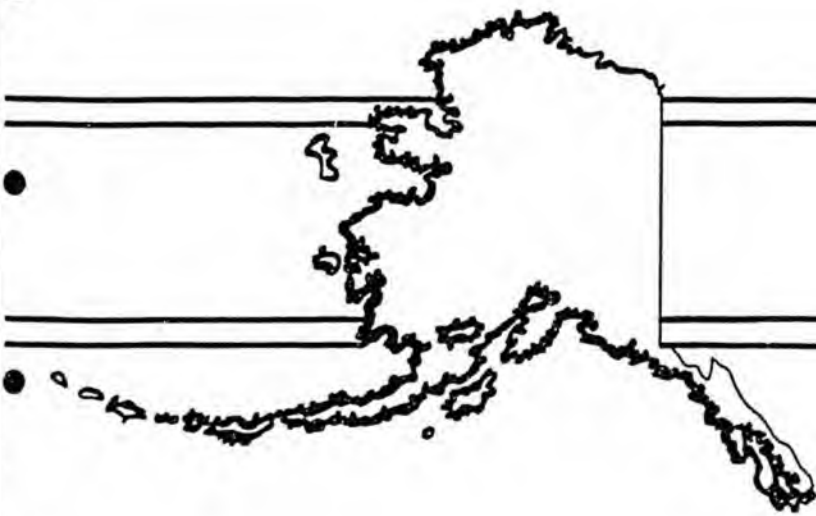
The interest rate on loans can be bought down to the current interest rate or a maximum of two points if the rate is to be bought down below the current market rate for the fund, whichever affords the greatest reduction to the borrower.

1. Cost of buydown to the borrower or assumptor is a percent of the outstanding principal balance per point bought down depending on the age of the loan as follows:
  - a. 4% per point through the first 5 years of the mortgage
  - b. 3.5% per point 6 years through 8 years of the mortgage
  - c. 3% per point 9 years through 11 years of the mortgage
  - d. 2.5% per point 12 years through 14 years of the mortgage
  - e. 2% per point 15 years through 17 years of the mortgage
  - f. 1.5% per point 18 years through 20 years of the mortgage
  - g. 1% per point 21 years to maturity of the mortgage
2. Depending upon the age of the mortgage, equity position, and current market opinion/appraisal, the buydown expenses may be capitalized at the request of the investor under the following conditions:
  - a. no other liens will be in place at the time of capitalization or those lien positions will be subordinate to the modification;
  - b. whenever feasible, the capitalized amount will not take the balance to more than the original loan amount;

- c. whenever feasible, the new balance will be reamortized so that the maturity on the loan will remain the same but in no case more than 25 years for commercial and 30 years for residential;
- d. if reamortization is not economically feasible, a balloon payment will be required at maturity for the remaining unpaid balance.

All of the above processes and procedures are the responsibilities of the Seller/Service and they are addressed in the Sales and Servicing Agreement and Sales and Servicing Agreement Addendum which is signed by each of the Seller/Service that do business with the State.

It is the discretionary responsibility of the investment staff that manages the mortgage loan portfolios to implement these policies. The Sales and Servicing Agreements follow industry standards and specifically address the Alaska Statutes. Updates to the contracts may take place as the industry changes.



PERS AND TRS FINANCIAL PROJECTIONS

FEBRUARY 29, 1988

WILLIAM M.  
**MERCER-Meidinger-Hansen**  
INCORPORATED

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WILLIAM M.  
**MERCER-Meidinger-Hansen**  
INCORPORATED

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February 29, 1988

Mr. James R. Wilson  
Statement Investment Officer  
State of Alaska  
Department of Revenue  
Treasury Division  
P.O. Box SB  
Juneau, AK 99811

Re: PERS and TRS Financial Projections

Dear Jim:

Enclosed you will find projections of financial results for both PERS and TRS for the next 15 years. As with any long-term financial projections, care should be exercised in using these results. Their greatest value lies in determining the sensitivity of contribution rates and funding ratios due to different investment performance and salary increases.

TRS

Table 1 for TRS shows projections based upon the current actuarial assumptions. These projections assume that there will be no actuarial gains or losses in future years. Thus, the funding ratio remains virtually unchanged. Note the decrease in member contribution rate as the number with supplemental contribution decreases.

Table 2 for TRS assumes the overall investment performance of the fund each year will be 10% . . . 1% greater than our 9% actuarial assumption. Greater-than-anticipated investment performance will result in an actuarial gain. These gains will lead to an increasing funding ratio and decreasing employer contribution rate.

Table 3 for TRS assumes actuarial gains from salary increases which are 1% less than our actuarial assumption. A one percent difference in salary increases is not as important as a one percent difference in investment return. Table 4 for TRS assumes both actuarial gains from both investment return and salary increases.

PERS

Unlike TRS, PERS has a small unfunded liability, with a funding ratio of 98.5%. Based upon the current actuarial assumptions, this small unfunded liability will gradually get amortized and the funding ratio will stay very close to 100%, assuming that there are no actuarial gains or losses.

Mr. James R. Wilson  
February 29, 1988  
Page Two

Table 2 for PERS shows projections assuming an extra 1% investment return each year. The funding ratio for PERS increases 11.2% (from 98.5% to 109.7%) after 15 years.

