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STATE OF ALASKA
1991 LEGISLATIVE SESSION

BILL NO. SB #39

Revision Date: _____ Department Affected: AK Permanent Fund Corporati
 Title: An Act relating to the permanent BRU: AK Permanent Fund Corporation
fund and the Alaska Permanent Fund Corp. Component: #109 AK Permanent Fund Corporation

Sponsor: Senator Pourchot

Requestor: _____

COMPONENT SERIAL NO.

0	1	0	9
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Expenditures/Revenues: (Thousands of Dollars)

OPERATING	FY 92	FY 93	FY 94	FY 95	FY 96	FY 97
PERSONAL SERVICES	-0-	-0-	-0-	-0-	-0-	-0-
TRAVEL	-0-	-0-	-0-	-0-	-0-	-0-
CONTRACTUAL	-0-	-0-	-0-	-0-	-0-	-0-
SUPPLIES	-0-	-0-	-0-	-0-	-0-	-0-
EQUIPMENT	-0-	-0-	-0-	-0-	-0-	-0-
LAND & STRUCTURES	-0-	-0-	-0-	-0-	-0-	-0-
GRANTS, CLAIMS	-0-	-0-	-0-	-0-	-0-	-0-
MISCELLANEOUS	-0-	-0-	-0-	-0-	-0-	-0-
TOTAL OPERATING	-0-	-0-	-0-	-0-	-0-	-0-

CAPITAL	-0-	-0-	-0-	-0-	-0-	-0-
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REVENUE	-0-	-0-	-0-	-0-	-0-	-0-
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FUNDING: (Thousands of Dollars)

GENERAL FUND	-0-	-0-	-0-	-0-	-0-	-0-
FEDERAL FUNDS	-0-	-0-	-0-	-0-	-0-	-0-
OTHER	-0-	-0-	-0-	-0-	-0-	-0-
TOTAL	-0-	-0-	-0-	-0-	-0-	-0-

POSITIONS:

FULL-TIME	-0-	-0-	-0-	-0-	-0-	-0-
PART-TIME	-0-	-0-	-0-	-0-	-0-	-0-
TEMPORARY	-0-	-0-	-0-	-0-	-0-	-0-

Estimate of current year impact: -0-

ANALYSIS: (Attach a separate page if necessary.)

Prepared By: Jim Kelly, Research & Liaison Officer

Phone: 907/465-2047

Division: AK Permanent Fund Corporation

Date: 1/31/91

Approved by Commissioner: _____

Agency: Alaska Permanent Fund Corporation

Date: 1/31/91

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

**STATE OF ALASKA
1991 LEGISLATIVE SESSION**

BILL NO. SB 39

Revision Date: 8-Feb-91 Department Affected: Natural Resources
 Title: Permanent Fund Technical BRU: Management & Administration
 Revision: _____ Components: Administrative Services
 Sponsor: Senator Pourchot
 Requestor: Senate Labor & Commerce COMPONENT SERIAL NO. 424

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 92	FY 93	FY 94	FY 95	FY 96	FY 97
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND&STRUCTURES						
GRANTS,CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL						
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REVENUE						
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FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
CTHER						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

Estimate of Current year impact:

ANALYSIS: (Attach a separate page if necessary)

 See Attached

Prepared by: Sharon Barton Phone: 465-2400
 Division: Management and Administration Date: 8-Feb-91

Approved by Commissioner: HB Harold Heinze Date: 8-Feb-91
 Agency: Department of Natural Resources

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

ALASKA STATE LEGISLATURE

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Senator Pat Pourchot

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**SB 39: Technical Changes to Permanent Fund statutes
presented to Senate Labor and Commerce Committee
February 11, 1991**

Contents:

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(with copies of affected statutes)
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- G. Page 10 from the Division of Policy report, "Permanent Fund Policy Issues"; Maximizing Deposits
- H. Pages 14 and 15 from the Division of Policy report, "Permanent Fund Policy Issues"; Treatment of Royalty Litigation Interest Earnings

SB 39 Summary

SB 39, "An Act relating to the permanent fund and the Alaska Permanent Fund Corporation; and providing for an effective date."

Recent Office of Management and Budget research, the final report of the Commission on the Future of the Permanent Fund, and the Permanent Fund Board of Trustees have all identified several needed clarifications of statutory intent to ensure the legality of current Corporation practices. **Senate Bill 39** attempts to clean up many of the following inconsistencies, ambiguities and other confusing provisions currently in the statutes governing the Permanent Fund.

Language Consistency:

Currently in statute, the terms "Alaska Permanent Fund" and "Alaska Permanent Fund Corporation" are used inconsistently. The first term should refer to assets owned by the State of Alaska, and second term should refer only to the government instrumentality created to manage and invest those assets. The proposed legislation modifies AS 37.13.010 - AS 37.13.210 to use these terms correctly and consistently.

Adjustments to the Legislated List of Investments:

The Corporation is limited to investments of the types specified in statute. Unfortunately this list has not been updated to reflect the current state of financial markets. **Section 10** of SB 39 makes it possible for the Corporation to take advantage of investment opportunities in AA rated or better municipal and state bonds. This section also provides specific authorization for investments in money market instruments.

This proposal removes several investment instruments that have never been used, are not appropriate for the Fund, and have been prohibited by Board policy (page 4, lines 4-24). Neither the Permanent Fund Board, PERS, or TERS have invested in savings and loan or credit union CDs in Alaska because there are no secondary markets for

Alaskan certificates of deposits. Though the CDs are federally insured, once a savings and loan or credit union is in federal bankruptcy court, that security may be tied up for a number of years. In addition, the packages of investments are generally so small as to be undesirable on an administrative level; and there are very few savings and loans and credit unions in Alaska with AA or AAA rating.

Inflation-proofing Deposits:

Money is added to the principal of the Fund once a year to offset the loss of value of the principal due to inflation. Inflation-proofing monthly deposits to the principal from mineral lease royalties and rents could be a very complex task if each deposit were inflation-proofed at a different rate depending on when during the year it was added to the Fund. To ensure that the simplest, most conservative method of inflation-proofing is used, **Section 18** of this legislation mandates that all deposits to the principal of the Fund shall be inflation-proofed at the full annual rate. This change in statute conforms to the current practice of the Corporation.

