

HB 221

SENATE FINANCE COMMITTEE REPORT

DATE: 5/13/91

FURTHER:

DATE TURNED INTO OFFICE: 5/16/91

Finance Committee considered CS FOR HOUSE BILL NO. 221 (FINANCE) am

"An Act creating the investment loss trust fund; and providing for an effective date."

and recommended:

- replace with § CS CSHB 221 (Fin)
- or adopt _____ CS _____
- attached amendment(s)
- _____ letter of intent adopted

- same title
- new title
- technical title change (HB only)

do pass

do not pass

no recommendation

individual recommendations

further referral to _____

ATTACHES NEW FISCAL NOTE(S):

Dept/Date:

fiscal note(s) DOR 26.c 5/14/91

zero fiscal note(s) _____

appropriation-no fiscal note

APPROVES PREVIOUS:

Dept/Date:

fiscal note(s) _____

zero fiscal note(s) _____

SIGNING DO PASS:

[Signature]

[Signature]

[Signature]

[Signature]

[Signature]

[Signature]

OTHER RECOMMENDATIONS:

Co-Chairs: Signatures and Recommendations

2: [Signature] [Signature]

FISCAL NOTE

STATE OF ALASKA
1991 LEGISLATIVE SESSION

BILL NO. CSHB 221
/CSHB 51

Revision Date: May 14, 1991

Department Affected: Revenue

Title: An act creating the investment loss trust fund; and providing for an effective date."

BRU: Treasury

Component: _____

Sponsor: House Rules/Legislative Budget and Audit Comm.

Component Serial No.

Requestor: House Finance

	1	2	1
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Expenditures/Revenues: (Thousands of Dollars)

OPERATING	FY 92	FY 93	FY 94	FY 95	FY 96	FY 97
PERSONAL SERVICES	5.0	5.0	5.0	5.0	5.0	5.0
TRAVEL						
CONTRACTUAL	20.0	20.0	20.0	20.0	20.0	20.0
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	25.0	25.0	25.0	25.0	25.0	25.0

CAPITAL						
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REVENUE						
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FUNDING: (Thousands of Dollars)


GENERAL FUND						
FEDERAL FUNDS						
OTHER	25.0	25.0	25.0	25.0	25.0	25.0
TOTAL	25.0	25.0	25.0	25.0	25.0	25.0

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

Estimate of current year impact:

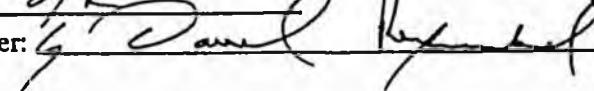
ANALYSIS: Basic personal services and contractual costs for a trust fund consisting of \$45 million dollars managed by the Treasury Division. Contractual costs would consist of external investment management, auditing and custodial services. Future costs increases are dependent on the asset growth of the trust fund from contributions and market gains.

Prepared by: Brian C. Andrews 

Phone: 465-2350

Division: Treasury 

Date: May 14, 1991

Approved by Commissioner: 

Agency: Revenue

Distribution (by preparer): Legislative Finance, Legislative Sponsor, Requestor, OMB, & Impacted Agency(ies).

SENATE CS FOR CS FOR HOUSE BILL NO. 221 (FINANCE)

IN THE LEGISLATURE OF THE STATE OF ALASKA

SEVENTEENTH LEGISLATURE - FIRST SESSION

BY THE SENATE FINANCE COMMITTEE

Offered:
Referred:

Sponsor(s): HOUSE RULES/LEGISLATIVE BUDGET AND AUDIT COMMITTEE

A BILL

FOR AN ACT ENTITLED

1 "An Act creating the investment loss trust fund; and providing for an effective date."

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

3 * Section 1. LEGISLATIVE PURPOSE. The purpose of AS 37.14.300, enacted by sec. 2 of this Act,
4 is to provide financial security to participants in the state supplemental annuity plan established under
5 AS 39.30.150 - 39.30.180 and other annuity holders who may be harmed by the possible insolvency of
6 the Executive Life Insurance Company of California.

7 * Sec. 2. AS 37.14 is amended by adding a new section to read:

8 ARTICLE 4. INVESTMENT LOSS TRUST FUND.

9 Sec. 37.14.300. INVESTMENT LOSS TRUST FUND. (a) There is established as a
10 separate fund in the state treasury the investment loss trust fund. The trust fund consists of
11 money appropriated to it by the legislature. The Department of Revenue is the custodian of the
12 trust fund and shall invest the trust fund in accordance with AS 37.10.071. Subject to
13 appropriation, the amount earned on money in the trust fund shall be retained in the trust fund.
14 The trust fund shall be held in trust for the benefit of participants in the supplemental annuity

1 plan established under AS 39.30.150 - 39.30.180 and for other purposes authorized by this
2 section, subject to the conditions set out in this section.

3 (b) The Department of Administration shall spend money from the trust fund as
4 necessary to

5 (1) hold participants in the plan and annuity holders harmless from a loss on
6 investments in guaranteed investment and annuity contracts issued by Executive Life Insurance
7 Company of California;

8 (2) pursue a right to recover amounts from persons who may have unlawfully
9 caused or contributed to the loss on investments; and

10 (3) protect the interest of participants in the plan and annuity holders during
11 proceedings to conserve or liquidate the assets of Executive Life Insurance Company of
12 California.

13 (c) If the plan or an annuity holder does not incur a loss on investments, or, if after
14 compensating the plan and annuity holders for the loss on investments, a balance remains in the
15 trust fund, the trust fund created in (a) of this section is terminated and the balance of the trust
16 fund lapses pro rata into the funds from which the appropriations to the trust fund were made.
17 The state is subrogated to a right of claim held by participants in the plan and annuity holders
18 to the extent of amounts spent from the trust fund.

19 (d) In this section,

20 (1) "annuity holder" means

21 (A) a plan participant who elects to receive an annuity contract acquired
22 by the Department of Administration and issued by Executive Life Insurance Company
23 of California; and

24 (B) members of the Unlicensed Vessel Personnel Annuity Retirement Plan
25 who receive an annuity contract acquired by the Department of Administration and issued
26 by Executive Life Insurance Company of California;

27 (2) "loss on investments" means

28 (A) the difference between the principal amount plus accrued interest
29 earned through May 3, 1991, on the guaranteed investment contracts issued by Executive
30 Life Insurance Company of California, according to the terms of the contracts, and a
31 lesser amount received by the plan upon maturity, sale, or other termination of the

1 contracts; plus

2 (B) accrued earnings on the amount described in (A) of this subsection,
3 beginning May 4, 1991, and continuing until the earlier of a participant's benefit
4 commencement date or the maturity, sale, or other termination of the contracts, at a rate
5 equal to the rate, less one percent to be used for the purposes of (b)(2) - (3) of this
6 section, earned each month on the investment loss trust fund; or

7 (C) any unpaid annuity amounts due to annuity holders under an annuity
8 contract issued by Executive Life Insurance Company of California;

9 (3) "plan" means the supplemental annuity plan established under AS 39.30.150 -
10 39.30.180;

11 (4) "trust fund" means the investment loss trust fund established under this
12 section.

13 * Sec. 3. The Department of Revenue shall notify the lieutenant governor, the revisor of statutes,
14 the commissioner of administration, and the legislative budget and audit committee when the investment
15 loss trust fund is terminated under AS 37.14.300(c), enacted by sec. 2 of this Act.

16 * Sec. 4. This Act takes effect immediately under AS 01.10.070(c).

Added by
JPC 515-92
P. 3
add notice
to LBA



7-LS0988P-
Bannister
5/15/91

SENATE CS FOR CS FOR HOUSE BILL NO. 221 (FINANCE)

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SEVENTEENTH LEGISLATURE - FIRST SESSION

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11 proceedings to conserve or liquidate the assets of Executive Life Insurance Company of
12 California.

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15 trust fund, the trust fund created in (a) of this section is terminated and the balance of the trust
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STATE OF ALASKA

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

WALTER J. HICKEL, GOVERNOR

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PHONE: (907) 452-1568
FAX: (907) 456-1317

P.O. BOX K— STATE CAPITOL
JUNEAU, ALASKA 99811-0300
PHONE: (907) 465-3600
FAX: (907) 463-5295

May 15, 1991

Honorable Pat Pourchot
Co-chairman Senate Finance Committee
Alaska State Senate
P O Box V
Juneau, Alaska 99811

Re: Analysis of CS HB 221 (Fin);
CS HB 51 (Fin) SBS investment
loss trust fund

Dear Senator Pourchot:

At the request of your aide Susan K. Barnette, we submit for your consideration the following analysis of CS HB 221 (Fin), an Act creating the investment loss trust fund. This bill and the accompanying appropriation bill (CS HB 51) is intended to provide a means for holding employees and former employees harmless from potentially failing investments made in guaranteed investment contracts issued by Executive Life Insurance Company of California (the insurer). The insurer is subject to an order issued by the superior court of the State of California appointing a conservator and directing other measures as to the operation of the company. Insurance Comm'r of Calif. v. Executive Life Insurance Company, Calif. Superior Court for Los Angeles County Case No. BS006912.

ANALYSIS

I. HB 221 - Investment loss trust fund:

A. HB 221 would establish a trust fund for the benefit of plan participants limited to the purpose of making up a loss on investments of the supplemental annuity plan (the plan).

1. The trust remains in effect until the loss on investment incurred by plan participants is satisfied. Upon satisfaction, the balance of the fund lapses into the fund from which the original appropriations were made.

2. The trust would be used to compensate for a loss incurred on four guaranteed investment contracts purchased for the plan issued by Executive Life of California. The details on the contracts are set out below:

Hon. Pat Pourchot
Re: Analysis of CS HB 221 (Fin);
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loss trust fund

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<u>Year</u>	<u>Surrender value</u>	<u>Maturity</u>	<u>Rate</u>	<u>Contrib.</u>
A) 1990	\$ 2 million	January 2, 1996	8.46%	\$ 1.3
B) 1989	\$90.3 million	July 1, 1994	9.10%	\$58.4
C) 1988	\$52.9 million	January 3, 1994	9.9%	\$30
D) 1987	\$27.1 million	January 4, 1993	8.6%	\$16.6

The contribution column set out above shows the principal contributed by participants to each contract during the applicable window period for each contract. The surrender value column shows the amount that would be paid, including principal and interests, upon maturity.

B. The phrase "loss on investments" is a defined term. It means the book value of the four guaranteed investment contracts on May 3, 1991 (approximately \$134.7 million consisting of principal plus accrued interest at the contract rate) plus interest earned by the Department of Revenue after May 3 less one percent.

1. The May 3rd date is used in the bill because it is the deadline imposed by the public employees retirement board for the final payment of full value on plan accounts. Unless this bill is enacted, for applications received after May 3, plan participants will receive their account balances less twenty-one percent. This retention (known as a "wall off") is designed to protect active plan participants from having to absorb the loss on investment if the loss is realized.

2. The amount of loss will not be known until the conservatorship is litigated through the California court system (this could take a substantial amount of time).

3. The principal of the trust fund will be invested at market rates by the Department of Revenue according to the prudent man rule applicable to investment of treasury receipts. The one percent interest reduction will finance the cost of administering the fund and legal fees incurred to recover losses either from the conservator of the insurer or third party advisers to the plan.

C. The bill would provide benefits to terminated employees who elected to receive an annuity under a group annuity purchased by the plan.

1. Approximately 300 terminated employees received annuities under a group annuity plan with Executive Life of California. Under the terms of a court order, these annuitants are receiving only seventy percent of their annuities until the status of the insurer is finally determined.

Hon. Pat Pourchot
Re: Analysis of CS HB 221 (Fin);
CS HB 51 (Fin) SBS investment
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2. Because the employees are covered under a group contract held by the plan, it is expected that the California guarantee association will question their entitlement to coverage under a guarantee fund established by California law. Under California law, claims by states are not covered by the guarantee fund.

D. The trust fund is established separate from the SBS annuity account to anticipate any problems that may arise with the Internal Revenue Service.