Tables 3 and 4 for PERS project similar results to the TRS tables. Please note that the financial projections for PERS are less "responsive" to this decrease in projected salary increases than for TRS. This is primarily because benefits to retirees, under the automatic PRPA, will continue to be provided even though benefits to new retirees will be relatively smaller because of the lower salary increase assumption.

Summary

Actuarial gains, primarily from greater-than-anticipated investment performance, as well as the prudent and disciplined funding procedures adopted by both TRS and PERS Boards, have contributed to the excellent funding progress of both plans. Both PERS and TRS are virtually 100% funded. In the ensuing years, employer contribution rates will continue to decrease if the system continues to realize actuarial gains. The two most important sources of actuarial gains are investment performance and salary increases. Actuarial gains and/or losses from other sources are relatively minor when compared to the importance of these two assumptions.

Sincerely,

*Robert F. Richardson*

Robert F. Richardson, ASA  
Principal

RFR:js

Enclosures

State of Alaska PERS- TABLE 1  
Financial Projections ('000 omitted)

Year	Investment Return 9.00% (nominal)			Salary Increases 6.04% (6.5/5.5 assumed)							Ending Asset Valuation
	--Valuation Amounts on July 1--			-----Flow Amounts During Flowing 12 Months-----							
	Assets	Accrued Liability	Surplus* (Deficit)	Total Salaries	Employer Contris	Employee Contris	Total Benefit Contris	Net Investment Contris	Earnings		
1987	1,898,253	1,926,488	(28,235)	891,300	88,927	60,876	149,802	87,347	62,455	181,341	2,142,049
1988	2,142,049	2,164,620	(22,570)	945,135	92,559	64,553	157,112	95,459	61,654	204,234	2,407,937
1989	2,407,937	2,425,131	(17,194)	1,002,221	96,560	68,452	165,012	104,231	60,781	229,202	2,697,920
1990	2,697,920	2,709,914	(11,994)	1,062,755	100,921	72,586	173,507	113,715	59,793	256,430	3,014,142
1991	3,014,142	3,021,014	(6,871)	1,126,945	105,638	76,970	182,608	123,764	58,644	286,119	3,358,905
1992	3,358,905	3,360,639	(1,733)	1,195,013	110,708	81,619	192,328	135,036	57,291	318,483	3,734,680
1993	3,734,680	3,731,175	3,505	1,267,191	116,634	86,549	203,184	146,994	56,189	353,775	4,144,645
1994	4,144,645	4,135,199	9,446	1,343,730	123,144	91,777	214,921	159,904	55,017	392,280	4,591,941
1995	4,591,941	4,575,492	16,449	1,424,891	129,981	97,320	227,301	173,837	53,465	434,278	5,079,684
1996	5,079,684	5,055,060	24,624	1,510,934	137,161	103,198	240,360	188,869	51,490	480,061	5,611,235
1997	5,611,235	5,577,145	34,089	1,602,216	144,701	109,431	254,132	205,084	49,048	529,944	6,190,227
1998	6,190,227	6,145,251	44,977	1,698,990	152,616	116,041	268,657	222,568	46,089	584,265	6,820,582
1999	6,820,582	6,763,155	57,427	1,801,609	160,925	123,050	283,975	241,416	42,559	643,391	7,506,532
2000	7,506,532	7,434,938	71,593	1,910,426	169,646	130,482	300,128	261,728	38,399	707,717	8,252,649
2001	8,252,649	8,165,004	87,644	2,025,816	178,797	138,363	317,160	283,614	33,546	777,671	9,063,866
2002	9,063,866	8,958,105	105,761	2,148,175	188,399	146,720	335,119	307,189	27,930	853,713	9,945,510

\* Surpluses reduce employer contributions over 5 years  
\* Deficits increase employer contributions over 25 years

PERCENTAGE RATIO RELATIONSHIPS OF ABOVE DATA

Year	Funding Ratio	-----As % of Salaries-----				---As % of Assets---	
		Employer Contris	Employee Contris	Total Benefit Contris	Net Investment Contris	Earnings	
1987	98.5	9.98%	6.83%	16.81%	9.80%	3.10%	9.00%
1988	99.0	9.79%	6.83%	16.62%	10.10%	2.72%	9.00%
1989	99.3	9.63%	6.83%	16.46%	10.40%	2.39%	9.00%
1990	99.6	9.50%	6.83%	16.33%	10.70%	2.10%	9.00%
1991	99.8	9.37%	6.83%	16.20%	11.00%	1.84%	9.00%
1992	99.9	9.26%	6.83%	16.09%	11.30%	1.62%	9.00%
1993	100.1	9.20%	6.83%	16.03%	11.60%	1.43%	9.00%
1994	100.2	9.16%	6.83%	15.99%	11.90%	1.26%	9.00%
1995	100.4	9.12%	6.83%	15.95%	12.20%	1.11%	9.00%
1996	100.5	9.08%	6.83%	15.91%	12.50%	0.97%	9.00%
1997	100.6	9.03%	6.83%	15.86%	12.80%	0.83%	9.00%
1998	100.7	8.98%	6.83%	15.81%	13.10%	0.71%	9.00%
1999	100.8	8.93%	6.83%	15.76%	13.40%	0.60%	9.00%
2000	101.0	8.88%	6.83%	15.71%	13.70%	0.49%	9.00%
2001	101.1	8.83%	6.83%	15.66%	14.00%	0.39%	9.00%