Litigation Revenue:

The Permanent Fund has received and will probably continue to receive hundreds of millions of dollars from settlements and awards from contested leasing and royalty issues. The money received by the Fund as a result of royalty and leasing litigation has two components, the original amount owed the fund and the interest that money has garnered during the dispute. Current statutes are silent on how these individual components are to be treated by the Corporation. Auditors have differed in their opinions on how such funds should be treated.

This confusion raises two important questions that require legislative clarification: 1) Should interest earned on monies due the Permanent Fund be included in the monies deposited in the Fund when the state eventually receives the funds? and 2) If interest is deposited in the fund, should it be counted as a contribution to principal or counted as income in the year in which the money was received?

The resolution could have a serious fiscal impact on the Fund. For example, the Fund could receive as much as \$385 million in disputed rents, bonuses and royalties from the Dinkum Sands and North Slope Royalty disputes. In the years since litigation was initiated those monies have earned \$386 million in interest (source: April 1990 OMB Report as altered by 1990 Arco Settlement). If the interest income is not dedicated to the Fund, then the interest funds would be general funds available for legislative appropriation. If the interest income is

transferred to the Corporation, but is treated as income generated in the year it is received, the income picture of the Corporation for that year could be dramatically skewed, affecting dividends in that year. The four subsequent years of dividends would be affected as well because of the averaging method currently used to calculate dividends.

The final alternative, treating all interest received as contributions to principal is the course of action currently being used by the Corporation. The legislature ratified this interpretation in the FY91 Operating Budget by mandating similar treatment for any litigation settlement interest monies in FY91.

Section 1 of the proposed legislation clears up this uncertainty by ensuring that all interest on the Fund's share of any settlements or awards will be transferred to the Fund, and that both the original amount due the Fund and any interest it has garnered shall be counted as deposits to the principal of the Fund. This represents the most conservative approach to this question. It adds the greatest amount possible to the principal of the Fund and prevents unpredictable and destabilizing surges in the Corporation's earnings.

Timely Transfers from DNR:

Current law mandates the transfer of funds due the Fund from royalty and lease income from the Department of Natural Resources on a monthly basis. During the thirty-day period between transfers DNR can accumulate sizable balances of monies that will eventually be transferred to the Fund. During recent months of exceptionally high oil prices and high production these monthly transfers have been as high as \$55 million, (November of 1990).

Section 2 of this proposal changes the process so that the Fund receives a transfer whenever \$5 million dollars owed the Fund accumulates at DNR or once a month, whichever is sooner. This will allow the Fund to gain the greatest possible benefit from the monies that have been constitutionally and statutorily dedicated for that purpose.

DIVISION OF LEGAL SERVICES

**LEGISLATIVE AFFAIRS AGENCY
STATE OF ALASKA**

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MEMORANDUM

February 7, 1991

SUBJECT: Permanent Fund Corporation (SB 39)
TO: Senator Pat Pourchot
FROM: Tamara Brandt Cook *TBC*
Director

Here is the sectional summary of SB 39 that you requested.

Section 1. Expands the statute setting out sources of deposits to the principal of the permanent fund to include interest earned by the state on those sources before the money is deposited into the fund.

Sec. 2. Requires that payments due to the permanent fund be paid on the day the amount due to the fund reaches at least \$5,000,000 or at least once each month.

Sec. 3. Substitutes references to the Alaska Permanent Fund Corporation with references to the fund itself.

Sec. 4. Deletes reference to assets allocated to the corporation with language requiring assets of the fund to be managed by the corporation.

Sec. 5. Replaces a reference to the board with a reference to the corporation. Substitutes a reference to the corporation with a reference to the fund itself.

Sec. 6. Substitutes a reference to the corporation with a reference to the fund itself.

Sec. 7. Substitutes a reference to the corporation with a reference to the fund itself. Deletes "Alaska Permanent" as it modifies "fund" because a definition of "fund" has been added in Sec. 24 of the bill and made applicable to the chapter. The same change is made throughout other sections of this bill.

Sec. 8. Substitutes a reference to the corporation with a reference to the fund itself.

Sec. 9. Reworded for clarity.

EXPANDED Sec. 10. Substitutes a reference to the corporation with a reference to the fund itself. Deletes certain types of investments from those the fund assets may be invested in, including investments in notes secured by mortgages on commercial property. Expands the specific types of investments that may be made in real estate improved by substantially rented buildings while deleting the general authority to make those investments on substantially the same terms as those specifically set out in statute. Permits investments in taxable municipal or state securities rated "AA" or better. Permits investments in certain money market or short-term investment funds.

Sec. 11. Corrects cross-references to statutes to reflect changes in Sec. 10.

Sec. 12. Deletes "Alaska Permanent" as it modifies "fund."

Sec. 13. Substitutes a reference to the corporation with a reference to the fund.

Sec. 14. Substitutes a reference to the corporation with a reference to the fund.

Sec. 15. Adds additional types of collateral that may be used as security for investments in certificates of deposit that are not of a quality that may be readily sold in a secondary market at prices reflecting fair value.

Sec. 16. Adds a new provision permitting the board to require substitution of collateral to secure investments in certificates of deposit that are not of a quality that may be readily sold in a secondary market at prices reflecting fair value.

Sec. 17. References to "corporation" are replaced with references to "fund."

Sec. 18. Makes the way the rate of inflation is determined more specific for purposes of "inflation proofing" the principal of the permanent fund.

Sec. 19. Deletes a reference to the corporation in favor of a reference to the fund itself.

Sec. 20. Deletes a reference to the corporation in favor of a reference to the fund itself.

Sec. 21. Deletes references to the corporation and substitutes reference to the fund.

Sec. 22. Adds the fund as specifically tax exempt.

Sec. 23. Specifically provides resources of the fund, as well as those of the corporation, may not be used to influence political activities.

Senator Pat Pourchot
February 5, 1991
Page 3

Sec. 24. Adds a definition of "fund" applicable to the chapter.

Sec. 25. Provides a July 1, 1991 effective date.

TBC:lmb
91-018.lmb

TO: Tamara Cook, Director
Division of Legal Services

FROM: Rod Mourant, Committee Aide
Senate Labor & Commerce Committee

RE: Senate Bill 39

DATE: February 12, 1991

Please draft a committee substitute for SB 39 incorporating the changes titled amendments two through and including six on the attachment.

The version that is being drafted has been passed out of committee and will be read across to the Senate Judiciary Committee.