1. The IRS may contend that the benefit provided by the bill is additional compensation that will exceed limits imposed for governmental plans.

2. Another tax issue concerns the affect of the benefits on highly compensated participants and whether the IRS will consider the plan to discriminate in favor of those persons.

3. Under the plan document, amounts going into the annuity account cannot be returned to the state. By establishing a separate fund, it would be possible to return amounts to unrestricted status when the loss is finally liquidated.

II. HB 51 - Implementing Appropriations:

HB 221 is accompanied by appropriations made in CS HB 51 (Fin).

A. If HB 221 is enacted, \$45,000,000 plus interest would be appropriated from the general fund.

B. An additional appropriation of \$93,100,000 is made from the statutory budget reserve fund if HB 221 is enacted and would take effect on the effective date of HB 221 or July 1, 1991, whichever date is later. It is expected that the statutory budget reserve fund will have a sufficient balance to cover this appropriation through the operation of sec. 20(b) of ch. 209 SLA 1990.

C. Amounts could be expended from the budget reserve fund appropriation only if the commissioners of administration and revenue determine that the trust fund balance is insufficient to compensate beneficiaries and subject to the budgetary review process set out in the Executive Budget Act.

Hon. Pat Pourchot
Re: Analysis of CS HB 221 (Fin);
CS HB 51 (Fin) SBS investment
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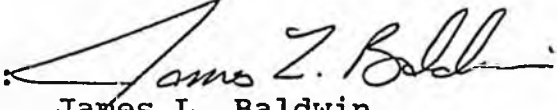
May 15, 1991
Page 4

D. The total appropriation amounts to \$138.1 million. Of that amount, \$134.7 would compensate plan participants for a loss in investment, and \$3.4 million is to cover any loss suffered by annuitants receiving payments under the group annuity policy.

Thank-you for the opportunity to comment on this bill.

Sincerely yours,

CHARLES E. COLE
ATTORNEY GENERAL

By: 
James L. Baldwin
Assistant Attorney General

JLB:jr

WALTER J. HICKEL, GOVERNOR

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DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

May 10, 1991

The Honorable Jim Duncan
Alaska State Senate
P O Box V
Juneau, Alaska 99811

Re: HB 221; Potential conflict
of interest arising from vote
on SBS annuity plan
Our file: 663-91-0459

Dear Senator Duncan:

You requested our advice concerning whether legislators have a conflict of interest to the extent that they will be unable to vote on HB 221, a bill establishing an investment loss trust fund for the benefit of participants in the supplemental annuity plan established under AS 39.30.150 - 39.30.180. Under this bill, participants in the plan will benefit to the extent that the trust fund is drawn upon to make up losses caused by the expected insolvency of an insurer that has issued guaranteed investment contracts to the plan. The plan provides a part of the benefits for public officers and state employees that were substituted when the state withdrew from the social security system. All sitting legislators are participants in the plan along with approximately 21,000 other persons.

In our opinion, even though legislators have a pecuniary interest in the passage of HB 221, a vote on the bill does not present a conflict of interest that would require a legislator to be excused from voting. The statutory standards of conduct applicable to legislators contains the following provision:

A conflict exists if benefits accrue to a person to whom this chapter applies beyond that which may accrue uniformly to members of the profession, occupation or group to which the person belongs, or to the public at large.

AS 24.60.030(d); accord Mason's Manual of Legislative Procedure Sec. 552, para 1 (1989 Ed.). The pecuniary interest gained through the enactment of HB 221 is identical to the benefit to be received by all other legislators and a large group of persons in the state.

Hon. Jim Duncan
AG file: 663-91-0459

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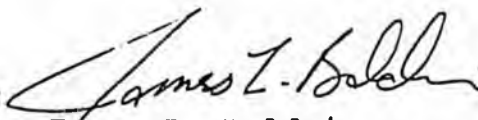
The benefit provided by the bill will be applied uniformly according to the valuation of guaranteed investment contracts on a date certain. The amount of the benefit will be set by factors which existed before HB 221 was voted upon by the legislature and over which individual legislators will have no control.

We believe that the pecuniary benefit realized by legislators under this bill does not go beyond that which accrues to all plan participants. The leeway granted under the standard of conduct cited above recognizes, that there is no other lawmaking body in the state with the power to take the action necessary to repair the injury to the large number of persons affected by the pending insolvency of a major asset of the plan. Any apparent benefit to individual legislators will be offset by the benefit realized by the state treasury through an equitable settlement of potential liability claims without incurring substantial additional liability for consequential damages, costs, and attorney fees.

We hope this adequately answers your question.

Sincerely yours,

CHARLES E. COLE
ATTORNEY GENERAL

By: 
James L. Baldwin
Assistant Attorney General

JLB: jr

DIVISION OF LEGAL SERVICES
LEGISLATIVE AFFAIRS AGENCY
STATE OF ALASKA

P.O. Box Y, Juneau, Alaska 99811
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FAX (907) 465-2029

Deliveries to: 240 Main Street
Court Plaza, Room 500
Mail Stop 3101

MEMORANDUM

May 3, 1991

SUBJECT: Conflicts of interest and SBS vote (Work Order No. 7-LS1332)

TO: Senator Jim Duncan
Attn: Pete Carran

FROM: John B. Gaguine *JBG*
Legislative Counsel

You have asked whether it would be a conflict of interest for members of the legislature to vote on the SBS "bailout" legislation. Because all senators and most representatives (except for those who are very new) will have SBS accounts with significant investments in Executive Life, and therefore would be significantly affected by the bailout bill, it would appear to be a violation of the language of AS 24.60.030(b) for them to vote on the bill.^{1/}

However, since this conflict is inescapable, and applies to a majority of the legislature, I believe that AS 24.60.030(b) is simply not applicable here. If it were applicable, the legislature would never be able to vote on matters such as legislative pay and allowances, or even on matters that financially benefit the entire Alaskan population, such as permanent fund dividends. While there is no specific statutory language creating this exception to AS 24.60.030(b),^{2/} I think that this construction of (b) is necessary as a matter of common sense and sound policy.

^{1/} AS 24.60.030(b) provides, "A conflict of interest exists when a person to whom this chapter applies takes or withholds official action or exerts official influence that could substantially benefit or harm a financial matter in which the person has a direct or indirect private interest." It could be argued that a legislator's SBS account is not a "private" interest, thus making the subsection inapplicable. However, I think that this would be an inappropriately narrow reading of the subsection.

^{2/} AS 24.60.030(c), which creates an exception for certain conduct that would otherwise be a conflict of interest, provides, "(c) Conflicts of interest are prohibited but there is not a conflict of interest if, as to a specific matter, there is no substantial impropriety or appearance of impropriety because (1) the person's interest is relatively insignificant; or (2) the person's authority is relatively far removed from any official action that could reasonably be affected by the potential conflict of interest, provided that no attempt has been made to remove the appearance of impropriety by delegating responsibility for official action."

Senator Jim Duncan
May 3, 1991
Page 2

The analogous situation arises with regard to the courts when a case presents issues with a financial impact on all judges, as, for instance, a case concerning the judicial retirement system. In such a case the courts have stated that they will hear the case out of necessity, despite their personal interest in the outcome, which might otherwise disqualify them under rules such as a code of judicial conduct. See generally 48A C.J.S. Judges, sec. 100 ("The rules for disqualification of judges must yield to necessity and will not prevail if disqualification will prevent resort to the only tribunal in which relief may be obtained").

At any rate, even if a conflict rule were held to be applicable, under Uniform Rule 34(b) a legislator may not choose to abstain, but may only ask for the body's permission to abstain. Since, as a matter of tradition, this permission is never granted, even a legislator who has a genuine, individual conflict as to a matter must always vote on it. In view of Uniform Rule 34(b), it might even be argued that AS 24.60.030(b) simply does not apply to votes taken on the floor of the legislature.

If I may be of further assistance, please advise.

JBG:pl
91-333.plm

DIVISION OF LEGAL SERVICES

LEGISLATIVE AFFAIRS AGENCY STATE OF ALASKA

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Deliveries to: 240 Main Street
Court Plaza, Room 500
Mail Stop 3101

MEMORANDUM

May 8, 1991

SUBJECT: Dedicated funds issue in proposed CSHB 221(Finance)

TO: Representative Mike Navarre
Co-Chair, House Finance Committee
Attn: Carol

FROM: Theresa L. Bannister *TB*
Legislative Counsel

Enclosed is the committee substitute you requested. Section 1, establishing the investment loss trust fund, may violate the state constitutional prohibition contained in article IX, section 7, against the dedication of funds. The section provides that the fund includes interest on money in the fund.

In an opinion concerning the dedicated funds prohibition, November 30, 1982, the Attorney General noted that the retention of interest earned on the principal and other earnings of a fund (in that opinion, a revolving loan fund) raises a dedicated fund question. The opinion goes on to note, at page 16,

A difficulty that arises from the view that the dedicated funds prohibition is not applicable to interest or investment income on separate funds is that it permits steadily increasing amounts of money to be received and used by state departments and agencies without legislative control through the annual budget process. . . . (W)e doubt that a blanket exception for derivative income would be approved by the courts.

If you wish to avoid this issue, you could add "subject to appropriation," before "Interest" on page 1, line 8 of the bill.

If I may be of further assistance, please advise.

TBL:pl
91-349.plm

Enclosure

DIVISION OF LEGAL SERVICES
LEGISLATIVE AFFAIRS AGENCY
STATE OF ALASKA

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Court Plaza, Room 500
Mail Stop 3101

M E M O R A N D U M

May 2, 1991

SUBJECT: Appropriations to satisfy judgments (Work Order No. 7-LS1333)

TO: Senator Jim Duncan

FROM: Tamara Brandt Cook
Director *TBC*

You have asked whether the judicial branch could force the state to pay a judgment for recent investment losses suffered by SBS if the state were found liable for those losses. In my opinion, this is extremely unlikely to happen.

No money may be expended from the state treasury without an appropriation and only the legislature may enact an appropriation, subject to the governor's veto power. For this reason, generally the state is not bound to pay court judgments without an appropriation. (Chevron U.S.A., Inc. v. Hammond, A77-195 Civil, United States District Court (1978) unpublished) AS 09.50.270 sets out a procedure for payment of a judgment that is subject to the appropriation process. The court cannot order the legislature to appropriate money to pay a particular settlement without creating very severe questions regarding the application of the separation of powers doctrine. The "power of the purse" is after all, a very important legislative power, distinct from those powers exercised by the judicial or executive branches.

There have been some cases from other jurisdictions in which a judge has ordered a state or local government to spend money or to raise money through taxation. However, this is a very unusual remedy, applied only in cases involving utter failure on the part of the government to carry out its constitutionally mandated duties, and it is very unlikely that a court in this state would choose to follow those precedents with respect to the SBS situation. While legislators should, as a matter of policy, appropriate funds to pay properly entered judgments against the state because otherwise this results in unfair treatment by the state of its citizens, the legislature has discretion in the matter and may decline to pay a judgment.

TBC:pl
91-330.plm

DIVISION OF LEGAL SERVICES

LEGISLATIVE AFFAIRS AGENCY STATE OF ALASKA

P.O. Box Y, Juneau, Alaska 99811
(907) 465-3867 or 465-2450
FAX (907) 465-2029

Deliveries to: 240 Main Street
Court Plaza, Room 500
Mail Stop 3101

MEMORANDUM

April 30, 1991

SUBJECT: State payment of Supplement Benefit System accounts (W.O. No. 7LS-1252)

TO: Senator Jim Duncan

FROM: Teresa B. Cramer *TBC*
Legislative Counsel

You have asked whether the state is obligated to pay the accounts of members of the Supplemental Benefits System (SBS) who terminated from state service and whether that answer changes depending on when the employee terminated from state service. You have also asked whether the full balance in the employee contribution account should be paid or whether that amount should be reduced to reflect the reduction in value of the SBS portfolio and whether the state may delay payment because of the current financial condition of Executive Life.