State of Alaska PERS- TABLE 2  
Financial Projections ('000 omitted)

Year	Investment Return 10.00% (nominal)			Salary Increases 6.04% (6.5/5.5 assumed)					Ending Asset Valuation		
	--Valuation Amounts on July 1--			-----Flow Amounts During Following 12 Months-----							
	Assets	Accrued Liability	Surplus* (Deficit)	Total Salaries	Employer Contribs	Employee Contribs	Total Benefit Payments	Net Contribs		Investment Earnings	
1987	1,898,253	1,926,488	(28,235)	891,300	88,927	60,876	149,802	87,347	62,455	202,439	2,163,147
1988	2,163,147	2,164,620	(1,472)	945,135	87,583	64,553	152,136	95,459	56,677	229,964	2,449,709
1989	2,449,789	2,425,131	24,658	1,002,221	90,202	68,452	158,654	104,231	54,423	259,949	2,764,161
1990	2,764,161	2,709,914	54,247	1,062,755	93,026	72,586	165,612	113,715	51,897	292,832	3,108,689
1991	3,108,887	3,021,014	87,876	1,126,945	95,810	76,970	172,780	123,964	48,816	328,874	3,486,580
1992	3,486,580	3,360,639	125,941	1,195,013	98,537	81,619	180,157	135,036	45,120	368,347	3,900,047
1993	3,900,047	3,731,175	168,872	1,267,191	101,190	86,549	187,739	146,994	40,745	411,542	4,352,334
1994	4,352,334	4,135,199	217,135	1,343,730	103,747	91,777	195,523	159,904	35,619	458,776	4,846,729
1995	4,846,729	4,575,492	271,237	1,424,891	106,185	97,320	203,505	173,837	29,668	510,390	5,386,787
1996	5,386,787	5,055,060	331,727	1,510,954	108,479	103,198	211,677	188,869	22,808	566,753	5,976,348
1997	5,976,348	5,577,146	399,202	1,602,216	110,600	109,431	220,032	205,084	14,948	628,264	6,619,560
1998	6,619,560	6,145,251	474,309	1,698,990	112,518	116,041	228,559	222,568	5,991	695,353	7,320,904
1999	7,320,904	6,763,155	557,749	1,801,609	114,196	123,050	237,246	241,416	(4,169)	768,486	8,085,221
2000	8,085,221	7,434,938	650,283	1,910,426	115,598	130,482	246,080	261,728	(15,648)	848,166	8,917,739
2001	8,917,739	8,165,004	752,734	2,025,816	116,680	138,363	255,043	283,614	(28,571)	934,934	9,824,102
2002	9,824,102	8,958,105	865,997	2,148,175	117,395	146,720	264,116	307,189	(43,073)	1,029,377	10,810,405

\* Surpluses reduce employer contributions over 5 years  
\* Deficits increase employer contributions over 25 years

PERCENTAGE RATIO RELATIONSHIPS OF ABOVE DATA

Year	Funding Ratio	-----As % of Salaries-----				---As % of Assets---	
		Employer Contribs	Employee Contribs	Total Contribs	Benefit Payments	Net Contribs	Investment Earnings
1987	98.5	9.98%	6.83%	16.81%	9.80%	3.09%	10.00%
1988	99.9	9.27%	6.83%	16.10%	10.10%	2.46%	10.00%
1989	101.0	9.00%	6.83%	15.83%	10.40%	2.09%	10.00%
1990	102.0	8.75%	6.83%	15.58%	10.70%	1.77%	10.00%
1991	102.9	8.50%	6.83%	15.33%	11.00%	1.48%	10.00%
1992	103.7	8.25%	6.83%	15.08%	11.30%	1.22%	10.00%
1993	104.5	7.99%	6.83%	14.82%	11.60%	0.99%	10.00%
1994	105.3	7.72%	6.83%	14.55%	11.90%	0.78%	10.00%
1995	105.9	7.45%	6.83%	14.28%	12.20%	0.58%	10.00%
1996	106.6	7.18%	6.83%	14.01%	12.50%	0.40%	10.00%
1997	107.2	6.90%	6.83%	13.73%	12.80%	0.24%	10.00%
1998	107.7	6.62%	6.83%	13.45%	13.10%	0.09%	10.00%
1999	108.2	6.34%	6.83%	13.17%	13.40%	-0.05%	10.00%
2000	108.7	6.05%	6.83%	12.88%	13.70%	-0.18%	10.00%
2001	109.2	5.76%	6.83%	12.59%	14.00%	-0.31%	10.00%

State of Alaska PERS- TABLE 3  
Financial Projections ('000 omitted)