RRM

ATTACHMENT

PROPOSED AMENDMENTS TO SENATE BILL NO. 39

Amendment #1: Change Sec. 5, page 2, line 31 to read:

of the corporation [BOARD] is to manage and invest the assets of the permanent fund and other funds designated by law

ALASKA: YES - LEGAL OPINION

Purpose: to recognize in the Permanent Fund Management Act that the Corporation is authorized to managed other funds (like the Alaska Science and Technology Fund) as designated by law. No change from the status quo.

Amendment #2: Change Sec. 7, page 3, lines 9-11 to read:

(a) The prudent-investor [MAN] rule shall be applied by the corporation [BOARD] in the management and investment of [ALASKA PERMANENT] fund assets. The prudent-investor [MAN] rule as applied to investments of the fund [CORPORATION] means that in making investments the corporation [BOARD] shall

Purpose: to eliminate the reference to gender in the prudent-investor rule, and to make it clear that not only the trustees but also the staff of the Corporation are bound to follow this rule. No change from the status quo.

Amendment #3: Change Sec. 17, page 9, line 8 to read:

Sec. 37.13.140. INCOME. Net income of the fund includes income of the earnings reserve account established under AS 37.13.145. Net income [CORPORATION] shall be computed

Purpose: to clarify that income of the Fund includes income of the earnings reserve account as well as income of the principal. No change from the status quo.

Amendment # 4: Replace Sec. 18, page 9, lines 14-31 with the following:

* **Sec. 18.** AS 37.13.145 is repealed and reenacted to read:

DISPOSITION OF INCOME. (a) The earnings reserve account is established as a separate account in the fund. Income from the fund shall be deposited by the corporation into the account as soon as it is received. Money in the account shall be invested in investments authorized under AS 37.13.120.

(b) At the end of each fiscal year, the corporation shall transfer from the earnings reserve account to the dividend fund established under AS 43.23.045 50 percent of the income available for distribution under AS 37.13.140. However, income earned on money awarded after trial in *State v. Amerada Hess, et. al.*, 1JU-77-847 Civ. (Superior Court, First Judicial District) shall be treated in the same manner as other income of the permanent fund, except that it is not available for distribution to the dividend fund, and shall be annually deposited into the principal of the permanent fund.

(c) After the transfer under (b) of this section, the corporation shall transfer from the earnings reserve account to the principal of the fund an amount sufficient to offset the effect of inflation on principal of the fund during that fiscal year. The corporation shall calculate the amount to transfer to the principal under this subsection by

(1) computing the average of the monthly United States Consumer Price Index for all urban consumers for each of the two previous calendar years;

(2) computing the percentage change between the first and second calendar year average; and

(3) applying that rate to the value of the principal of the fund on the last day of the fiscal year just ended.

Purpose: to rewrite AS 37.13.145: (1) to clarify original legislative intent and Corporation practice regarding the annual disposition of Fund income; (2) to bring (without substantive change) the section of law addressing the annual Permanent Fund dividend transfer from AS 43.23 into AS 37.13; and (3) to spell out the procedure used by the Corporation in the annual inflation-proofing transfer.

Although this amendment represents no change from current legislative practice, there is one minor policy change: this amendment makes it clear that the annual inflation-proofing transfer shall be made from the earnings reserve account rather than from net income as provided for in existing law.

Amendment #5: Add new Sec. 25 to read:

* Sec. 25. AS 43.23.025(a) is amended to read:

Sec. 43.23.025. Amount of dividend. (a) By October 1 of each year the commissioner shall determine the value of a permanent fund dividend for that year by

(1) determining the total amount available for dividend payments, which equals

(A) the amount of income of the Alaska permanent fund transferred to the dividend fund under AS 37.13.145(b) [AS 43.23.045(b)] during the current year;

(B) plus the unexpended and unobligated balances of prior fiscal year appropriations that lapse into the dividend fund under AS 43.23.045(d);

(C) less the amount necessary to pay dividends from the dividend fund in the current year under AS 43.23.055(3) and(7);

(D) less the amount necessary to pay dividends from the dividend fund due to eligible applicants, who, as determined by the department, filed for a previous year's dividend by the filing deadline but who were not included in a previous year's dividend computation;

(E) less appropriations from the dividend fund during the current year, including amounts to pay the costs of administering the dividend program and the hold harmless provisions of AS 43.23.075;

(2) determining the number of individuals eligible to receive a dividend payment for the current year; and

(3) dividing the amount determined under (1) of this section by the amount determined under (2) of this section.

Purpose: this is a conforming amendment to amendment #4 above.

Amendment #6: Add new Sec. 26 to read:

* Sec. 26. AS 43.23.045(b) is repealed.

Purpose: this is also a conforming amendment to amendment #4 above.

.. SUBMITTED TO SENATOR PAT POURCHOT
BY DAVID A. ROSE, EXECUTIVE DIRECTOR
ALASKA PERMANENT FUND CORPORATION
FEBRUARY 1, 1991

(c) An individual who, in claiming a permanent fund dividend, or an individual who, in certifying another person's eligibility, wilfully misrepresents, exercises gross negligence, or recklessly disregards a material fact pertaining to eligibility forfeits the dividend, is subject to a civil fine of up to \$5,000, and loses eligibility to receive the next five dividends following the forfeited dividends. The commissioner may commence proceedings in court to enforce this subsection. (§ 1 ch 102 SLA 1982; am § 3 ch 159 SLA 1988)

Revisor's notes. — Sections 9 and 10, ch. 99, SLA 1985, amend (a) and (b) of this section, and add a new (c). The amendments are effective if § 1, ch. 99, SLA 1985 is repealed (see § 25, ch. 99, SLA 1985). If the amendments become law, the section will read: "(a) In addition to any criminal penalties imposed by state law, if an individual is convicted of a crime in connection with a false statement made in a certification required under AS 43.23.015, and the conviction is not reversed, that individual forfeits all permanent fund dividends credited or paid, together with any interest credited to that individual's annuity account and is not eligible for a future permanent fund dividend.

"(b) If the commissioner determines that a cash dividend should not have been claimed by or paid to an individual, the commissioner may use all collection procedures or remedies available for collec-

tion of taxes under this title to recover the payment of a permanent fund dividend that was improperly made. A notice of an improperly paid dividend must be sent to the individual within 10 years after the improper payment. If notice is not sent within the 10-year period, proceedings may not be commenced in court for recovery of the improper payment.

"(c) If the commissioner determines that a permanent fund dividend should not have been credited to an individual's annuity account, the commissioner may, after notice and opportunity for hearing, direct the commissioner of administration to debit the individual's annuity account for the amount wrongly credited. If the credit is the fault of the individual, the debit must be made within 10 years. If the credit is the fault of the state, the debit must be made within three years."