Summary

In my opinion, the state is required to pay in full the accounts of members of SBS who terminated from state service, regardless of when they terminated from state service. The reduction in the value of the SBS portfolio may not be passed on to participants of the system under the system as it is currently structured. The state does not have a legal basis to delay paying those obligations.

Discussion

1. Provisions of the SBS statutes, plan and insurance contract.

An employee of a participating employer who would have been required to participate in the federal social security system if the employer had not opted out of social security is required to participate in the supplemental benefits system. AS 39.30.150(a).^{1/} A "participating employer" is defined in AS 39.30.170 as the

^{1/} There is an exception for certain marine highway employees covered by collective bargaining contracts contained in AS 39.30.150(c).

state or an employer as defined by the Public Employees' Retirement System who is not participating in the federal social security system and whose participation in SBS has been approved by the commissioner of administration.

The mandatory contributions to SBS from employee wages and from the employer are paid into the employee's individual employee annuity account under AS 39.30.150(a).^{2/} Under AS 39.30.153, the amount held on behalf of a terminating employee in that account is to be paid to the employee under the terms of the state's Supplemental Annuity Plan.

The plan, which is set out at the end of the State of Alaska Supplemental Benefits System Information Booklet, Plan Year 1991, beginning at page 100, provides that the accounts be maintained by the employer (Art. IV.A), that each participant's account is fully vested and nonforfeitable at all times (Art. V. A), and that a terminated employee is eligible for payment of the account 90 days after the termination of employment (Art. A. B). The plan offers various forms of payment, including a lump sum payment and several forms of annuities (Art. V. D). The plan administrator may not modify or amend the plan retroactively to reduce the accrued benefits of any participant. (Art. VII. C.2.)

The amount in the account depends on the valuation. Under the plan,

[a]ccounts shall be valued and investment earnings and contract dividends shall be credited to each Participant's account at least annually in accordance with the Insurance Contract.

(State of Alaska Supplemental Annuity Plan, Art. IV.B.) By regulation, investment income is posted monthly to the individual annuity accounts. 2 AAC 37.171. Under the insurance contract between the state and Executive Life dated December 19, 1989, interest is guaranteed at a net effective annual rate of 8.46 percent (Part VI, B, page 26).

The state is responsible for determining the value of accounts and notifying the insurance carrier to purchase annuities or make lump sum payments (Part III, Annuity Contract Terms, sec. 4.01). There is also a provision for a penalty payment for lump sum benefit payments that are made more than 15 days after the state notifies the carrier to process the payment. (Part III, Annuity Contract Terms, sec. 4.06).

^{2/} Under AS 39.30.150(c), employees may choose to make additional contributions to pay for supplemental benefits that the system offers under AS 39.30.160. Before 1989, employees could purchase health, death, disability, and survivor benefits from the mandatory contributions. In 1988, the supplemental benefit statutes were amended to require that those benefits be paid for from special benefit accounts. The mandatory contributions could only be used for annuities.

Senator Jim Duncan
April 30, 1991
Page 3

1. Is the state obligated to pay in full the accounts of members of SBS who terminated from state service? Does the answer depend on when the member terminated?

In my opinion, the state is obligated to pay the full value of the accounts of employees who have terminated their employment with the state. The answer does not depend on when the employee terminated.

Under AS 39.30.153, the state is required to pay the employee the amount in the employee's annuity account. Payment is to be made under the terms of the Supplemental Annuity Plan. Nothing in the plan limits the obligation to pay the full amount.

As quoted above, Art. IV. B, of the plan requires that accounts be valued and investment earnings credited to employee accounts in accordance with the insurance contract. It is possible that a court would interpret this to refer to the performance the insurance contract rather than the term of the insurance contract. I believe the better interpretation is to look to the terms of the contract.

Under the plan, the employee is eligible to receive the amount 90 days after employment with the employer ended or, if the employee chooses, at a later date. The value of the account the employee is entitled to receive is the value of the account as of the benefit commencement date. There is nothing that permits the state to pass investment losses to the employees. The insurance contract, which is made applicable to the valuation of employee accounts under Art. IV.B., guarantees a net interest rate of 8.46 percent. These provisions apply regardless of whether the employee was eligible to receive the SBS payment before or after the State of California acted to take over Executive Life and the Internal Revenue Service assessed overdue taxes and penalties against it.

2. Can the state delay payment of SBS payments because of the financial condition of Executive Life?

In my opinion, the state may not delay payment because of the financial condition of Executive Life. Under AS 39.30.153, the individual employee annuity account "must be paid to the employee under the terms of" the annuity plan. The plan provides that the account is fully vested and nonforfeitable and that employees are eligible for payment 90 days after terminating employment. (Art. V, A and B). Benefits commence "as soon as administratively feasible" after the first date that the employee satisfies the waiting period and has made a complete application for payment unless the employee has requested that the benefit payment be deferred to

Senator Jim Duncan
April 30, 1991
Page 4

a later date. ^{3/} Since the plan administrator may not modify the plan to reduce benefits of any recipient (Art. VII.C.2), administrative feasibility cannot be based on the expected financial condition of the insurer.

If I may be of further assistance, please advise.

TC:pl:gc
91-321.plm

^{3/} There are also provisions for payment to participants who reach normal retirement age and for the beneficiaries of participants who have died who have not applied for payment.

April 29, 1991

The Honorable Pat Pourchot
P. O. Box V
Juneau, AK 99811

Dear Senator Pourchot:

Bashing of state employees is popular right now; especially with the Hickel administration saying that the state government is overstaffed, so at times you might feel that refunding of SBS is not the popular thing to do. You might also be concerned that because you're covered by SBS, your constituents might feel that your primary reason for refunding is to cover yourself. However, there are many, many people within Alaska that feel the SBS should be refunded, myself included.

I'm sending you the attached article to show that there are also people nationwide who believe the employer has a fiduciary responsibility to do so. This writer says better than I could how I feel about the present situation.

Please do what you can to help resolve this problem..

Sincerely,



Colleen Rutledge
mail: P. O. Box 92752
Anchorage, AK 99509

Residence: 3016 W. 31st
Anchorage, AK

Attachment

DEPARTMENT OF ADMINISTRATION

OFFICE OF THE COMMISSIONER

P.O. BOX C
JUNEAU, ALASKA 99811-0200
PHONE: (907) 465-2200
FAX: (907) 465-2135

April 22, 1991

APR 25 1991

All Legislators
Public Employee Union Leaders

Re: SBS Annuity Plan--April Distributions

Enclosed is a letter that is being sent to approximately 300 SBS participants. These former employees have requested a lump sum payment or annuity purchase during the March/April cycle.

We are taking this action to give the PERS Board adequate time to consider and approve a revised policy on SBS distributions. These revisions are necessary due to the extraordinary events that have occurred since April 1, 1991, regarding Executive Life Insurance Company of California.

Please call me at 465-2200 if you have any questions or need further information.

Sincerely,



Millett Keller
Commissioner

MK/nl
Enclosure
cc: PERS Board

Governor Hickel

Max Hodel
Chief of Staff
Office of the Governor

Charles Cole
Commissioner
Department of Law

STATE OF ALASKA

DEPARTMENT OF ADMINISTRATION

OFFICE OF THE COMMISSIONER

WALTER J. HICKEL, GOVERNOR

P.O. BOX C
JUNEAU, ALASKA 99811-0200
PHONE: (907) 465-2200
FAX: (907) 465-2135

April 22, 1991

Dear SBS Participant:

During the past year there has been considerable concern over the troubled financial condition of Executive Life Insurance Company of California (ELIC).

On April 11, the California Commissioner of Insurance seized control of the company. One of the stated goals of the California Commissioner was to "ensure maximum protection for Executive Life Insurance Company policyholders." The Supplemental Benefit Annuity Plan has approximately \$132 million (current value) invested in contracts with ELIC.

If the California Insurance Commissioner is not able to recover ELIC, your SBS investments may be affected. It is therefore prudent to review our current policy in the event that changes in account values or fund distribution are required.

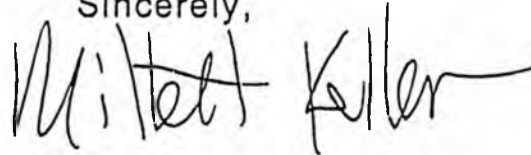
On May 3, the Public Employees' Retirement System Board will meet to consider our valuation and fund distribution policies. The ongoing work by our attorneys, accountants, and other advisors should provide the Board with sufficient information to make informed policy decisions.

I am writing you because you are scheduled to receive either a lump sum payment or purchase an annuity during the April cycle. Due to the extraordinary circumstances surrounding the Executive Life seizure and the resultant uncertainties, I am unable to process the April list until the Board makes a determination of our account valuation policies. Pat Wellington, Chairman of the Public Employees' Retirement Board, also believes valuation policies should be adopted by the Board before we make the April distribution.

April 22, 1991

I truly regret having to advise you of this delay. It is possible there will be policy changes made at the May 3 meeting that affect the benefit election you previously made. We will inform you of the actions taken by the Board after the May 3 meeting. If you have any further questions, please contact Retirement and Benefits at 465-4460.

Sincerely,

A handwritten signature in cursive script that reads "Millett Keller". The signature is written in dark ink and is positioned above the printed name and title.

Millett Keller
Commissioner

STATE OF ALASKA

WALTER J. HICKEL, GOVERNOR

DEPARTMENT OF ADMINISTRATION

OFFICE OF THE COMMISSIONER

P.O. BOX C
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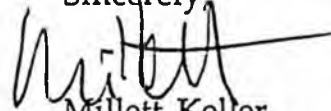
April 12, 1991

The Honorable Pat Pourchot
Co-Chairman
Senate Finance Committee
P.O. Box V
Juneau, AK 99811

Dear Senator Pourchot:

During testimony on SB 204, Senator Duncan requested a short history of the Supplemental Benefits System. Enclosed is some information that I hope will serve to answer any general historical questions that Senator Duncan or other members of the committee may have.

Sincerely,



Millett Keller
Commissioner

MK/MBC/crd
Enclosure

April 9, 1991

A Brief History of the State of Alaska Supplemental Benefits System

WITHDRAWAL FROM SOCIAL SECURITY

The State of Alaska began consideration of withdrawal from the social security system in the early 70's when studies were requested by the State legislature to determine the advantages and disadvantages of withdrawal. The first study consisted of a detailed description of the benefits which would be lost through termination of coverage and a proposal of alternatives for the replacement of those benefits in the event coverage was actually terminated.

In December 1975, the State notified the Social Security Administration of their intent to terminate coverage on January 1, 1978. The alternative benefits proposed in the study were further described as to their probable cost and administrative expediency. The study concluded that the duplication of benefits that would be lost under social security would cost approximately 22% of covered wages as compared to the approximate 12% of covered wages under social security. In addition, the study painted a grim picture of the expense and difficulty of administering such a duplicate plan.

STATE CHANGES ITS MIND

As a result of the study and because of the lack of time to examine other alternatives, Alaska rescinded its notice of intent to withdraw in May of 1977. Since a strong desire to continue the investigations remained among employees and union representatives, a second notice of intent to withdraw was filed in November 1977 with the Social Security Administration to become effective on January 1, 1980. A second study was initiated at that time to examine alternate kinds of benefits that might be more desirable to State employees, but did not attempt to duplicate social security benefits.

STATE LEGISLATURE TAKES ACTION

As a result of this second study conducted by an ad hoc committee composed of employee representatives, legislators and administrators, legislation was introduced in 1978 to provide for an employee vote on social security withdrawal and for various enhancements to the Alaska Public Employees' Retirement System in the

event that employees approved the withdrawal. The legislation which finally passed in May of 1979 did provide for a secret ballot, with a simple majority of those employees voting deciding the outcome. However, instead of enhancing the PERS, a program consisting of five categories of benefits was specifically named in the final legislation and ultimately became the defined contribution plan that still forms the basis for the program today.