Year	Investment Return 9.00% (nominal)			Salary Increases 5.04% (5.5/4.5 assumed)					Ending Asset		
	--Valuation Amounts on July 1--			-----Flow Amounts During Following 12 Months-----							Valuation
	Assets	Accrued Liability	Surplus* (Deficit)	Total Salaries	Employer Contribs	Employee Contribs	Total Benefit Contribs	Net Investment Contribs	Earnings		
1987	1,898,253	1,926,488	(28,235)	891,300	88,927	60,876	149,802	87,347	62,455	181,341	2,142,049
1988	2,142,049	2,152,141	(10,092)	936,222	88,794	63,944	152,738	94,558	58,179	204,078	2,404,306
1989	2,404,306	2,397,803	6,503	983,407	90,161	67,167	157,328	102,274	55,053	228,602	2,687,962
1990	2,687,962	2,665,110	22,852	1,032,971	93,209	70,552	163,761	110,528	53,233	255,198	2,996,393
1991	2,996,393	2,955,832	40,561	1,085,033	96,360	74,108	170,468	119,354	51,114	284,111	3,331,619
1992	3,331,619	3,271,882	59,737	1,139,718	99,617	77,843	177,459	128,708	48,671	315,529	3,695,819
1993	3,695,819	3,615,323	80,495	1,197,160	102,980	81,766	184,746	138,871	45,875	349,656	4,091,350
1994	4,091,350	3,988,390	102,960	1,257,497	106,451	85,887	192,338	149,642	42,696	386,713	4,520,759
1995	4,520,759	4,393,494	127,265	1,320,875	110,031	90,216	200,246	161,147	39,100	426,937	4,986,795
1996	4,986,795	4,833,243	153,553	1,387,447	113,720	94,763	208,483	173,431	35,052	470,585	5,492,433
1997	5,492,433	5,310,453	181,980	1,457,374	117,519	99,539	217,058	186,544	30,514	517,936	6,040,833
1998	6,040,833	5,828,171	212,712	1,530,826	121,429	104,555	225,934	200,538	25,446	569,290	6,635,619
1999	6,635,619	6,389,690	245,929	1,607,979	125,448	109,825	235,272	215,469	19,803	624,971	7,280,393
2000	7,280,393	6,998,568	281,825	1,689,021	129,575	115,360	244,935	231,396	13,539	685,330	7,979,263
2001	7,979,263	7,658,654	320,609	1,774,148	133,810	121,174	254,984	248,381	6,604	750,747	8,736,613
2002	8,736,613	8,374,109	362,504	1,863,565	138,150	127,282	265,432	266,490	(1,058)	821,631	9,557,166

\* Surpluses reduce employer contributions over 5 years  
\* Deficits increase employer contributions over 25 years

PERCENTAGE RATIO RELATIONSHIPS OF ABOVE DATA

Year	Funding Ratio	-----As % of Salaries-----				---As % of Assets---	
		Employer Contribs	Employee Contribs	Total Benefit Contribs	Net Investment Contribs	Earnings	
1987	98.5	9.98%	6.83%	16.81%	9.80%	3.10%	9.00%
1988	99.5	9.48%	6.83%	16.31%	10.10%	2.57%	9.00%
1989	100.3	9.17%	6.83%	16.00%	10.40%	2.17%	9.00%
1990	100.9	9.02%	6.83%	15.85%	10.70%	1.88%	9.00%
1991	101.4	8.88%	6.83%	15.71%	11.00%	1.62%	9.00%
1992	101.8	8.74%	6.83%	15.57%	11.30%	1.39%	9.00%
1993	102.2	8.60%	6.83%	15.43%	11.60%	1.18%	9.00%
1994	102.6	8.47%	6.83%	15.30%	11.90%	0.99%	9.00%
1995	102.9	8.33%	6.83%	15.16%	12.20%	0.82%	9.00%
1996	103.2	8.20%	6.83%	15.03%	12.50%	0.67%	9.00%
1997	103.4	8.08%	6.83%	14.89%	12.80%	0.53%	9.00%
1998	103.6	7.93%	6.83%	14.76%	13.10%	0.40%	9.00%
1999	103.8	7.80%	6.83%	14.63%	13.40%	0.29%	9.00%
2000	104.0	7.67%	6.83%	14.50%	13.70%	0.18%	9.00%
2001	104.2	7.54%	6.83%	14.37%	14.00%	0.08%	9.00%

State of Alaska PERS- TABLE 4  
Financial Projections ('000 omitted)

Year	Investment Return 10.00% (nominal)			Salary Increases 5.04% (5.5/4.5 assumed)							Ending Asset Valuation
	--Valuation Amounts on July 1--			-----Flow Amounts During Following 12 Months-----							
	Assets	Accrued Liability	Surplus* (Deficit)	Total Salaries	Employer Contribs	Employee Contribs	Total Benefit Payments	Net Contribs	Investment Earnings		
1987	1,898,253	1,926,488	(28,235)	891,300	88,927	60,876	149,802	87,347	62,455	202,439	2,163,147
1988	2,163,147	2,152,141	11,006	936,222	85,385	63,944	149,329	94,558	54,771	229,869	2,447,787
1989	2,447,787	2,397,803	49,984	983,407	86,100	67,167	153,267	102,274	50,992	259,567	2,758,347
1990	2,758,347	2,665,110	93,237	1,032,971	86,635	70,552	157,187	110,528	46,659	291,959	3,096,966
1991	3,096,966	2,955,832	141,133	1,085,033	86,967	74,108	161,075	119,354	41,721	327,267	3,465,954
1992	3,465,954	3,271,882	194,073	1,139,718	87,070	77,843	164,913	128,788	36,125	365,731	3,867,810
1993	3,867,810	3,615,323	252,487	1,197,160	86,916	81,766	168,682	138,871	29,812	407,611	4,305,233
1994	4,305,233	3,988,390	316,843	1,257,497	86,475	85,887	172,362	149,642	22,720	453,185	4,781,138
1995	4,781,138	4,393,494	387,644	1,320,875	85,712	90,216	175,928	161,147	14,781	502,759	5,298,678
1996	5,298,678	4,833,243	465,435	1,387,447	84,591	94,763	179,354	173,431	5,923	556,657	5,861,258
1997	5,861,258	5,310,453	550,805	1,457,374	83,072	99,539	182,611	186,544	(3,933)	619,235	6,472,560
1998	6,472,560	5,828,171	644,389	1,530,826	81,111	104,555	185,667	200,538	(14,871)	678,875	7,136,564
1999	7,136,564	6,389,690	746,874	1,607,979	78,661	109,825	188,486	215,469	(26,983)	747,990	7,857,571
2000	7,857,571	6,998,568	859,003	1,689,021	75,669	115,360	191,029	231,396	(40,367)	823,027	8,640,230
2001	8,640,230	7,658,654	981,576	1,774,148	72,078	121,174	193,252	248,381	(55,129)	904,468	9,489,569
2002	9,489,569	8,374,109	1,115,460	1,863,565	67,827	127,282	195,108	266,490	(71,382)	992,836	10,411,023