Effect of amendments. — The 1988 amendment added subsection (c).

Sec. 43.23.040. Penalties and enforcement. [Repealed, § 22 ch 102 SLA 1982.]

Sec. 43.23.045. Dividend fund. (a) The dividend fund is established as a separate fund in the state treasury. The dividend fund shall be administered by the commissioner and shall be invested by the commissioner in the same manner as provided in AS 37.10.070.

(b) Notwithstanding any contrary provision of law, each year the commissioner shall transfer to the dividend fund 50 percent of the income of the Alaska permanent fund earned during the fiscal year ending on June 30 of the current year and available for distribution. However, income earned on money awarded after trial in State v. Amerada Hess, et al., 1JU-77-347 Civ. (Superior Court, First Judicial District) shall be treated in the same manner as other income of the Alaska permanent fund, except that it is not available for distribution to the dividend fund, and shall be annually deposited into the principal of the Alaska permanent fund.

(c) [Repealed, § 24 ch 99 SLA 1985.]

Amendment #4
Deletes (b)
from the
Revenue
Statutes
and moves
it to P.F.
Statutes
37.13.145(b)

Amendment #5

§ 43.23.020

REVENUE AND TAXATION

§ 43.23.025

state managed or disposed of permanent fund dividends received on behalf of the minor or incompetent, or an election made or not made on that individual's behalf under AS 43.23.005(d).

"(i) The permanent fund dividend application form shall be prepared to allow an applicant, other than a person who is exempt under AS 47.45.015(b), to elect to receive the dividend either in cash or as an annuity credit."

Cross references. — For voluntary contributions to Alaska Winter Olympics account, see AS 05.35.100.

Effect of amendments. — The 1989 amendment rewrote the statement of eligibility and certification of residency in subsection (b) to the extent that a detailed comparison is impracticable.

The 1989 amendment substituted "24 months" for "six months" in the first two paragraphs of the form in subsection (b).

The 1990 amendment, effective January 1, 1991, inserted "a disabled or" before "an incompetent" in subsection (d) and near the beginning of subsection (f) and inserted "disabled or" before "incompetent" near the end of subsection (f).

Sec. 43.23.020. Proof of eligibility. [Repealed, § 22 ch 102 SLA 1982.]

Sec. 43.23.025. Amount of dividend. (a) By October 1 of each year the commissioner shall determine the value of each permanent fund dividend for that year by

(1) determining the total amount available for dividend payments, which equals

(A) the amount of income of the Alaska permanent fund transferred to the dividend fund under AS 43.23.045(b) during the current year;

(B) plus the unexpended and unobligated balances of prior fiscal year appropriations that lapse into the dividend fund under AS 43.23.045(d);

(C) less the amount necessary to pay dividends from the dividend fund in the current year under AS 43.23.055(3) and (7);

(D) less the amount necessary to pay dividends from the dividend fund due to eligible applicants who, as determined by the department, filed for a previous year's dividend by the filing deadline but who were not included in a previous year's dividend computation;

(E) less appropriations from the dividend fund during the current year, including amounts to pay costs of administering the dividend program and the hold harmless provisions of AS 43.23.075;

(2) determining the number of individuals eligible to receive a dividend payment for the current year; and

(3) dividing the amount determined under (1) of this section by the amount determined under (2) of this section.

(b) For the purpose of calculating the amount of a permanent fund dividend under (a) of this section, an individual who is ineligible to receive a dividend under AS 43.23.005(d) is counted as an eligible individual whether or not the individual has applied for the dividend. (§ 1 ch 102 SLA 1982; am § 1 ch 55 SLA 1983; am § 2 ch 43 SLA 1984; am § 2 ch 57 SLA 1987; am § 2 ch 54 SLA 1988; am § 4 ch 68 SLA 1990; am § 1 ch 198 SLA 1990)

changes references to AS 37.13.14(b) to reflect new location of dividend language pursuant to amendment #4

Sec. 37.13.130. Gains and losses. [Repealed, § 13 ch 81 SLA 1982.]

Sec. 37.13.140. Income. Net income of the corporation shall be computed annually as of the last day of the fiscal year in accordance with generally accepted accounting principles, excluding any unrealized gains or losses. Income available for distribution equals 21 percent of the net income of the corporation for the last five fiscal years, including the fiscal year just ended, but may not exceed net income of the corporation for the fiscal year just ended plus the balance in the earnings reserve account described in AS 37.13.145. (§ 5 ch 18 SLA 1980; am § 8 ch 81 SLA 1982; am § 1 ch 28 SLA 1986)

Effect of amendments. — The 1986 amendment in the first sentence substituted "shall" for "must" and in the second sentence substituted "21 percent of the net income" for "the average net income" and "earnings reserve" for "undistributed income."

Sec. 37.13.145. Disposition of income. At the end of each fiscal year, an amount sufficient to offset the effect of inflation on principal of the Alaska permanent fund during that year, as measured by the change in the calendar year average United States consumer price index for all urban consumers shall be transferred from net income as defined in AS 37.13.140, excluding income on the earnings reserve account in the Alaska permanent fund, to the principal of the Alaska permanent fund for reinvestment. The balance of the income available for distribution under AS 37.13.140 shall be transferred to the earnings reserve account in the Alaska permanent fund. Money in the earnings reserve account shall be invested in investments authorized under AS 37.13.120. Income from the investment of the earnings reserve account shall be treated as an addition to that account. (§ 9 ch 81 SLA 1982; am § 2 ch 28 SLA 1986)

Cross references. — For transfer of certain income earned by the Alaska permanent fund prior to July 1, 1982, to the undistributed income account, see § 15, ch. 81, SLA 1982.

Effect of amendments. — The 1986 amendment in the first sentence substituted "the change in the calendar year average United States consumer price index for all urban consumers" for "a nationally recognized index," in the second sentence substituted "income available for distribution under" for "net income as defined in," and substituted "earnings reserve" for "undistributed income" throughout the section.