THE EMPLOYEE REFERENDUM

Informational materials that explained the advantages and disadvantages of social security and stressed the fact that each person would be uniquely affected by social security withdrawal were distributed to all employees during July and August of 1979. Information was also distributed which outlined the basic structure of the proposed replacement program.

The results of the balloting were announced in September 1979. Of the employees voting, 52% chose to withdraw, 39% chose to stay in, and 9%, not enough to change the outcome of the election, submitted ballots that were "questioned" and ruled invalid. This election resulted in all of Alaska's State employees "opting out" of social security effective January 1, 1980, the first such group of State employees ever to do so.

THE PROGRAM BECOMES EFFECTIVE

The Alaska Supplemental Benefits System (SBS) became effective upon withdrawal. The SBS offered benefit options from which the employee could select which would best meet his or her individual needs. The options could be changed on an annual basis in consideration of changing personal circumstances. The benefit options available to each employee were death benefits, survivor benefits, disability benefits, health benefits and annuities.

One of the primary differences between the SBS and social security is that under the federal program, contributions made by and on behalf of an employee may not be received by the employee or the employee's beneficiary. In contrast, the SBS program was designed so that benefits bear a direct relationship to the contributions made for the employee. This "individual oriented" defined contribution program was seen to be preferable to programs such as social security which are more "welfare oriented."

THE EARLY SBS

In accordance with the law, the State contributed 6.13% of gross wages into a special individual employee account for each employee up to the current social security wage base. Each employee's wages were reduced by 6.13% to match the State

contribution and were also allocated to the special individual accounts. Although the taxable wage base does change from year to year, the contribution rate was fixed in state statute, instead of increasing in steps like the federal social security rate. The monthly contribution was distributed among the various insurance coverages that had been chosen by each employee. Each employee had the option of choosing any, all or none of the types of insurance.

In the original system, contributions remaining after insurance premiums and the annual administrative fee were deposited in the individual employee's annuity account. Virtually all employees participated in the annuity program since any excess contributions remaining after insurance premiums were paid were automatically deposited in the annuity account.

SBS ANNUITY INVESTMENTS

The first annuity contract was procured with an RFP in 1979. The resulting contract with Mutual Benefit Life (MBL) Insurance Company guaranteed a rate of interest on all funds received from the state for a one year period. The company could announce the interest rate each November for the coming calendar year. All recordkeeping was performed by MBL including the distribution of checks to eligible employees. The state continued this relationship with MBL through 1984.

In 1984 all the funds that had accumulated at MBL were separated into two accounts. One account became payable in five equal installments beginning on 1/1/86. Each of these installments were rolled over to the then current investment carrier for the SBS. All installments on this contract have now been received.

The second account in MBL was rolled over to the 1985 investment carrier, State Mutual Life (SML). The 1985 contract with SML was the first of the GIC contracts that the SBS purchased. This GIC with SML matured on 1/1/91 at over \$150 million, and was deposited with the Department of Revenue.

The contract in 1985 was also the first that was purchased using an Invitation to Bid (ITB) rather than a Request for Proposal. The bid process was less cumbersome to use for both the state and carriers. The bid process was used for procuring GICs through 1990.

GICs were purchased annually through 1990. In some years, more than one GIC was purchased. For example, if large amounts of cash were due from an earlier maturity or rollover, the state would bid an "investment" GIC(s) for the rollover and purchase a "window" GIC for the year's contributions. For that reason, the state has 2 GICs maturing in 1992, 2 in 1993, 3 in 1994, 2 in 1995 and 1 in 1996. Following is a schedule of these GICs:

SBS ANNUITY CONTRACTS

Contractorholder and Initial year	Rate of Return	Maturity Value in Millions (est)	Present Value in Millions (est)	Maturity Date
Transamerica Occidental '86	10.66%.....	77.4.....	64.2.....	1/2/92
Actna..... '86	9.5%.....	41.5.....	35.0.....	1/2/92
Executive Life..... '87	8.6%.....	27.1.....	21.5.....	1/4/93
New York Life..... '87	8.6%.....	69.2.....	54.7.....	1/4/93
Transamerica..... Occidental '88	9.21%.....	59.7.....	42.6.....	1/3/94
Excutive Life..... '88	9.9%.....	52.9.....	36.8.....	1/3/94
Metropolitan..... '89	9.69%.....	73.7.....	46.8.....	1/3/95
Transamerica..... '89	9.15%.....	55.0.....	42.7.....	1/3/95
Excutive Life..... '89	9.10%.....	90.3.....	61.9.....	7/1/94
Excutive Life..... '90	7.07%.....	1.99.....	1.33.....	1/2/96

Shortly after the 1990 GIC was awarded to Executive Life Insurance, their risky financial position due to junk bond holding was highly publicized throughout the country. The state negotiated an end to the 1990 contract. In return for this early termination, the state agreed to accept a lower rate of interest on the \$1.9 million that had been deposited. Employee contributions received after January 1990 had been deposited with the Department of Revenue for investment.

An interim investment agreement was approved by the Public Employees Retirement System board and signed by the Departments of Administration and Revenue in 1990. Funds are currently being invested by the Department of Revenue in accordance with this agreement.

CHANGES OVER THE YEARS

The program has changed since its inception. In the first two years refunds of all contributions were made to a terminating employee ONLY if the account balance was less than \$1000. If the account was greater than \$1000, the employee was not eligible for receipt of the funds until age 55. Due to much employee dissatisfaction, the state sought and received IRS approval of a change in the Plan to allow payment of funds after termination for 90 days.

In 1986, federal legislation was enacted that required the restructuring of the SBS in 1989. Prior to the restructuring, the SBS had always been a combination annuity and insurance benefit plan. The annuity plan had a separate and unique qualification from the IRS. The benefit portion of the plan had no distinct qualification at that time.

The restructured SBS had two distinct parts--annuities and benefits. Annuities only would now receive a full 12.26% of salary. Insurance benefits would be paid for through additional voluntary pre-tax deductions to wages. Following extensive employee meetings in 1988, the structure was endorsed by the workforce and adopted by the legislature. Effective in 1989, the annuity plan and the benefit plan were separately qualified under IRS code sections 401(a) and 125. Effective also in 1989 was the addition of a dependent care benefit as a separately qualified and approved plan under IRC 129.

Legislative Budget and Audit
Committee Meeting
March 12, 1991

Issues and Questions
regarding the
Supplemental Benefits System ("SBS")

1. Ability to sell GIC's
 - does contract allow sale
 - is issuer willing to allow sale
 - are there any tax or ERISA implications for issuer or SBS
 - if issuer files bankruptcy prior to sale, can sale be consummated
2. Use of Legislative Authorization
 - is a purchase expected in the near future
 - is speedy action required by the Legislature
 - what is the reason for the December 31, 1992 repeal
3. Cash Flow
 - would State's payment for purchase be paid in lump sum or over time, at or toward the front or back of any time period, or on same schedule as GIC's mature
 - what would be the projected monthly liquid general fund balances through FY 93, given the expected payment schedule and updated revenue forecasts
4. Management of Purchased GIC's
 - would the State expect to hold the GIC's to maturity, barring default
 - if not,
 - what would the State attempt to negotiate to shorten or cash out GIC's
 - what would be the expected cost to the State
 - how would this compare to expected value of GIC's in bankruptcy liquidation or workout

- who would negotiate for State, including legal or investment counsel
- would results of negotiation be placed before the Legislature or Budget and Audit

5. Budget

- would the Governor's budget for FY 92 be reduced by either
 - cash paid for GIC purchases
 - cost to the State if GIC shortening or surrender is negotiated

6. Alternatives

- what sureties or collateral could be negotiated from issuers to reinforce their guarantee under GIC's (see page labelled "Alternatives" attached to enclosed memorandum of March 8, 1990)
- what would happen if the State enacted a law requiring amendment or rescission of GIC contracts, allowing withdrawal of funds (see paragraph 5 of enclosed memorandum of March 8, 1990)
- could the potential purchase of a non-investment grade, illiquid asset for the State's operating account (general fund) set a precedent for allowing other uses of the State treasury requiring waiver of the statutory rule of prudence
- would it be preferable to make an appropriation, contingent upon a GIC loss to the State--either as a result of negotiated surrender or bankruptcy settlement--that would avoid waiver of prudence and the holding of a much larger non-investment grade, illiquid asset in the general fund

7. Issuer Creditworthiness

- what is the financial condition and outlook for GIC issuers, including Executive Life and Great Western (Deferred Compensation GIC issuer)
- what rating changes have occurred recently for GIC issuers
- what are the trends in policy and contract surrenders for issuers

HELLER, EHRMAN, WHITE & MCAULIFFE
ATTORNEYS

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March 8, 1990

1200 S.W. FIFTH AVENUE
PORTLAND, OREGON 97201-0000
FACSIMILE (503) 241-0000
TELEPHONE (503) 227-7000

PAUL W. BUGARMAN
DIRECT DIAL (415) 772-6217

VIA TELECOPY

The Hon. Frank Baxter, Commissioner
The Department of Administration
P.O. Box C
Juneau, Alaska 99811

Executive Life Insurance Company

Dear Commissioner Baxter:

In anticipation of tomorrow's meeting with Executive Life, I suggest the following overall negotiating position be presented. (Based on our telephone conversation earlier this week, I have assumed that your immediate objective is to terminate the most recent contract and not to address the earlier contracts at this time.)

- (1) The State of Alaska's purchase of Guaranteed Investment Contracts from Executive Life using retirement fund contributions of state employees has become a heated political issue in Alaska. Executive Life must understand and appreciate the political realities. The State of Alaska cannot, and will not, accept any result which is politically untenable.
- (2) Whatever the true state of Executive Life's finances -- a matter about which Alaska currently lacks sufficient information -- it has become politically impossible for the State to invest additional funds in any contract issued by Executive Life.

- (3) For the moment Alaska is willing to leave the three earlier, paid-in-full contracts in place, at least until such time as circumstances (whether political in Alaska, or financial at Executive Life) dictate otherwise. But the most recent contract, No. 26805, must be terminated effective immediately, with the full value of Alaska's account (principal and compound interest) transferred to a carrier to be selected by Alaska for reinvestment.
- (4) Alaska has no desire to cause Executive Life any further negative publicity and proposes that the contract be terminated in a consensual, low-key fashion, without public relations fanfare.
- (5) If Executive Life refuses to consent to contract termination, then Alaska will be forced -- politically -- to pursue other actions. At a minimum, in all likelihood these would entail exercising Alaska's right to audit Executive Life, a right available to Alaska both under contract and by virtue of Executive Life's insurance activities in Alaska. Alaska will also seek to achieve termination non-consensually. One likely scenario is that the Legislature, which is currently in session, will enact legislation forbidding the State or any of its agencies from investing public funds, or retirement plan funds, in instruments such as guaranteed investment contracts issued by an institution whose own assets are disproportionately invested -- for example, in excess of 20 percent -- in junk bonds. The existing contracts obligate Executive Life to remain in compliance with the laws of Alaska, and such a law would, in Alaska's view, entitle it to terminate the most recent contract, and the earlier contracts as well.
- (6) Another option, which Alaska is not anxious to utilize, would entail litigation. Several political leaders in Alaska have questioned how the State could have awarded a contract to Executive Life as late as December of last year. They suggest that Executive Life should have disclosed its imminent junk bond-related charge against earnings and that its failure to do so gives Alaska the right to rescind the contract. If necessary, Alaska will seek such a ruling from the Alaska Superior Court, which is the court specified to resolve disputes in connection with the contract.

The Hon. Frank Baxter
March 8, 1990

Page 3

An alternative approach would focus not on terminating the current contract, but on obtaining security for both existing funds held by and future contributions to Executive Life. Alaska could also try to negotiate an arrangement whereby future contributions are segregated into a trust account. It is difficult to assess the advisability of these approaches, however, in the absence of more information than we now have about Executive Life's financial condition and overall stability. The absence of that information also makes it difficult for us to formulate a credible negotiating position which is likely to persuade Executive Life to agree to change the status quo.