\* Surpluses reduce employer contributions over 5 years  
\* Deficits increase employer contributions over 25 years

PERCENTAGE RATIO RELATIONSHIPS OF ABOVE DATA

Year	Funding Ratio	-----As % of Salaries-----				---As % of Assets---	
		Employer Contribs	Employee Contribs	Total Benefit Payments	Net Contribs	Investment Earnings	
1987	98.5	9.98%	6.83%	16.81%	9.80%	3.09%	10.00%
1988	100.5	9.12%	6.83%	15.95%	10.10%	2.38%	10.00%
1989	102.1	8.76%	6.83%	15.59%	10.40%	1.96%	10.00%
1990	103.5	8.39%	6.83%	15.22%	10.70%	1.60%	10.00%
1991	104.8	8.02%	6.83%	14.85%	11.00%	1.27%	10.00%
1992	105.9	7.64%	6.83%	14.47%	11.30%	0.99%	10.00%
1993	107.0	7.26%	6.83%	14.09%	11.60%	0.73%	10.00%
1994	107.9	6.88%	6.83%	13.71%	11.90%	0.50%	10.00%
1995	108.8	6.49%	6.83%	13.32%	12.20%	0.29%	10.00%
1996	109.6	6.10%	6.83%	12.93%	12.50%	0.11%	10.00%
1997	110.4	5.70%	6.83%	12.53%	12.80%	-0.06%	10.00%
1998	111.1	5.30%	6.83%	12.13%	13.10%	-0.22%	10.00%
1999	111.7	4.89%	6.83%	11.72%	13.40%	-0.36%	10.00%
2000	112.3	4.48%	6.83%	11.31%	13.70%	-0.49%	10.00%
2001	112.8	4.06%	6.83%	10.89%	14.00%	-0.61%	10.00%

State of Alaska TRS - TABLE 1  
Financial Projections ('000 omitted)

Year	Investment Return 9.00% (nominal)			Salary Increases 6.04% (6.5/5.5 assumed)				Ending Asset Valuation			
	--Valuation Total Assets	Amounts on Accrued Liability	July 1-- Surplus* (Deficit)	Total Salaries	Flow Employer Contribs	Amounts During Following 12 Months-- Employee Contribs	Total Benefit Payments		Net Investment Earnings		
1987	1,225,009	1,215,568	9,441	348,606	30,981	26,250	57,231	78,672	(21,441)	114,247	1,317,816
1988	1,317,816	1,306,100	11,715	369,662	32,693	27,725	60,418	80,539	(20,121)	123,035	1,420,730
1989	1,420,730	1,406,534	14,196	391,989	34,502	29,282	63,784	117,266	(53,483)	131,213	1,498,460
1990	1,498,460	1,481,548	16,912	415,666	36,412	30,926	67,338	137,433	(70,095)	137,776	1,566,141
1991	1,566,141	1,546,390	19,751	440,772	38,442	32,661	71,103	138,119	(67,016)	144,280	1,643,405
1992	1,643,405	1,620,744	22,661	467,394	40,603	34,494	75,097	153,207	(78,110)	151,047	1,716,342
1993	1,716,342	1,690,672	25,670	495,625	42,903	36,428	79,331	147,132	(67,801)	158,371	1,806,912
1994	1,806,912	1,778,164	28,748	525,561	45,351	38,471	83,822	153,540	(69,717)	166,803	1,903,997
1995	1,903,997	1,872,043	31,955	557,305	47,953	40,628	88,581	156,968	(68,388)	175,994	2,011,603
1996	2,011,603	1,976,301	35,303	590,966	50,717	42,904	93,621	175,007	(81,386)	185,529	2,115,747
1997	2,115,747	2,076,927	38,820	626,660	53,651	45,308	98,959	176,888	(77,929)	195,479	2,233,297
1998	2,233,297	2,190,819	42,478	664,510	56,769	47,845	104,614	187,376	(82,762)	206,317	2,356,852
1999	2,356,852	2,310,538	46,313	704,647	60,079	50,523	110,602	194,637	(84,034)	217,880	2,490,698
2000	2,490,698	2,440,363	50,335	747,207	63,594	53,351	116,944	191,111	(74,167)	230,913	2,647,444
2001	2,647,444	2,592,878	54,566	792,339	67,324	56,335	123,659	184,536	(60,877)	246,253	2,832,019
2002	2,832,819	2,773,740	59,079	840,196	71,276	59,486	130,762	193,912	(63,150)	261,585	3,033,254