Sec. 37.13.150. Corporation budget. The revenue generated by the corporation's investments must be identified as the source of the operating budget of the corporation in the state's operating budget under AS 37.07 (Executive Budget Act). The unexpended balance of the corporation's annual operating budget does not lapse at the end of the fiscal year but shall be treated as income under AS 37.13.140. (§ 5 ch 18 SLA 1980; am § 10 ch 81 SLA 1982)

SENATE BILL NO. 39

IN THE LEGISLATURE OF THE STATE OF ALASKA

SEVENTEENTH LEGISLATURE - FIRST SESSION

BY SENATOR POURCHOT

Introduced:
Referred:

A BILL

FOR AN ACT ENTITLED

1 "An Act relating to the permanent fund and the Alaska Permanent Fund Corporation; and
2 providing for an effective date."

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

4 * Section 1. AS 37.13.010(a) is amended to read:

5 (a) Under art. IX, sec. 15 of the state constitution, there is established as a separate fund
6 the Alaska permanent fund. The [ALASKA PERMANENT] fund principal consists of

7 (1) 25 percent of all mineral lease rentals, royalties, royalty sale proceeds, net
8 profit shares under AS 38.05.180(f) and (g), and federal mineral revenue sharing payments
9 received by the state from mineral leases issued on or before December 1, 1979, and 25 percent
10 of all bonuses received by the state from mineral leases issued on or before February 15, 1980;

11 (2) 50 percent of all mineral lease rentals, royalties, royalty sale proceeds, net
12 profit shares under AS 38.05.180(f) and (g), and federal mineral revenue sharing payments
13 received by the state from mineral leases issued after December 1, 1979, and 50 percent of all
14 bonuses received by the state from mineral leases issued after February 15, 1980;

language consistency

1. interest on revenue
2. litigation

(3) interest earned by the state on money described in (1) and (2) of this subsection before that money is deposited in the fund;

(4) any other money appropriated to or otherwise allocated by law to the [ALASKA PERMANENT] fund.

* Sec. 2. AS 37.13.010(b) is amended to read:

(b) Payments due the Alaska permanent fund under (a) of this section shall be made to the fund on the day the amount due to the fund reaches at least \$5,000,000 and at least once each month.

* Sec. 3. AS 37.13.020 is amended to read:

7. timely transfers from DNR

Sec. 37.13.020. FINDINGS. The people of the state, by constitutional amendment, have required the placement of at least 25 percent of all mineral lease rentals, royalties, royalty sale proceeds, and federal mineral revenue sharing payments and bonuses received by the state into a permanent fund. The legislature finds with respect to the fund [ALASKA PERMANENT FUND CORPORATION] that

14. language consistently

(1) the fund [CORPORATION] should provide a means of conserving a portion of the state's revenue from mineral resources to benefit all generations of Alaskans;

(2) the fund's [CORPORATION'S] goal should be to maintain safety of principal while maximizing total return;

(3) the fund [CORPORATION] should be used as a savings device managed to allow the maximum use of disposable income from the fund [CORPORATION] for purposes designated by law.

* Sec. 4. AS 37.13.030 is amended to read:

Sec. 37.13.030. PURPOSE. It is the purpose of this chapter to provide a mechanism for the management and investment of those [PERMANENT] fund assets by [ALLOCATED TO] the Alaska Permanent Fund Corporation in a manner consistent with the findings in AS 37.13.020.

* Sec. 5. AS 37.13.040 is amended to read:

Sec. 37.13.040. ALASKA PERMANENT FUND CORPORATION. There is established the Alaska Permanent Fund Corporation. The corporation is a public corporation and government instrumentality in the Department of Revenue managed by the board of trustees. The purpose of the corporation [BOARD] is to manage and invest the assets of the permanent fund

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1 [CORPORATION] in accordance with this chapter.

2 * Sec. 6. AS 37.13.110(b) is amended to read:

3 (b) If a member of the board or an employee of the corporation acquires, owns, or
4 controls an interest, direct or indirect, in an entity or project in which fund [CORPORATION]
5 assets are invested, the member shall immediately disclose the interest to the board. The
6 disclosure is a matter of public record and shall be included in the minutes of the board meeting
7 next following the disclosure.

8 * Sec. 7. AS 37.13.120(a) is amended to read:

9 (a) The prudent-man rule shall be applied by the board in the management and
10 investment of [ALASKA PERMANENT] fund assets. The prudent-man rule as applied to
11 investments of the fund [CORPORATION] means that in making investments the board shall
12 exercise the judgment and care under the circumstances then prevailing that an institutional
13 investor of ordinary prudence, discretion, and intelligence exercises in the management of large
14 investments entrusted to it not in regard to speculation but in regard to the permanent disposition
15 of funds, considering probable safety of capital as well as probable income.

16 * Sec. 8. AS 37.13.120(b) is amended to read:

17 (b) The fund [CORPORATION] assets shall only be used for income-producing
18 investments.

19 * Sec. 9. AS 37.13.120(e) is amended to read:

20 (e) The corporation may not borrow money [FUNDS] or guarantee from principal of the
21 [ALASKA PERMANENT] fund the obligations of others.

22 * Sec. 10. AS 37.13.120(g) is amended to read:

23 (g) Subject to the limitations contained in this section, the board may invest fund
24 [CORPORATION] assets at the competitive national market rates or prices that are applicable
25 to each investment only in

26 (1) obligations of, or obligations insured by or guaranteed by, the United States
27 or agencies or instrumentalities of the United States;

28 (2) obligations secured by reserves paid in by the United States or agencies or
29 instrumentalities of the United States or obligations of corporations in which the United States
30 is a shareholder or member;

31 (3) certificates of deposit and term deposits of United States domestic banks that

1 are members of the Federal Deposit Insurance Corporation and that may be readily sold in a
2 secondary market at prices reflecting fair value or that are fully secured at all times as to
3 payment of principal and interest as described in (m) of this section;

4 (4) [CERTIFICATES OF DEPOSIT AND TERM DEPOSITS OF FEDERALLY
5 CHARTERED SAVINGS AND LOAN ASSOCIATIONS IN ALASKA THAT MAY BE
6 READILY SOLD IN A SECONDARY MARKET AT PRICES REFLECTING FAIR VALUE
7 OR THAT ARE FULLY SECURED AT ALL TIMES AS TO PAYMENTS OF PRINCIPAL
8 AND INTEREST AS DESCRIBED IN (m) OF THIS SECTION;

9 (5) CERTIFICATES OF DEPOSIT AND TERM DEPOSITS OF STATE
10 CHARTERED SAVINGS AND LOAN ASSOCIATIONS IN ALASKA THAT MAY BE
11 READILY SOLD IN A SECONDARY MARKET AT PRICES REFLECTING FAIR VALUE
12 OR THAT ARE FULLY SECURED AT ALL TIMES AS TO PAYMENTS OF PRINCIPAL
13 AND INTEREST AS DESCRIBED IN (m) OF THIS SECTION;