Obviously, Alaska's opening negotiating position can be softened or hardened as circumstances and judgment warrant. I understand that I will be joining you in your meeting on Friday, and I look forward to discussing these suggestions beforehand when we meet at the Radisson Hotel in Manhattan Beach. I am flying to LAX on Friday morning and, unless delayed by weather conditions, should arrive at your hotel by 9:00 A.M.

I look forward to meeting you tomorrow.

Very truly yours,



Paul W. Sugarman

cc: James Baldwin, Esq.

SBS ANNUITY CONTRACTS

These companies currently hold "net" deposits from "window period" and "bullet" GICs. At maturity these monies will be reinvested. In what types of investments and with what goals and objectives will be determined by the Public Employees' Retirement System (PERS) board as they diversify from GICs.

Name/Initial Year	06/30/90 Balance	Percent	Value at Maturity	Maturity Date
State Mutual Life Insurance Co./1985	\$142.0 million	13.01%	\$151.1 million	January 1, 1991
Transamerica Occidental Life Insurance Co./1986	\$66.5 million	10.66%	\$77.4 million	January 2, 1992
AEtna Life Insurance Co./1986	\$36.2 million	9.5%	\$41.5 million	January 2, 1992
Executive Life Insurance Co./1987	\$22.1 million	8.6%	\$27.1 million	January 2, 1993
New York Life Insurance Co./1987	\$56.3 million	8.6%	\$69.2 million	January 4, 1993
Transamerica Occidental Life Insurance Co./1988	\$43.8 million	9.21%	\$59.7 million	January 3, 1994
Executive Life Insurance Co./1988	\$37.9 million	9.9%	\$52.9 million	January 3, 1994
Metropolitan Life Insurance Co./1989	\$48.6 million	9.69%	\$73.7 million	January 3, 1995
Transamerica Occidental Life Insurance Co./1989	\$43.9 million	9.15%	\$65.2 million	January 3, 1995
Executive Life Insurance Co./1989	\$63.7 million	9.10%	\$90.3 million	July 1, 1994
Executive Life Insurance Co./1990	\$1.4 million	7.07%	\$2.0 million	January 2, 1996
Total at 6/30/90	<u>\$562.4 million</u>			

RECEIVED
MAR 22 9 00 AM '90

HELLER, EHRMAN, WHITE & MCAULIFFE
ATTORNEYS

A PARTNERSHIP INCLUDING PROFESSIONAL CORPORATIONS

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March 22, 1990

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PAUL W. SUGARMAN
DIRECT DIAL (415) 772-6217

The Hon. Frank Baxter, Commissioner
The Department of Administration
P.O. Box C
Juneau, Alaska 99811

Executive Life Insurance Company
Contract Award No. 26805

Dear Frank:

You have asked that I summarize my views concerning the modification of the above-referenced agreement (the "Agreement") which is memorialized in your letter of March 16, 1990 to Allan Chapman, Senior Vice President of Executive Life Insurance Company. Briefly, the proposed modification:

1. Relieves the State of Alaska ("Alaska") of any obligation to remit further payments to Executive Life Insurance Company ("Executive Life") under the Agreement, leaving only January's initial net contribution of \$1,377,375.90 to be retained by Executive Life until the end of the contract period (January 2, 1996);
2. Reduces the interest to be earned by Alaska on the \$1,377,375.90 by approximately \$160,770, which sum has a present value of \$100,000 discounted at the existing contract rate;
3. Enables Alaska to select an alternative investment medium for the approximately \$34,000,000 of SBS funds to be invested in 1990, which sum otherwise would have to be invested with Executive Life in accordance with the terms of the Agreement. I understand from you that you believe that, because of the recent

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upward movement in interest rates, Alaska will be able to negotiate an interest rate of approximately 9.1% per annum for SBS funds to be invested in 1990; and

4. Precludes Alaska from seeking withdrawal of funds previously invested with Executive Life under Contract Awards Nos. 25980, 25992 and 26681 until maturity of those contracts, and from seeking to amend, rescind or otherwise modify those contracts, unless (a) Alaska is precluded by law from so refraining to act or (b) Alaska discovers facts of which it is currently unaware entitling it to relief (i.e., on the grounds of fraud, misrepresentation or material omission).

Whether one views the modification of the Agreement from a business or legal perspective, it appears to be a prudent and reasonable deal for Alaska. Although the proposed modification will entail a "cost" of \$100,000 (in present value terms) to be paid to Executive Life in the form of a reduced interest rate, that cost will be recouped several times over as a result of Alaska's ability to place 1990 SBS funds in another investment vehicle earning a significantly higher rate of interest. This situation is thus analogous to an investor who purchases a six year certificate of deposit at the rate of 8.46%, only to discover that interest rates move sharply higher after the CD is purchased. Although withdrawal of the funds prior to maturity of the CD would entail payment of a penalty, as long as the additional interest to be earned from an alternative investment more than offsets the penalty, it is prudent for the investor to withdraw the funds, pay the penalty and invest elsewhere.

An additional factor militating in favor of the modification, again from the business perspective, is that Alaska may well be able to negotiate more favorable terms for investment of its 1990 SBS funds if it has succeeded in resolving the uncertainty concerning its obligations to Executive Life. Otherwise, Alaska might need to negotiate an "out" in any substitute investment contract to protect Alaska in the event it must, for whatever reason, resume sending payments to Executive Life under the Agreement. Such an escape clause would no doubt come at a cost.

I also believe that the modification is prudent from a legal perspective. As you know, I have not researched Alaska's rights and obligations under the Agreement and therefore am unable to express any opinion concerning the likelihood of success on the merits should Alaska and Executive Life litigate their respective rights and obligations under the Agreement. I have been able to conceive of several legal arguments which Alaska might consider advancing -- whether asserted affirmatively in litigation initiated

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by Alaska or in defense in response to claims brought by Executive Life -- in support of a claim that it is entitled to rescind the Agreement or at least terminate its future performance. (For example, Alaska might claim that Executive Life misrepresented and/or failed to disclose material facts at the time that the contract was awarded or that the laws of Alaska (in particular, the prudent investor rule) preclude Alaska from investing further funds with Executive Life.) Were these arguments successful, Alaska would be entitled to walk away from the contract and perhaps even to obtain return of the \$1,377,375.90 currently held by Executive Life. But I believe it unlikely that Alaska would be able to establish that it is entitled to affirmative damages beyond return of the January payment, with accumulated interest.

On the other hand, were Alaska's arguments to fail -- i.e., were Executive Life able to prove that Alaska breached its contractual obligations by discontinuing payments under the Agreement -- Alaska would have significant damage exposure. Executive Life would no doubt claim that it was damaged in an amount calculated as the difference between the Agreement's rate of interest (8.46%) and the amount Executive Life would have been able to earn on investment of those funds. (Executive Life claims that it has historically earned more than 11% on its investments.) A spread of 2.5% on approximately \$34,000,000 for 5-plus years would yield damages in excess of \$4,000,000. In addition, Executive Life would claim consequential damages, including damage to its reputation and, perhaps, damages resulting from further erosion of public confidence occasioned by Alaska's default. In short, litigation with Executive Life offers Alaska little upside potential and significant downside risk.

Furthermore, one cannot overlook the cost that such litigation would entail. Particularly if Alaska sought to establish misrepresentation on the part of Executive Life, a lawsuit would be fact-intensive and thus expensive to litigate. Executive Life might itself decide that such litigation involves a question of principle, because it could not afford to be perceived as a "soft touch" by any contract holder who wanted to terminate the relationship. It would thus be prudent for Executive Life to commit substantial resources to the litigation in the hope of obtaining a high profile victory.

The principal consideration Executive Life demanded for modifying the Agreement was Alaska's assurance that it would not seek rescission, amendment or modification of the three earlier, fully-funded contracts, or withdrawal of funds already invested, except under certain circumstances. Ideally, Alaska would not have had to give any undertakings with respect to those earlier contracts. From a practical perspective, however, Executive Life

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apparently made it clear during your negotiations that it would not agree to forgive \$34,000,000 of future investments, only to be confronted down the road with a further demand from Alaska that funds already invested be returned.

I do not, however, think that Alaska gave up much by agreeing to this term, although again, I have not had the opportunity to research the law, nor have I investigated Executive Life's financial condition. However, some of the same factors which militated in favor of payment of \$100,000 to Executive Life in the form of a lower interest rate also support Alaska's decision to leave the earlier contracts in place.

First, whatever the merits of Alaska's arguments in support of a claim that it is entitled to rescind the most recent contract -- i.e., to decline to invest additional funds with Executive Life -- those arguments are weaker when directed to the earlier contracts, which were entered into 6 to 24 months ago and which Alaska has fully performed. I think it highly unlikely, for example, that Alaska could successfully rescind the contracts based on misrepresentation, given the passage of time and the fact that Executive Life's investments in junk bonds were public knowledge. And even if Alaska law (e.g., the prudent investor rule) precluded further investment of funds with Executive Life, it is more difficult to argue that that law entitles Alaska to withdraw funds already invested and avoid compensating the injured party for its damages.

Second, any effort by Alaska to seek return of the funds would in all likelihood require protracted, and expensive, litigation, which Executive Life would have every incentive to resist strenuously. While the litigation was pending Executive Life would continue to retain Alaska's funds. Moreover, even a final judgment in Alaska's favor might well prove either unnecessary (because in the meantime Executive Life would have successfully weathered the current storm) or Pyrrhic (because Executive Life would in the meantime have become insolvent, rendering enforcement of Alaska's judgment at full value impossible).

Third, and perhaps most importantly, the agreed-to modification contains two "outs" for Alaska: (1) it enables Alaska to seek to withdraw funds or to amend, rescind or otherwise modify the contracts, if required by law to do so; and (2) it permits such action on the basis of newly discovered facts of which Alaska is not now aware, or should not reasonably be aware. Thus, if the law of Alaska (including, presumably, laws enacted in the future by a cooperative legislature), should require Alaska to seek contract modification, Alaska is free so to act; similarly, Alaska is free

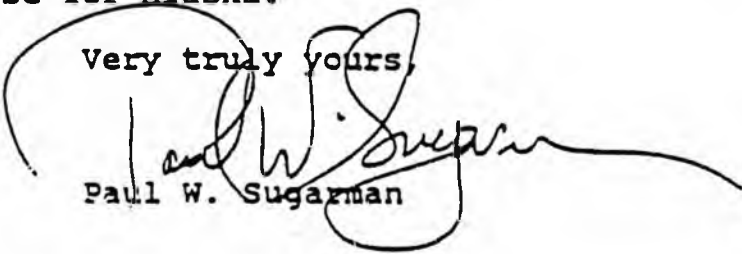
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to bring an action based on fraud or misrepresentation if new facts are discovered. These provisions should give Alaska sufficient future flexibility with respect to the earlier contracts.

For all of these reasons, I believe that the modification to the Agreement makes sense for Alaska.

Very truly yours,



Paul W. Sugarman

cc: James Baldwin, Esq.

ALTERNATIVES

1. Obtain domestic or non-domestic LC.
BENEFIT: Guarantee financial viability of contract.
OBSTACLE: Given state of banking worldwide, extremely doubtful.
2. Assign proceeds of each Executive contract to a single or series of U. S. Trust(s).
 - o Identify Pacific Rim investor(s) willing to purchase assignment value.
 - o Equalize loss in future.**BENEFIT:** No book value loss.
OBSTACLE: Find assignment buyer(s).
Length of time to amortize loss and yield.
What if Executive does not default?
3. Transfer proportionate share of underlying assets to stronger issuer in return for principal guarantee.
BENEFIT: Stronger Issuer surplus.
Principal guaranteed.
Investment experience pass-through if Executive Life Survives.
OBSTACLE: No incentive to Executive Life.
If Executive Life does not default, what is the cost?
4. Master Issuers(s).
BENEFIT: One or more issuers guarantees principal without assignment.
OBSTACLE: Assembling appropriate group of issuers.
Cost to plan absent Executive Life failure.
5. Assignment of contracts to another plan and equalize smaller loss.
BENEFIT: No book value loss.
OBSTACLE: Determination of appropriate cost.
Identifying buyer that views such a transaction as prudent.
If sale is intra-state, various potential legal and fiduciary issues.