\* Surpluses reduce employer contributions over 5 years  
\* Deficits increase employer contributions over 25 years

PERCENTAGE RATIO RELATIONSHIPS OF ABOVE DATA

Year	Funding Ratio	--As % of Salaries--			--As % of Assets--		
		Employer Contribs	Employee Contribs	Total Contribs	Benefit Payments	Net Investment Earnings	
1987	100.8	8.89%	7.53%	16.42%	22.57%	-1.69%	9.00%
1988	100.9	8.84%	7.50%	16.34%	21.79%	-1.47%	9.00%
1989	101.0	8.80%	7.47%	16.27%	29.92%	-3.67%	9.00%
1990	101.1	8.76%	7.44%	16.20%	33.06%	-4.58%	9.00%
1991	101.3	8.72%	7.41%	16.13%	31.34%	-4.18%	9.00%
1992	101.4	8.69%	7.38%	16.07%	32.78%	-4.65%	9.00%
1993	101.5	8.66%	7.35%	16.01%	29.69%	-3.85%	9.00%
1994	101.6	8.63%	7.32%	15.95%	29.21%	-3.76%	9.00%
1995	101.7	8.60%	7.29%	15.89%	28.17%	-3.50%	9.00%
1996	101.8	8.58%	7.26%	15.84%	29.61%	-3.95%	9.00%
1997	101.9	8.56%	7.23%	15.79%	28.23%	-3.59%	9.00%
1998	101.9	8.54%	7.20%	15.74%	28.20%	-3.61%	9.00%
1999	102.0	8.53%	7.17%	15.70%	27.62%	-3.47%	9.00%
2000	102.1	8.51%	7.14%	15.65%	25.58%	-2.89%	9.00%
2001	102.1	8.50%	7.11%	15.61%	23.29%	-2.22%	9.00%
2002	102.1	8.48%	7.08%	15.56%	23.08%	-2.16%	9.00%

State of Alaska IRS - TABLE 2  
Financial Projections ('000 omitted)

Year	Investment Return 10.00% (nominal)			Salary Increases 6.04% (6.5/5.5 assumed)							
	--Valuation Total Assets	Amounts on Accrued Liability	July 1-- Surplus* (Deficit)	Total Salaries	Employer Contribs	Employee Contribs	Total Contribs	Benefit Payments	Net Contribs	Investment Earnings	Ending Asset Valuation
1987	1,225,009	1,215,568	9,441	348,606	30,981	26,250	57,231	78,672	(21,441)	127,554	1,331,122
1988	1,331,122	1,306,100	25,022	369,662	31,450	27,725	59,175	80,539	(21,364)	138,700	1,448,458
1989	1,448,458	1,406,534	41,924	391,989	31,912	29,282	61,194	117,266	(56,072)	149,284	1,541,670
1990	1,541,670	1,481,548	60,122	415,666	32,377	30,926	63,302	137,433	(74,131)	158,169	1,625,708
1991	1,625,708	1,546,390	79,318	440,772	32,878	32,661	65,540	138,119	(72,579)	167,070	1,720,199
1992	1,720,199	1,620,744	99,455	467,394	33,431	34,494	67,925	153,207	(85,282)	176,357	1,811,274
1993	1,811,274	1,690,672	120,602	495,625	34,036	36,428	70,465	147,132	(76,667)	186,350	1,920,957
1994	1,920,957	1,778,164	142,793	525,561	34,700	38,471	73,171	153,540	(80,369)	197,682	2,038,270
1995	2,038,270	1,872,043	166,227	557,305	35,413	40,628	76,040	156,968	(80,928)	209,972	2,167,314
1996	2,167,314	1,976,301	191,013	590,966	36,174	42,904	79,078	175,007	(95,929)	222,772	2,294,157
1997	2,294,157	2,076,927	217,230	626,660	36,988	45,308	82,296	176,888	(94,592)	236,157	2,435,722
1998	2,435,722	2,190,819	244,903	664,510	37,863	47,845	85,708	187,376	(101,668)	250,667	2,584,721
1999	2,584,721	2,310,538	274,183	704,647	38,797	50,523	89,320	194,637	(105,317)	266,130	2,745,534
2000	2,745,534	2,440,363	305,171	747,207	39,793	53,351	93,143	191,111	(97,967)	283,383	2,930,950
2001	2,930,950	2,592,878	338,071	792,339	40,845	56,335	97,180	184,536	(87,356)	303,382	3,146,976
2002	3,146,976	2,773,740	373,236	840,196	41,935	59,486	101,421	193,912	(92,492)	325,808	3,380,292

\* Surpluses reduce employer contributions over 5 years  
\* Deficits increase employer contributions over 25 years