14 (6) CERTIFICATES OF DEPOSIT AND TERM DEPOSITS OF MUTUAL
15 SAVINGS BANKS IN ALASKA THAT MAY BE READILY SOLD IN A SECONDARY
16 MARKET AT PRICES REFLECTING FAIR VALUE OR THAT ARE FULLY SECURED AT
17 ALL TIMES AS TO PAYMENTS OF PRINCIPAL AND INTEREST AS DESCRIBED IN (m)
18 OF THIS SECTION;

19 (7) FIXED-TERM CERTIFICATES OF INDEBTEDNESS OF FEDERALLY
20 INSURED CREDIT UNIONS IN ALASKA THAT MAY BE READILY SOLD IN A SECON-
21 DARY MARKET AT PRICES REFLECTING FAIR VALUE OR THAT ARE FULLY
22 SECURED AT ALL TIMES AS TO PAYMENTS OF PRINCIPAL AND INTEREST AS
23 DESCRIBED IN (m) OF THIS SECTION;

24 (8) domestic corporate debt securities that are rated AA or better by a nationally
25 recognized rating service, or nondomestic corporate debt securities of comparable quality;

26 (5) [(9)] short-term

27 (A) domestic corporate promissory notes of the highest ratings assigned
28 by a nationally recognized rating service; [,] or

29 (B) nondomestic corporate promissory notes of comparable quality, the
30 interest on which may be payable in either United States dollars or nondomestic
31 currencies;

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(6) [(10)] bankers' acceptances drawn on and accepted by United States banks each of which has a combined capital and surplus aggregating at least \$200,000,000;

(7) [(11)] repurchase agreements, the securities underlying the agreements being any of the items in (1) - (6) [(1) - (3) AND (8) - (10)] of this subsection;

(8) [(12)] THE GUARANTEED PORTION OF FEDERAL SMALL BUSINESS ADMINISTRATION LOANS;

(13) THE PORTION OF FIRST LIEN REAL ESTATE MORTGAGES GUARANTEED BY THE FEDERAL VETERANS ADMINISTRATION;

(14)] the portions of business and industrial loans made under the Rural Development Act of 1972 that are guaranteed by the Farmers Home Administration;

(9) [(15)] the guaranteed portion of Farmers Home Administration loans;

(10) [(16)] notes secured by mortgages granting a first lien on [COMMERCIAL OR] residential real estate improved by completed buildings if the mortgages are insured by a private mortgage insurance corporation that is authorized to do business in this state [ALASKA] and has combined capital and surplus aggregating at least \$20,000,000, and if loan-to-value ratios do not exceed [75 PERCENT FOR COMMERCIAL MORTGAGES AND] 90 percent [FOR RESIDENTIAL MORTGAGES]; however,

[(A) MORTGAGE INSURANCE IS NOT NECESSARY FOR COMMERCIAL LOANS HAVING LOAN-TO-VALUE RATIOS OF LESS THAN 50 PERCENT AND THE MINIMUM COVERAGE OF OTHER COMMERCIAL LOANS SHALL BE 10 PERCENT FOR THOSE HAVING A LOAN-TO-VALUE RATIO OF 50 - 60 PERCENT AND 15 PERCENT FOR THOSE HAVING A LOAN-TO-VALUE RATIO GREATER THAN 60 PERCENT BUT NO MORE THAN 75 PERCENT; AND

(B)] mortgage insurance is not necessary for residential loans having a loan-to-value ratio of less than 70 percent and the minimum coverage of other residential loans shall be 10 percent for those having a loan-to-value ratio greater than 70 percent but less than 90 percent and 20 percent for those having a loan-to-value ratio of 90 percent;

(11) [(17)] NOTES SECURED BY MORTGAGES GRANTING A FIRST LIEN ON COMMERCIAL REAL ESTATE IMPROVED BY COMPLETED BUILDINGS IF THE ORIGINATING FINANCIAL INSTITUTION RETAINS AT LEAST 25 PERCENT OF THE

deletion of non trust grade investments

high risk investments which have been prohibited by bond policy

1 MORTGAGE UNTIL MATURITY;

2 (18)] preferred and common stock of corporations incorporated in the United
3 States;

4 (12) [(19)] certificates of deposit, term deposits, or bankers' acceptances, that are
5 issued by a United States or nondomestic bank or trust company located outside of the United
6 States and are denominated in United States or nondomestic currency, if either (A) they may be
7 readily sold in a secondary market at prices reflecting fair value, or (B) the issuing bank or trust
8 company has capital, surplus, and retained earnings at the date of issue equaling at least
9 \$500,000,000; investments made under this paragraph are not subject to the collateral
10 requirements for domestic certificates under (m) of this section;

11 (13) [(20)] equity interests in, and debt obligations secured by mortgages granting
12 a first lien on, real estate improved by completed and substantially rented buildings and located
13 in the United States, if these investments are made

14 (A) in a corporation, partnership, trust, or other entity in which, at the
15 conclusion of each investment transaction, at least 60 percent of the beneficial ownership
16 interests are held by other institutional investors, and which is organized and operated for
17 the purpose of making real estate investments by a bank, insurance company, or other
18 manager of institutional funds that has had at least five years of experience in the
19 management of real estate investments of institutional investors; or

20 (B) with corporations, partnerships, trusts, or entities in which, at the
21 conclusion of each investment transaction, at least 60 percent of the beneficial
22 ownership interests in the co-investing entity or entities as a whole are held by
23 institutional investors, if

24 (i) at the time of investment the fund has no more than
25 a 40 percent beneficial ownership interest in the real estate invested in as a
26 whole;

27 (ii) the rights and obligations of the fund are
28 substantially similar to those of the other institutional investors, except for the
29 percentage interest in the property; and

30 (iii) the property is managed and operated by an entity
31 that has had at least five years of experience in the management of real estate

*more comprehensive
replacement
language deleted
in lines 1-3
on page 7*

1 investments of institutional investors [IN CONJUNCTION WITH AND ON
2 SUBSTANTIALLY THE SAME TERMS AS AN ENTITY DESCRIBED IN (A)
3 OF THIS PARAGRAPH];

4 (14) [(21)] securities of non-domestic governments and non-domestic government
5 agencies, the principal of, or interest on, which is payable in either United States dollars or non-
6 domestic currencies;

7 (15) [(22)] securities of non-domestic corporations, including common and
8 preferred stock, whose dividends, if any, may be payable in either United States dollars or non-
9 domestic currencies;

10 (16) taxable municipal or state debt securities that are rated "AA" or better
11 by a nationally recognized rating service;

12 (17) shares in a money market or short-term investment fund that has either
13 collateral securities of a type authorized elsewhere in this section as acceptable collateral
14 or securities of similar quality to those authorized elsewhere in this section as acceptable
15 collateral.