HB 221 An Act authorizing the Department of Revenue to purchase either the guaranteed investment contracts held by the supplemental benefits system or the underlying securities; and providing for an effective date.

The Committee adopted Amendments #1 and #2 to be incorporated into HB 221. The bill was HELD in Committee for further discussion.

HOUSE BILL 221

"An Act authorizing the Department of Revenue to purchase either the guaranteed investment contracts held by the supplemental benefits system or the underlying securities; and providing for an effective date."

MILLETT F. KELLER, COMMISSIONER, DEPARTMENT OF ADMINISTRATION, discussed the State of Alaska's investment of the Supplemental Benefits System (SBS) with Executive Life Investment firm. He suggested that action be taken in order to minimize damage resulting from that investment.

He expounded that the State has several plans of action. The Attorney General has asked for a legal determination to identify the concerns. He will then determine the legal rights of the employees with funds in the SBS and also will determine the legal right of the State's responsibility to pay those funds. These opinions are due by April 15, 1991. They are critical to the legislation.

Commissioner Keller explained that the normal action would be to reduce the account balances of the SBS participants. The State should be prepared for a lawsuit pending that decision. The alternative, proposed in HB 221, would be for the General Fund to bail out the SBS investment. Currently, the concern is to minimize the damage from the investment. There is a possibility of insurance coverage from the State of California if Executive Life liquidates. He suggested the possibility of exchanging the assets and corporate bonds owned by Executive Life which could have more value to Alaska than the actual contract.

Commissioner Keller pointed out the change made to Section 2 in the Senate Finance Committee which changed the notification to the Legislative Budget and Audit Committee (LBA) from twenty days to two days.

Co-Chair Navarre asked if Executive Life had filed for bankruptcy. Commissioner Keller denied they had. He said there had been an erroneous news report containing that

information. He agreed they are in trouble. Co-Chair Navarre asked for a copy of the legal analysis and asked what action would be taken if the legal analysis indicated the State was not liable. Commissioner Keller replied that if the State were not liable, SBS would cover the investment.

Commissioner Keller explained that legislation assumes the State is liable; the General Fund will then provide the funds. The Guaranteed Investment Contract (GIC) would be purchased at face value from SBS, at which time SBS would be made whole and the General Fund would take the loss. The loss would amount from \$0 to \$132 million, depending at the value on the time the transfer took place.

Representative Boyer stated he thought that SBS should be responsible for working out the situation with Executive Life. Commissioner Keller noted that the fiscal year ended for SBS on January 31st. The auditors are investigating the situation to make a determination of the asset values. Executive Life will be required to recognize the loss.

DARREL REXWINKLE, DEPUTY COMMISSIONER, DEPARTMENT OF REVENUE, clarified that there has been a substantial decline in the market place of the Executive Life securities. The securities have declined two billion dollars. The audit will provide the exact figure.

Representative Boyer asked for further discussion on recouping the loss. Mr. Rexwinkle responded that the program replaced the Social Security System in 1980. The amount deducted from the contribution of the employee/employer is vested at the beginning of the contribution. When the employee separates from the State or retires, they can withdraw all the funds saved. As earnings are accumulated, they are posted to the participants account; should there be a loss in value, that should also be posted to the participant's account.

Representative Boyer asked how this system differed from investing in an IRA account from a local stock broker. Mr. Rexwinkle said it was the same.

Representative Ulmer acknowledged there was a difference between a person purchasing an individual IRA account and the investment in the SBS. The most obvious difference would be the individual choice in the selection of the IRA. The Department of Administration choose investments for the employees, in this case Executive Life. The employee had no control in the decision made by the Department.

Representative Boyer asked if there was a trustee/fiduciary relationship which would hold an individual liable for the loss. Mr. Rexwinkle pointed out that this was a 401A program in which the employee contributes and the employer matches. The employer does direct the investment, and if there is a

gain or loss, the employee is the direct recipient.

Representative Larson asked if there was fiduciary responsibility in the purchase of the contracts. Commissioner Keller stated that there was fiduciary responsibility and the law places it with the PERS Board and the Commissioner of Administration.

Representative Brown inquired if the accounts would be paid back without legal action. Commissioner Keller clarified that if HB 221 does not pass, the Department assumes there would be lawsuits brought against the State. If the lawsuits are successful, the General Fund would be required to make the State whole. Should the State prevail, there would be no obligation on the part of the State to restore the balances.

Mr. Rexwinkle explained the Department of Revenue's fiscal note. The estimated impact would range from \$0 to \$132 million reduction in unrestricted revenues. This reduction is based on 8% interest compounded annually, assuming the entire \$132 million is non-performing and no cash would be realized at the GIC maturity or sale of underlying securities. This would be the worst case scenario.

Representative Phillips asked when the last communication was made with Executive Life. Commissioner Keller stated that there had been a meeting the end of March in order to discuss all the issues and negotiations. The panic resulted from the incomplete 10K filing and the year end audit.

Mr. Rexwinkle summarized the history of Executive Life. First Executive Corporation is the parent company which publishes the financial report. First Executive has many subsidiaries, the largest being Executive Life of California. The parent company is no longer honoring the accounts of Executive Life. Commissioner Keller noted that Executive Life, since September 1991, has been seeking outside investors. He thought that most of those undertakings had been "press fluff". Representative Phillips commented that the company was in serious trouble.

Representative Brown recommended replacing "may" with "shall" in Line 5, Page 1 of the proposed legislation. She felt that the best course of action for the State would be to protect the employees. She then acknowledged her conflict of interest regarding the matter, owning funds in the SBS account. Commissioner Keller opposed replacing the "may" with "shall". He said that decision would be based on a legal determination regarding the State's position. Currently, there are two opinions being drafted, one law firm is representing SBS and another firm will represent the State. The Attorney General will then decide the State's standing. Until that decision is available, Commissioner Keller urged that the language be left permissive. Representative Brown suggested no action be taken

until the legal analysis is received.

Representative Ulmer asked if time was of the essence. Commissioner Keller replied that the Department had previously insinuated that. At this time the perspective has changed regarding discussions with Executive Life. Introduction of the proposed legislation was a significant factor to the status of the account and to Executive Life. The Commissioner of Insurance in California is now involved with the concern. He said no other State has been willing to exchange the GIC contracts for underlining assets. This would be a unique offer. Representative Ulmer reiterated that the position has been enhanced by the introduction of the legislation and questioned if the position would be further enhanced if the legislation were passed. Commissioner Keller did not think that that negotiation position would change by the passage of the legislation.

Representative Sharp commented on his concerns with the State purchasing the depressed securities from Executive Life. He suggested that SBS should sell the depressed securities and then the State could be given the option to make them whole.

Mr. Rexwinkle commented on the GIC contracts. He thought that the market value could be worse than last reported by Executive Life. There are no assignment clauses in the GIC contracts and the company has to approve them in order to assign them. The "no assignment" clauses keep them from being a marketable security.

(Tape change, HFC 91-46, Side 2).

Representative Ulmer criticized Executive Life's position and unwillingness to admit that that junk funds are worthless. She asked how that would be consistent with recording the GIC's involving the SBS portfolio. Darrell Rexwinkle noted that Executive Life has a deficiency in assets. Representative Ulmer reiterated the question. What would substantiate the need for the action to happen sooner rather than later. Mr. Rexwinkle replied that this information would affect the permanent impairment decision and he felt he could not adequately answer the question.

Co-Chair Navarre inquired who made the investments for the Department of Administration. Commissioner Keller explained that since March 1990, all the SBS funds are being invested by the Department of Revenue. Co-Chair Navarre asked for a chronology of all Executive Life decisions. Commissioner Keller said there were four Executive Life contracts released on an invitation to bid basis, one in 1987, two in 1988, and one in 1989. The bids were based on the highest interest rate.

Representative Phillips questioned the current retirement

investment. Deputy Commissioner Rexwinkle replied that these investments are all short term papers. Representative Phillips asked what criteria will be used for future investments. Commissioner Keller replied an elaborate criteria has been established in developing the asset allocation plan creating strict requirements for recordkeeping and investment. Commissioner Keller offered to provide a copy of the RFP to the Committee. Co-Chair Navarre questioned if underlying securities would be purchased from Executive Life. Commissioner Keller said it would be an exchange of the GIC contracts and the junk bonds which would need to be managed.

Co-Chair Navarre asked when the problems with Executive Life were first obvious. Commissioner Keller said the first problems occurred fifteen months ago, in 1989, at which point the funds began to be downgraded because 40% of their assets were in junk bonds. When the junk bond market began to decline, the majority of their assets began to decline. Their rating continued to decline with that process. In March 1990, the State of Alaska issued their fourth GIC contract to Executive Life. At that point, the State negotiated a termination of any further participation. There were no provisions in the contract with Executive Life for the State to prematurely end the contract on the basis of the investment falling below the investment grade.

Representative Boyer asked if Executive Life was current with their negotiated rate. Commissioner Keller pointed out that we are accruing that rate, and the first amount would be due 1993. The four contracts are due for receipt in 1993, 1994, 1995 and 1996. Representative Boyer did not understand the urgency of the situation. Commissioner Keller was convinced that the underlying assets of Executive Life have deteriorated so much in value at this time, that there will not be enough cash produced from the "junk bond pay off" to pay the GIC contracts as they become due.

BRUCE LUDWIG, ALASKA PUBLIC EMPLOYEE ASSOCIATION, JUNEAU, ALASKA, spoke in favor of passage of HB 221. He said the State took the responsibility to invest the SBS funds into sound investments.

Representative Boyer affirmed that persons who withdrew their money from SBS have received the entire amount due. Mr. Ludwig said that if Executive Life represents 20% of the fund, persons who started work three years ago and withdrew their funds, would have been drawing on the Executive Life funds. Those persons removed the "good" money from the other eighty percent and the remaining funds will be greater than twenty percent of the whole. The impact on those persons remaining in the SBS will be greater than the twenty percent depending on the amount taken out.

Representative Ulmer affirmed Mr. Ludwig's position. Representative Boyer pointed out that is how the stock market works. Mr. Ludwig explained that the guarantee to each State employee was that their money would be guaranteed and at a rate of 9.15%. He added that the employees of the State have no voice in determining how the money of the SBS funds are invested. Representative Jacko asked Mr. Ludwig if he supported changing the "may" to "shall". Mr. Ludwig supported the change.

Representative Larson provided the Committee with Amendment #1 and #2. [Attachment #1 and #2]. Amendment #1 would place before the word "guaranteed" the words "Executive Life Insurance Company" in Lines 1 and 6, Page 1. Representative Larson MOVED Amendment #1. There being NO OBJECTION, it was so ordered.

Representative Larson spoke in favor of Amendment #2. Commissioner Keller pointed out concerns with Amendment #2. Representative Larson MOVED Amendment #2. Representative Boyer OBJECTED for purposes of additional clarification.

Representative Boyer asked what the purpose of notification would be and what recourse LBA would have in regard to that purpose. Representative Larson said the members of LBA would be polled to address their concerns, allowing time to make a recommendation to the Commissioner. Representative Boyer asked if two days would be enough time. Representative Larson said that decisions have to be made in emergency situations and granting a longer amount of time would complicate the situation. Representative Boyer disagreed that there would be a tight time frame for the movement of funds. Representative Larson stated that this amendment would conform with action taken in the Senate and requested by Commissioner Keller.

GARY BADER, DIRECTOR, DIVISION OF RETIREMENT AND BENEFITS, DEPARTMENT OF ADMINISTRATION, stated that the Administration sought the cooperation of the Legislature and thought that the addition of Amendment #2 would provide that cooperation. Mr. Bader stated it would not be urgent to purchase the contracts.

(Tape change, HFC 91-47, Side 1).