PERCENTAGE RATIO RELATIONSHIPS OF ABOVE DATA

Year	Funding Ratio	---As % of Salaries---				---As % of Assets---	
		Employer Contribs	Employee Contribs	Total Contribs	Benefit Payments	Net Contribs	Investment Earnings
1987	100.8	8.89%	7.53%	16.42%	22.57%	-1.68%	10.00%
1988	101.9	8.51%	7.50%	16.01%	21.79%	-1.54%	10.00%
1989	103.0	8.14%	7.47%	15.61%	20.92%	-3.76%	10.00%
1990	104.1	7.79%	7.44%	15.23%	33.06%	-4.69%	10.00%
1991	105.1	7.46%	7.41%	14.87%	31.34%	-4.34%	10.00%
1992	106.1	7.15%	7.38%	14.53%	32.78%	-4.84%	10.00%
1993	107.1	6.87%	7.35%	14.22%	29.69%	-4.11%	10.00%
1994	108.0	6.60%	7.32%	13.92%	29.21%	-4.07%	10.00%
1995	108.9	6.35%	7.29%	13.64%	28.17%	-3.85%	10.00%
1996	109.7	6.12%	7.26%	13.38%	29.61%	-4.31%	10.00%
1997	110.5	5.90%	7.23%	13.13%	28.23%	-4.01%	10.00%
1998	111.2	5.70%	7.20%	12.90%	28.20%	-4.06%	10.00%
1999	111.9	5.51%	7.17%	12.68%	27.62%	-3.96%	10.00%
2000	112.5	5.33%	7.14%	12.47%	25.58%	-3.46%	10.00%
2001	113.0	5.15%	7.11%	12.26%	23.29%	-2.88%	10.00%
2002	113.5	4.99%	7.08%	12.07%	23.08%	-2.84%	10.00%

State of Alaska TRS - TABLE 3  
Financial Projections ('000 omitted)

Year	Investment Return 9.00% (nominal)			Salary Increases 5.04% (5.5/4.5 assumed)				Ending Asset Valuation			
	--Valuation Total Assets	Amounts on July 1-- Accrued Liability	Surplus* (Deficit)	Total Salaries	Employer Contribs	Employee Contribs	Total Benefit Payments		Net Investment Earnings		
1987	1,225,009	1,215,568	9,441	348,606	30,981	26,250	57,231	78,672	(21,441)	114,247	1,317,816
1988	1,317,816	1,301,220	16,596	366,176	31,910	27,463	59,382	80,497	(21,115)	122,990	1,419,691
1989	1,419,691	1,395,499	24,192	384,631	32,896	28,732	61,628	117,178	(55,550)	131,022	1,495,163
1990	1,495,163	1,462,895	32,267	404,016	33,913	30,059	63,972	137,293	(73,321)	137,321	1,559,162
1991	1,559,162	1,518,443	40,719	424,379	34,985	31,446	66,432	137,922	(71,490)	143,422	1,631,094
1992	1,631,094	1,581,589	49,505	445,768	36,120	32,898	69,017	152,947	(83,930)	149,628	1,696,791
1993	1,696,791	1,638,129	58,662	468,234	37,318	34,415	71,733	146,803	(75,070)	156,205	1,777,926
1994	1,777,926	1,709,757	68,169	491,833	38,587	36,002	74,589	153,135	(78,546)	163,679	1,863,059
1995	1,863,059	1,784,965	78,094	516,622	39,925	37,662	77,587	156,480	(78,893)	171,671	1,953,837
1996	1,953,837	1,867,378	88,459	542,659	41,337	39,397	80,734	174,427	(93,693)	179,730	2,041,875
1997	2,041,875	1,942,574	99,300	570,009	42,825	41,212	84,036	176,208	(92,172)	187,891	2,137,594
1998	2,137,594	2,026,997	110,596	598,738	44,395	43,109	87,504	186,587	(94,082)	196,562	2,235,093
1999	2,235,093	2,112,700	122,393	628,914	46,052	45,093	91,145	193,728	(102,583)	205,594	2,338,105
2000	2,338,105	2,203,401	134,704	660,611	47,799	47,168	94,967	190,072	(95,105)	215,619	2,458,619
2001	2,458,619	2,311,060	147,558	693,906	49,642	49,337	98,978	183,355	(84,377)	227,436	2,601,678
2002	2,601,678	2,440,643	161,035	728,879	51,579	51,605	103,184	192,577	(89,393)	240,665	2,752,951

\* Surpluses reduce employer contributions over 5 years  
\* Deficits increase employer contributions over 25 years

PERCENTAGE RATIO RELATIONSHIPS OF ABOVE DATA

Year	Funding Ratio	--As % of Salaries--			--As % of Assets--		
		Employer Contribs	Employee Contribs	Total Contribs	Benefit Payments	Net Investment Earnings	
1987	100.8	8.89%	7.53%	16.42%	32.57%	-1.69%	9.00%
1988	101.3	8.72%	7.50%	16.22%	21.98%	-1.55%	9.00%
1989	101.7	8.55%	7.47%	16.02%	30.47%	-3.82%	9.00%
1990	102.2	8.39%	7.44%	15.83%	33.98%	-4.81%	9.00%
1991	102.7	8.24%	7.41%	15.65%	32.50%	-4.49%	9.00%
1992	103.1	8.10%	7.38%	15.48%	34.31%	-5.05%	9.00%
1993	103.6	7.97%	7.35%	15.32%	31.35%	-4.33%	9.00%
1994	104.0	7.85%	7.32%	15.17%	31.14%	-4.32%	9.00%
1995	104.4	7.73%	7.29%	15.02%	30.29%	-4.14%	9.00%
1996	104.7	7.62%	7.26%	14.88%	32.14%	-4.69%	9.00%
1997	105.1	7.51%	7.23%	14.74%	30.91%	-4.42%	9.00%
1998	105.5	7.41%	7.20%	14.61%	31.16%	-4.54%	9.00%
1999	105.8	7.32%	7.17%	14.49%	30.80%	-4.49%	9.00%
2000	106.1	7.24%	7.14%	14.38%	28.77%	-3.97%	9.00%
2001	106.4	7.15%	7.11%	14.26%	26.42%	-3.34%	9.00%
2002	106.6	7.08%	7.08%	14.16%	26.42%	-3.34%	9.00%