16 * Sec. 11. AS 37.13.120(i) is amended to read:

17 (i) The [ALASKA PERMANENT] fund may at no time own more than five percent of
18 the voting stock of a corporation. Domestic stocks, except for bank and insurance company
19 stocks, must be listed at the date of purchase on an exchange registered with the Securities and
20 Exchange Commission. At the time of each investment, the aggregate investment of the fund in
21 each stated category of investment may not exceed the following stated percentage of the total
22 investments of the fund:

23 (1) mortgages under (g)(10) [(g)(16)] of this section - 15 percent;

24 (2) real estate investments under (g)(13) [(g)(20)] of this section - 15 percent;

25 (3) certificates of deposit, term deposit, or bankers' acceptances under (g)(12)
26 [(g)(15)] of this section - 20 percent;

27 (4) securities of nondomestic governments, nondomestic government agencies, and
28 nondomestic corporations under (g)(4), (14), and (15) [(g)(8), (21), AND (22)] of this section,
29 domestic corporate stocks and debt securities under (g)(4) [(g)(8)] and (11) [(18)] of this section,
30 and short-term nondomestic corporate promissory notes under (g)(5)(B) [(g)(9)(B)] of this section
31 - 50 percent.

replaced by
lines 20-31
on preceding
page

authorizes
immediate deposit
of new money
into "overnight"
vehicles with
an investment
decision IS made

1 * Sec. 12. AS 37.13.120(j) is amended to read:

2 (j) The assets of the [ALASKA PERMANENT] fund may not be used for the purchase
3 of bonds of a corporation, upon which any regular interest payment has been defaulted within
4 five years before purchase, except bonds never in default but which have been outstanding for
5 less than five years.

6 * Sec. 13. AS 37.13.120(k) is amended to read:

7 (k) The board shall establish and from time to time as necessary modify guidelines for
8 the investment of the assets of the fund [CORPORATION]. Before adoption of any guidelines
9 the guidelines shall be reported to the Legislative Budget and Audit Committee for review and
10 comment.

11 * Sec. 14. AS 37.13.120(l) is amended to read:

12 (l) The board shall invest the assets of the fund [CORPORATION] in in-state
13 investments to the extent in-state investments are available if the in-state investments

14 (1) have a risk level and expected yield comparable to alternate investment
15 opportunities; and

16 (2) are included in the list of permissible investments in (g) of this section.

17 * Sec. 15. AS 37.13.120(m) is amended to read:

18 (m) Certificates of deposit or the equivalent instruments that are not of a quality that may
19 be readily sold in a secondary market at prices reflecting fair value must be secured by a pledge
20 as collateral of

21 (1) investments authorized for the [ALASKA PERMANENT] fund under (g)(1),
22 (2), (4), or (8) - (10) [(8), OR (12) - (17)] of this section;

23 (2) [OR BY A PLEDGE AS COLLATERAL OF] obligations of the state or
24 instrumentalities of the state that are rated at least "A" by a major bond rating service and have
25 a demonstrated secondary market, which investments or obligations have value at least equal to
26 the face value of the certificate of deposit;

27 (3) the guaranteed portion of Federal Small Business Administration loans;

28 (4) the portion of first lien real estate mortgages guaranteed by the federal
29 Department of Veterans Affairs; or

30 (5) notes secured by mortgages granting a first lien on commercial or
31 residential real estate improved by completed buildings if the originating financial

1 institution retains at least 25 percent of the mortgage until maturity. [THE BOARD MAY
2 REQUIRE SUBSTITUTION OF COLLATERAL IN ORDER TO ENSURE CONTINUED
3 SATISFACTION OF THE REQUIREMENTS SET OUT IN THIS SUBSECTION.]

4 * Sec. 16. AS 37.13.120 is amended by adding a new subsection to read:

5 (n) The board may require substitution of collateral in order to ensure continued
6 satisfaction of the requirements set out in (m) of this section.

7 * Sec. 17. AS 37.13.140 is amended to read:

8 Sec. 37.13.140. INCOME. Net income of the fund [CORPORATION] shall be computed
9 annually as of the last day of the fiscal year in accordance with generally accepted accounting
10 principles, excluding any unrealized gains or losses. Income available for distribution equals 21
11 percent of the net income of the fund [CORPORATION] for the last five fiscal years, including
12 the fiscal year just ended, but may not exceed net income of the corporation for the fiscal year
13 just ended plus the balance in the earnings reserve account described in AS 37.13.145.

14 * Sec. 18. AS 37.13.145 is amended to read:

15 Sec. 37.13.145. DISPOSITION OF INCOME. (a) At the end of each fiscal year, an
16 amount sufficient to offset the effect of inflation on principal of the [ALASKA PERMANENT]
17 fund during that year [, AS MEASURED BY THE CHANGE IN THE CALENDAR YEAR
18 AVERAGE UNITED STATES CONSUMER PRICE INDEX FOR ALL URBAN CONSUMERS]
19 shall be transferred by the corporation from net income as defined in AS 37.13.140, excluding
20 income on the earnings reserve account [IN THE ALASKA PERMANENT FUND], to the
21 principal of the [ALASKA PERMANENT] fund for reinvestment. The corporation shall
calculate the amount to transfer to the principal under this subsection by determining the
average rate of inflation for the previous fiscal year as measured by the change in the
calendar year average United States Consumer Price Index for all urban consumers and
applying that rate to the value of the principal of the fund on the last day of the previous
fiscal year.