Representative Ulmer observed that LBA does not have independent authority over the decision or appropriation. The action of the Committee would be a notification to the Chairman of the Budget and Audit Committee of what the Administration is currently doing. This would be a curtsey notification. Representative Boyer withdrew his OBJECTION to Amendment #2.

Amendment #2 was adopted. CSHB 221 (FIN) was HELD in Committee for further discussion.

HB 221 An Act authorizing the Department of Revenue either the guaranteed investment contracts held by the supplemental benefits system or the underlying securities; and providing for an effective date.

HB 221 was HELD in Committee.

HOUSE BILL 221

"An Act authorizing the Department of Revenue either the guaranteed investment contracts held by the supplemental benefits system or the underlying securities; and providing for an effective date."

Co-Chair Navarre expressed his intention to hold House Bill 221 in Committee, pending receipt of opinions from the Department of Law. House Bill 221 was HELD in Committee.

Is Your Pension Fund Safe?

If an insurer holds it, it may not be guaranteed

BY JANE BRYANT QUINN

The collapse of the Executive Life Insurance Co. is scary news for pension holders. Billions of dollars in retirement funds are backed by insurance-company annuities like the ones widely sold by Executive Life—and much of that money isn't guaranteed. Executive Life can meet its immediate obligations (or so says California's insurance commissioner). But if its money runs out, the checks may stop.

Employers buy pension annuities for a couple of reasons: to make the insurer responsible for paying your pension, or to invest in the high interest rates some annuities offer. "Individual" annuities are bought in your name. "Unallocated" annuities provide pensions to a group of workers as a whole.

But what if the insurer fails? In theory, two safety nets hang between you and poverty: the Pension Benefit Guaranty Corporation (PBGC), which protects against failed pension plans, and state guaranty associations, which clean up behind defunct insurers. In practice, however, the PBGC won't cover all insurance-backed pensions.

As for the guaranty funds, just 15 states specifically protect unallocated pension annuities. At least 21 cover individual annuities, mostly to \$100,000 a person.

Who's secure? To see if you're protected, check your situation on the following list:

- *You're retired and getting a pension based on your age, salary and years of service.* It's paid by your company, directly from the pension trust. You're safely insured by the PBGC, to a top of \$2,250 a month for individual retirees at age 65.

- *You're retired and getting a monthly pension funded by an individual insurance annuity.* You are not protected by the PBGC or by your employer. You'll lose your income if the insurer runs out of assets, unless a guaranty fund steps in.

- *You're working and your retirement fund is building up.* Your protection depends on the type of pension you have.

(1) If you're guaranteed a fixed monthly benefit, and your fund buys such things as stocks and fixed-income securi-

ties, you're insured by the PBGC up to the maximum allowed.

(2) If you have a profit-sharing plan, a 401(k) or a typical Keogh, you're not insured. These plans rarely fail, although your investments could drop in value.

(3) If you're guaranteed a fixed monthly benefit, and it's backed by an insurance contract, the nature of your protection depends on the contract. With an unallocated annuity, your employer usually has to step in if the insurance compa-



Shutting the barn door: A threat to your retirement money

ny fails, says Carol Flowe, general counsel for the PBGC. If the pension plan fails, the PBGC would pay. But if your entire pension benefit is dumped into an individual annuity, the obligation is transferred to the insurer, Flowe says. If the insurer fails, and doesn't have the assets to pay, your only hope is a guaranty fund.

Now for the rest of the bad news: when it comes to big insurers, the guaranty funds are essentially a fraud. They couldn't even handle the much smaller Baldwin United failure back in 1983. That rescue package took years to assemble and involved insurers and stockbrokers as well as the state funds.

Losses mount: A company the size of Executive Life will most likely overwhelm the guaranty funds and perhaps the insurance industry, too. If losses mount and retirees can't get their pension checks, they'll holler at Congress, which might dump the whole mess onto the PBGC, says Washington, D.C., attor-

ney and pension expert Michael Gordon.

But that's no solution, either. The PBGC's funding comes from private corporations and they're not paying enough as it is. Right now, the pension insurance fund is nearly \$2 billion in the hole. If it had to back annuities, too, premiums would leap—probably to more than employers could handle. Besides, it's foolish to ask the PBGC to guarantee the solvency of the whole insurance industry.

Who, then, will pay? If every insurance annuity were bought by individuals, the answer might be "no one." You're responsible for the investments you make.

But employees usually have no choice. Their companies buy the annuities, often from a low-cost insurer like Executive Life. You may not know that your carrier

is second rate; even if you did you wouldn't be able to opt out. So why should you suffer if payments stop?

Instead, fault should cling to the employer who bought the bad annuity in the first place. You can sue a company that doesn't make proper and prudent pension investments.

In a class action against California-based MagneTek, Inc., which stowed large amounts of pension money in Executive Life, workers in two of its Wisconsin plants are charging conflict of interest. MagneTek's management floated junk bonds to raise the money to buy the company. Executive Life bought a lot of the bonds and later received the bulk of the workers' pension fund, over the objection

of the union and key executives. "We're afraid that the state guaranty fund will run for the woods," says union attorney Jim Mauro. (The fund hasn't said.) The insurance agent may also be sued.

If a company implies that annuities are safe, that might also give workers ground for suit, says consultant Harry Gross of Kwasha Lipton in Fort Lee, N.J.

At bottom, this is yet another tale of blinkered regulators teamed up with grasping business people who, in the words of Henny Youngman, hand out baloney disguised as food for thought. Risky insurers have been selling annuities for years. Yet only last year did the PBGC start flagging risky pension annuities. Only last year did the Department of Labor take up the oversight job that was its all along. Even as we speak, the National Association of Insurance Commissioners is debating solvency standards. Talk about shutting the barn door.

Associate: VIRGINIA WILSON

Anch. Daily News Wed. April 24, 1991

Hickel backs retirement bailout

By HAL BERNTON
Daily News business reporter

Gov. Wally Hickel said Tuesday he thinks the state should stand behind an ailing state employee retirement fund and would "strongly consider" signing legislation to make up any of its losses.

Hickel's comments Tuesday came in response to a constituent's question during a radio call-in show on

the Alaska Public Radio Network.

They are at odds with statements Monday by Millett Keller, a Hickel Cabinet member who has taken a lead role in dealing with the crisis in the state Supplemental Benefits System, which could lose up to \$130 million invested in a crumbling California insurance company.

Keller said he thought the

state — unless faced with a legal obligation — shouldn't use money from the general fund to rescue the retirement fund.

"If you have to choose sides between the public and employees, then my belief is that our oath is to the citizens of Alaska," said Keller, Hickel's commissioner of administration, during a legis-

Please see Back Page, SBS

SBS: Bailout supported

Continued from Page A-1

lative hearing.

By late Tuesday, administration spokesmen were scrambling to clarify Hickel administration policy on an issue that touches more than 20,000 past and present state employees.

John Manly, a deputy press secretary, said Hickel was speaking in broad terms about the state's obligations. If the legislature sends Hickel a bill to make up any losses, then the governor would probably sign it, Manly said. "He feels like there was a state fiduciary responsibility."

Since 1980, state employees — including most legislators — have made mandatory payments into the Supplemental Benefits System. It supplements a much larger pension system, administered by the Revenue Department, that is not at risk.

State workers had no say in how the supplemental funds were invested. From 1987 to 1989, Department of Administration officials put up to a third of the funds in Executive Life Insurance Co., a California insurer with a portfolio full of junk bonds that was seized earlier this month by regulators. The state of Alaska's entire investment may be lost.

In March, as Executive Life's problems intensified, the Hickel administration proposed a bill that would authorize the use of general fund money to make good on any losses to the employee retirement fund. But that bill was voted down on the Senate floor.

After that, Sen. Pat Pourchot, D-Anchorage, spoke out in favor of bailing out the Supplemental Benefits System, saying it was the state's responsibility to protect the workers. But the administration then backed away from the bill as it sought a still-pending legal opinion on whether the state is liable for lost funds.

On Tuesday, Hickel appeared to once again throw administration support behind general fund appropriations to cover losses that could run as high as \$130 million.

"Somehow, the state has to stand behind the retirement fund," he said. "If the legislation looks like it will solve the problem ... we will strongly consider it because we have an obligation."

Juneau Empire 5/10/91

Bailout pricetag growing

House gives unanimous OK to plan

By RALPH THOMAS

THE JUNEAU EMPIRE

The pricetag to bail out an ailing state-employee retirement fund grew by more than \$4 million this week.

Under a Hickey administration plan approved unanimously by the House today, the state will spend up to \$138.1 million to protect the Supplemental Benefits System from losing money on investment contracts with a sinking California insurance company.

If the plan clears the Senate and is signed by the governor, \$45 million will be taken from the state general fund to create a new "investment loss trust fund." The administration would also be allowed to draw up to \$93.1 million from the state's budget reserve to cover the bailout account.

The new fund would be used to prevent the SBS program from losing money on its investment contracts with Executive Life Insurance Co., a junk bond-riddled firm that was seized last month by California insurance regulators.

When the administration's plan was first presented to the House Finance Committee this week, the bailout price stood at \$132 million. But the figure was increased Thursday.

Department of Administration Commissioner Millett Keller said the cost grew by \$2.8 million in April — the increase in "paper value," or interest supposedly earned on the Executive Life contracts.

An additional \$3.3 million was tacked on after the administration discovered it might also have to cover losses suffered by former government workers who are getting monthly annuity checks from Executive Life.

The SBS program was started in 1960 after state workers opted out of the federal Social Security system. The fund has since grown to more than \$620 million, covering more than 22,000 past and present government workers.

Workers contribute about 6 percent of their wages to the program, which is matched by an equal amount from the state.

The Executive Life contracts were purchased between 1987 and 1990.

Under the bailout plan, money will be drawn as needed from the investment loss fund to cover losses on the Executive Life contracts. Meanwhile, the administration will try to recover some or all of the money through lawsuits and by holding out and hoping Executive Life might recover and pay off on the contracts.

If any money is recovered, it would go into the bailout fund and eventually back to the general fund and budget reserve.

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SBS...

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The administration requested the \$3.3 million to cover former employees receiving Executive Life annuities after it became apparent their losses might not be covered by the company or by California's insurance guarantee pool.

When SBS members go off the payroll, they can request a lump-sum payment or a monthly annuity check.

During 1987 and part of 1990, Executive Life operated the SBS annuity program, and people who chose the annuity option in those years get their checks directly from the insurance firm.

Keller said more than 300 people signed up for SBS annuities from Executive Life, and he estimates the amount owed on those accounts at about \$11 million.

Late last month, California's insurance regulators won court approval to reduce Executive Life's annuity payments by 30 percent until they can better determine the com-

pany's assets and liabilities.

When the company was seized, more than half of its assets were reportedly in high-risk, high-yield junk bonds.

Keller said the extra \$3.3 million in the bailout fund would be used to cover the 30 percent drop in the annuity checks to former Alaska government workers.

The bailout plan was submitted after the administration received a legal opinion on the state's obligation to protect the retirement fund. Details of the legal opinion have not been made public, but several legislators have said the contents of the opinion became obvious when the administration supported the bailout.

Rep. Mike Navarre, D-Kenai, tried during Thursday's Finance Committee meeting to get an admission of liability added to the bailout bill. But Assistant Attorney General Jim Baldwin advised against such a move.

"People can infer from the bill what they want," Baldwin said. "But I think it would not be in the interest of the state to do that at this time."

After the meeting, Baldwin said he would be comfortable discussing the legal opinion after the bailout had the full Legislature's approval.

Meanwhile, the House is scheduled Monday to consider a bill that would set up a system aimed partially at preventing future problems with the investment of employee pension funds.

Senate Bill 18 would establish a public corporation to invest nearly \$5 billion in public employee pension funds, including the SBS money. The corporation would be similar to the Alaska Permanent Fund Corp., which invests the state's \$11 billion oil savings account.

The corporation would include a nine-member board overseeing an executive director and investment staff.