State of Alaska TRS - TABLE 4  
Financial Projections ('000 omitted)

Year	Investment Return 10.00% (nominal)			Salary Increases 5.04% (5.5/4.5 assumed)				Ending Asset Valuation			
	--Valuation Total Assets	Amounts on Accrued Liability	July 1-- Surplus* (Deficit)	-----Flow Total Salaries	Employer Contris	Employee Contris	Amounts During Following 12 Months-- Total Contris		Benefit Payments	Net Contris	Investment Earnings
1987	1,225,009	1,215,568	9,441	348,606	30,981	26,250	57,231	78,672	(21,441)	127,554	1,531,122
1988	1,331,122	1,301,220	29,903	366,176	30,676	27,463	58,139	80,497	(22,358)	138,650	1,447,414
1989	1,447,414	1,395,499	51,915	384,631	30,307	28,732	59,039	117,178	(58,140)	149,072	1,538,346
1990	1,538,346	1,462,895	75,451	404,016	29,880	30,059	59,939	137,293	(77,354)	157,659	1,618,651
1991	1,618,651	1,518,443	100,208	424,379	29,429	31,446	60,876	137,922	(77,046)	166,106	1,707,710
1992	1,707,710	1,581,589	126,121	445,768	28,964	32,698	61,861	152,947	(91,086)	174,755	1,791,380
1993	1,791,380	1,638,129	153,250	468,234	28,484	34,415	62,899	146,803	(83,905)	183,900	1,891,375
1994	1,891,375	1,709,757	181,617	491,833	27,991	36,002	63,993	153,135	(89,142)	194,137	1,996,370
1995	1,996,370	1,784,965	211,405	516,622	27,475	37,662	65,136	156,480	(91,344)	205,052	2,110,078
1996	2,110,078	1,867,378	242,700	542,659	26,932	39,397	66,329	174,427	(108,098)	216,153	2,218,133
1997	2,218,133	1,942,574	275,559	570,009	26,363	41,212	67,574	176,208	(108,634)	227,472	2,336,972
1998	2,336,972	2,026,997	309,974	598,738	25,774	43,109	68,883	186,587	(117,704)	239,497	2,458,765
1999	2,458,765	2,112,700	346,065	628,914	25,161	45,093	70,255	193,728	(123,473)	251,997	2,587,288
2000	2,587,288	2,203,401	383,888	660,611	24,526	47,168	71,694	190,072	(118,378)	265,746	2,734,657
2001	2,734,657	2,311,060	423,596	693,906	23,860	49,337	73,197	183,355	(110,158)	281,631	2,906,130
2002	2,906,130	2,440,643	465,487	728,879	23,145	51,605	74,749	192,577	(117,827)	299,252	3,087,555

\* Surpluses reduce employer contributions over 5 years  
\* Deficits increase employer contributions over 25 years

PERCENTAGE RATIO RELATIONSHIPS OF ABOVE DATA

Year	Funding Ratio	-----As % of Salaries-----				--As % of Assets--	
		Employer Contris	Employee Contris	Total Contris	Benefit Payments	Net Contris	Investment Earnings
1987	100.8	8.09%	7.53%	16.42%	22.57%	-1.68%	10.00%
1988	102.3	8.38%	7.50%	15.88%	21.98%	-1.61%	10.00%
1989	103.7	7.88%	7.47%	15.35%	30.47%	-3.90%	10.00%
1990	105.2	7.40%	7.44%	14.84%	33.96%	-4.91%	10.00%
1991	106.6	6.93%	7.41%	14.34%	32.50%	-4.64%	10.00%
1992	108.0	6.50%	7.38%	13.88%	34.31%	-5.21%	10.00%
1993	109.4	6.08%	7.35%	13.43%	31.35%	-4.56%	10.00%
1994	110.6	5.69%	7.32%	13.01%	31.14%	-4.59%	10.00%
1995	111.8	5.32%	7.29%	12.61%	30.29%	-4.45%	10.00%
1996	113.0	4.96%	7.26%	12.22%	32.14%	-5.00%	10.00%
1997	114.2	4.62%	7.23%	11.85%	30.91%	-4.78%	10.00%
1998	115.3	4.30%	7.20%	11.50%	31.16%	-4.91%	10.00%
1999	116.4	4.00%	7.17%	11.17%	30.80%	-4.90%	10.00%
2000	117.4	3.71%	7.14%	10.85%	28.77%	-4.45%	10.00%
2001	118.3	3.44%	7.11%	10.55%	26.42%	-3.91%	10.00%
2002	119.1	3.18%	7.08%	10.26%	26.42%	-3.94%	10.00%