Aside from SBS, the pension corporation would also invest about \$2.7 billion from the Public Employees Retirement System and \$1.7 billion from the Teachers Retirement System. The pension funds currently are managed by the Department of Revenue.

State knew pension holder was shaky, invested anyway

By HAL BERNTON
Daily News business reporter

State officials who made ill-fated retirement investments in Executive Life Co. disregarded repeated, published warnings of the risk involved in buying into the California-based insurance company.

Instead, they took the advice of a Seattle consultant who worked for the subsidiary of one of the world's

largest insurance brokers, according to past and present state officials.

Between 1987 and 1990, state officials invested nearly \$130 million — up to 30 percent of a supplemental retirement fund — in Executive Life.

California regulators this month seized Executive Life's parent company — First Executive Corp. — in what might become the na-

tion's largest insurance company insolvency.

The state could lose its entire \$130 million investment, covering more than 20,000 past and present state workers, and might be forced to cover the lost money out of the state treasury.

The main state retirement funds — totaling more than \$5 billion — are separate from the supplemental fund and are handled by a staff of

investment professionals within the Department of Revenue.

But the \$435 million supplemental fund was under the day-to-day management of a Department of Administration accountant, Mike Halverson, who said he had no formal academic training in financial investing. For the past couple of years, he said, he lacked even a working computer system to ade-

quately track employee investments in the retirement fund.

Halverson said he read many press accounts that as early as 1987 cautioned that Executive Life was investing in high-risk "junk" bonds and had invested money in the scandal-racked firm of Wall Street trader Ivan Boesky.

"We were fully aware of what was happening at Ex-

ecutive Life. We just believed they would be all right," Halverson said.

Whenever he had doubts, Halverson said, he turned to Bob Richardson, a former principal in the benefits consulting firm of William M. Mercer Cos., a subsidiary of the huge insurance broker, Marsh & McLennan.

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INVESTMENTS

THE BACK PAGE

INVESTMENTS: State officials ignored warnings about Executive Life

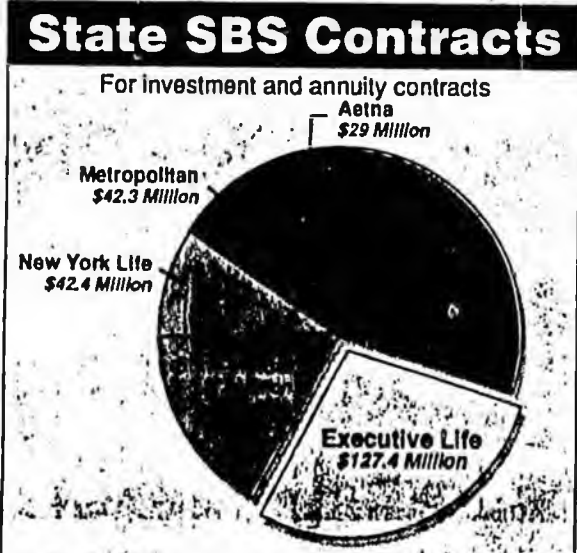
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Richardson, according to Halverson and other former Administration Department officials, developed the investment strategy that put 100 percent of the retirement money into a kind of insurance company savings bond known as "guaranteed income contracts." No bonds, no stocks, no bank certificates or any other investments to diversify the portfolio.

And according to Halverson, Richardson never wavered from that strategy.

"If I got nervous, what I would do is immediately call the only person I knew who could possibly help," Halverson said. "That would be Bob Richardson. I considered him the source of all wisdom."

Elsewhere in the nation, many state retirement fund managers have been wary of concentrating investments in the insurance industry and limit investments in any one company.



Source: Alaska Department of Administration

KEVIN POWELL / Anchorage Daily News

According to Halverson, Richardson repeatedly stated it was almost impossible for Executive Life to go bust within the six-year pay-back

period of the state investments."

Sally Smith, who as director of Halverson's division helped review investment

decisions, confirmed Richardson's company acted as the consultant and recommended that the entire fund be put in insurance companies.

Richardson no longer works for Mercer and could not be found for comment. Halverson and other state officials said he told them in 1989 that he was leaving for a round-the-world cruise and didn't know when he would return. "The last I heard, he was seen off of New Zealand," Halverson said.

Beth Rutherford, a consultant at Mercer, said her company does not get involved in specific investment advice.

The supplemental retirement fund was established in 1980 as state employees opted out of the Social Security system.

Early investments were made with Mutual Benefit Life, then in 1985 the state began taking bids annually to decide which insurance company would get state money. The highest bidder

won the contracts, as long as it was rated A-plus — the highest rating awarded by A.M. Best, a major rating firm.

Executive Life was high bidder for 1987 through 1990 contracts, according to state documents.

As early as 1987, warning alarms were going off about the insurance company. Conning & Co., a stock analyst, published a report stating that First Executive was paying investors higher interest rates due to "a sizable portfolio of high-yield 'junk' bonds. . . In addition to the usual concern over default risk, this strategy is particularly worrisome to investors . . . due to increasing concern by insurance regulators relating to the appropriateness of such investments for life insurers."

Best continued to rate the company A-plus, but in January 1988 other insurance rating companies downgraded First Executive, Halverson said.

But, he said, he was never

told to back away from Executive Life until January 1990, when Best downgraded the company amid an avalanche of press reports detailing the company's problems.

By then, the Administration Department had a new benefits consultant, DeLoitte & Touche. That winter, Administration Commissioner Frank Baxter flew to California and successfully bailed the state out of most of its final investment with First Executive.

By year end, the Administration Department transferred management of the fund to the Revenue Department investment professionals.

As for Halverson, his old files are under lock and chain, and he's planning to leave Juneau for a few weeks.

"There's been a lot of heat. The stress has almost killed me. As far as I'm concerned, this is ancient history. It's not my game anymore."

Wall St. Journal 5/7/91

WUUII HAVE BEEN A TRILING MATTER.

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SOURCE: LITTLEWING

Should the Company or the Employee Take the Hit on Troubled GIC Accounts?

YOUR MONEY MATTERS

By JAMES A. WHITE

Staff Reporter of THE WALL STREET JOURNAL

NEW YORK—Should companies pick up the tab for any losses their employees suffer because of problems at insurer First Executive Corp.?

That question is being put to a major test for companies that bought \$3.09 billion in guaranteed investment contracts, or GICs, from First Executive for their employee benefit plans. First Executive's troubled Executive Life units in California and New York were seized by state insurance regulators last month.

GICs, which are fixed-income contracts sold by insurance companies, are extremely popular retirement and savings plan options. While how much Executive Life will pay on the dollar to GIC holders may not be known for months, companies have begun freezing portions of their employee savings plans that were invested in GICs issued by Executive Life. Companies say freezing part of the plans is necessary until they know exactly how much Executive Life will repay on its GICs.

Among the companies imposing freezes are Honeywell Inc., Xerox Corp. and Unisys Corp.; others are expected to follow suit shortly.

Now, in what is believed to be an unprecedented move, Holiday Inns Inc., a unit of Bass PLC, has decided that it—and not employees—ought to bear any GIC-related loss. The hotel chain has promised to make up any losses of principal on the \$12.8 million of its employees' money in a company savings plan that was invested in GICs issued by Executive Life. "Our employees deserve to know that their invest-

Executive Life GICs Cause a Chill

Companies have frozen or purchased parts of their employee benefit plans invested in guaranteed investment contracts (GICs) issued by Executive Life.

COMPANIES	FACE VALUE OF EXECUTIVE LIFE GIC CONTRACTS (in millions)	PORTION OF GIC FUND	ACTION
Honeywell	\$72.0	16.0%	Executive Life portion frozen
Xerox	66.4	7.5	Executive Life portion frozen
Unisys (2 funds)	40.0 3.0	30.0 7.0	Executive Life portion of both funds frozen
Marathon Oil	20.0	2.0	Executive Life portion frozen
Holiday Inns	12.8	14.0	Executive Life portion frozen; company promises to cover any losses
Georgia-Pacific	5.4	N.A.	Company purchased Executive Life GICs from GIC Fund

N.A.=Not applicable

Source: Company reports

ments will be protected," the company said last week.

A widespread move by companies to shoulder losses for employees due to the problems at First Executive would be a sea change. That's because most of the employee benefit plans that hold First Executive GICs are so-called defined contribution plans.

Defined contribution plans—which include most company-sponsored thrift, profit-sharing and 401(k) plans—place responsibility for any investment losses squarely on employees. Employees usually are given the choice to allocate money in their accounts among several investment options, including stock, bond and GIC funds. (That contrasts with defined benefit plans, which include most long-established pension plans, in which the employer bears

the risk for any losses on the plan's investments.)

Record numbers of defined contribution plans have been set up in the past decade by companies that find them cheaper and easier to administer than defined benefit plans.

Employees in defined contribution plans have suffered losses in the past, most dramatically during the 1987 stock market crash. But the Executive Life GIC problems involve fiduciary questions that go beyond market risk. As a result, the way companies react to losses in this case could portend how they approach their defined contribution plans in future cases.

"We are walking new ground," says benefits consultant Roger C. Bransford of TPF&C. "I think the nature of the (defined

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Sen. Vebbing

Companies Address Employees' Losses From First Executive

Continued From Page C1

contribution) promise is going to be rethought."

Other companies may take a similar view to that of Holiday Inns as fallout from Executive Life spreads, experts say. For one thing, companies are concerned about morale problems if employees have to sustain GIC losses. In addition, though companies may not be legally bound to make up employee losses in defined contribution plans, some companies may worry about possible lawsuits charging them with lapses of their fiduciary duties for not having spotted problems with Executive Life.

"I'm sure there will be litigation surrounding this by people who have lost money on Executive Life," says Howard C. Welzmann, executive director of the Association of Private Pension & Welfare Plans, a benefits trade group that includes corporations, consultants and actuaries. "If the corporate wherewithall is there to make people whole, I think a lot of companies will do that."

Georgia-Pacific Corp. anticipated problems with Executive Life GIC contracts when it acquired Great Northern Nekoosa Corp. last year. Great Northern had purchased \$5.4 million in GICs from Executive Life for its employee savings plan, but Georgia-Pacific officials decided against combining those contracts with its own employee savings plan.

"We were uncomfortable with putting them in" the combined fund, says John E. Stettler, a Georgia-Pacific benefits official. "We felt we had a fiduciary issue." As a result, Georgia-Pacific decided to buy the Executive Life GICs from the employee plan so that any loss would come out of the corporate treasury, not from employees' savings.

3 of 3

Until now, GIC holders have never suffered a loss; but things could be different in the case of Executive Life. Payouts on Executive Life's GIC contracts were suspended when California regulators took over the California unit April 11. (Under a separate action, payments to holders of Executive Life annuities were cut back to 70%.)

Private Strategy Meeting

Corporate benefit executives from more than 20 companies with employee plans holding Executive Life GICs met privately late last month in New York to come up with a strategy for dealing with the insurer's problems. Unisys, one of the companies represented, says the group plans to hire legal counsel to press the claims of GIC holders before regulators.

Meanwhile, employees must cope with freezes announced by their employers on portions of their benefit plans represented by Executive Life GICs. But even with the freeze, employees can generally still make transfers, withdrawals and other transactions normally allowed on the remainder of their benefit accounts.

In letters to their employees, companies commonly stress that freezing part of their accounts doesn't necessarily mean that money will be lost. However, executives confess they don't yet know what will happen. "It's very frustrating to have to announce something like this to plan participants without having more concrete answers," says Robert Evans, Xerox assistant treasurer.

Some company executives are beginning to worry that a debacle with Executive Life GICs could hurt the GIC market as a whole. Already, a number of companies are shopping for alternatives to GIC that would offer some of the most attractive attributes of GICs, such as stable value, while still providing returns higher than Treasury securities. "A whole lot of people are scrambling to consider if they should do something else," says Charles H. Salisbury Jr., a marketing vice president with mutual fund company T. Rowe Price Associates Inc.