22 (b) After the transfer under (a) of this section, the [THE] balance of the income
23 available for distribution under AS 37.13.140 shall be transferred to the earnings reserve account
24 in the [ALASKA PERMANENT] fund. Money in the earnings reserve account shall be invested
25 in investments authorized under AS 37.13.120. Income from the investment of the earnings
26 reserve account shall be treated as an addition to that account.
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*inflation - proofing
based on the 23 value
of the principal on
the last day of the
fiscal year*

1 * Sec. 19. AS 37.13.150 is amended to read:

2 Sec. 37.13.150. CORPORATION BUDGET. The revenue generated by the fund's
3 [CORPORATION'S] investments must be identified as the source of the operating budget of the
4 *language* corporation in the state's operating budget under AS 37.07 (Executive Budget Act). The
5 unexpended balance of the corporation's annual operating budget does not lapse at the end of the
6 fiscal year but shall be treated as income under AS 37.13.140.

7 * Sec. 20. AS 37.13.160 is amended to read:

8 Sec. 37.13.160. AUDITS. The Legislative Budget and Audit Committee may provide
9 *language* for an annual post audit and annual operational and performance evaluations of the fund's
10 [CORPORATION'S] investments and investment programs.

11 * Sec. 21. AS 37.13.170 is amended to read:

12 Sec. 37.13.170. REPORTS AND PUBLICATIONS. By September 30 of each year, the
13 board shall publish a report of the fund [CORPORATION] for distribution to the governor,
14 legislature, and the public. The report shall be written in easily understandable language. The
15 *language* report must include financial statements audited by independent outside auditors, a statement of
16 *language* the amount of money received by the [ALASKA PERMANENT] fund from each investment
17 during the period covered, a statement of investments of the fund [CORPORATION] including
18 an appraisal at market value, a description of fund [CORPORATION] investment activity during
19 the period covered by the report, a comparison of the fund [CORPORATION] performance with
20 the intended goals contained in AS 37.13.020, an examination of the impact of the investment
21 criteria of this chapter on the fund [CORPORATION] portfolio with recommendations of any
22 needed changes, and any other information the board believes would be of interest to the
23 governor, the legislature, and the public. The annual income statement and balance sheet of the
24 fund [CORPORATION] shall be published in at least one newspaper in each judicial district. The
25 income statement and balance sheet for the two fiscal years preceding the publication of the
26 election pamphlet under AS 15.58 shall be included in that pamphlet.

27 * Sec. 22. AS 37.13.180 is amended to read:

28 Sec. 37.13.180. TAX EXEMPTION. The corporation and the fund are [IS] exempt
29 *language* from all taxes and assessments in the state. All security instruments issued by the corporation
30 or the fund, their transfer, and their income are exempt from all taxes and assessments in the
31 state.

1 * Sec. 23. AS 37.13.190 is amended to read:

2 Sec. 37.13.190. POLITICAL ACTIVITIES. The resources of the corporation or the fund
3 may not be used to finance or influence political activities.

4 * Sec. 24. AS 37.13.210 is amended by adding a new paragraph to read:

5 (3) "fund" means the Alaska permanent fund established under art. IX, sec. 15.
6 Constitution of the State of Alaska.

7 * Sec. 25. This Act takes effect July 1, 1991.

Educational endowment

The Governor's proposed education endowment engendered lengthy comment and healthy debate before the Commission. People discussed the issues of the Permanent Fund's role, government spending in general, and specifically the level and method of funding education. This issue is now before the Legislature and this appears to be the appropriate forum for deciding upon any proposal to be placed before the voters.

Recommendation: The Commission forwards no specific recommendation on the proposed educational endowment.

Clean up the statutory language

The Legislature should re-examine all of the current statutes involving the Permanent Fund for consistency and clarity. A clear and precise definition and method of calculating net income should be adopted (in the absence of the adoption of a payout method). There appears to be less than precise use of the terms "fund", "principal", and "Corporation".

For example, A.S. 37.13.010(a) discusses the Permanent Fund and is generally cited as the statutory definition of the principal of the Fund. It is often stated that the balance in the earnings reserve account (ERA) is not part of the principal. However, a reading of A.S. 37.13.010(a)(3) and 37.13.145 "allocates" the ERA which is "in the Alaska Permanent Fund". If the ERA is not part of the "fund", i.e. principal, why are the earnings from the ERA used to calculate dividends? Also A.S. 37.13.140 addresses "net income of the corporation" and A.S. 37.13.040 discusses the "assets of the corporation", while neither of these phrases is defined.

Recommendation: The ambiguities in the existing statutes regarding the Permanent Fund should be clarified.

income for the Fund over time and, hence, lesser principal. The current inflation-proofing procedure (converting investments into cash which can then be deposited into the principal) may actually be robbing the Fund of real growth over time.

(2) Maximizing Deposits: In the past, the Corporation has calculated annual inflation-proofing requirements so as to produce the maximum possible deposit for inflation-proofing each year. The Corporation assumes that the dedicated mineral revenue deposits are included in the fund's principal for the entire fiscal year, when in fact dedicated revenue deposits into the Fund occur continuously throughout the year, and their actual inflation-proofing requirements are less than the inflation-proofing deposits made. With the statute silent on this point, the Corporation has chosen an approach unusual by accounting practices, but designed to produce maximum contributions to the fund's principal. The Corporation sought legislative approval for this approach through Legislative Budget and Audit, albeit after the fact. After one unsuccessful attempt (October 24, 1983 meeting, where action was tabled), Legislative Budget and Audit approved the methodology at its January 12, 1984 meeting. But it remains a matter of policy, not statute nor regulation, and with a different Board of Trustees or Corporation staff, the outcome could be different.

(3) Inflation-proofing Transfers: Inflation-proofing transfers used to occur automatically under AS 37.13.145, but arguably require an appropriation. In an April 11, 1979 memorandum, the Dept. of Law examined the clause concerning disposition of permanent fund income: "all income from the permanent fund shall be deposited in the general fund unless otherwise provided by law." and concluded that the clause does not exempt the fund's income from the prohibition against dedicated funds. Further, the constitution provides that "No money shall be withdrawn from the treasury except in accordance with appropriations made by law" (Art. IX, Sec. 13). Furthermore, the Alaska courts have subsequently ruled that continuing appropriations are not constitutional. The counter argument is that the statutory dedication is arguably required to achieve the basic goal for which the fund was established, i.e. provide permanence, and hence is allowable. If that argument were carried to its logical conclusion, however, then inflation-proofing would be automatically the first priority for Fund earnings, which it clearly is not. If there is ambiguity, it seems

Net Income of \$1.069 billion, minus Permanent Fund Dividends (PFD) of \$391 million, minus Inflation-Proofing of \$148 million, leaves a Net Income residual of \$530 million.

Income Available for Distribution of \$787 million, minus PFD of \$391 million, minus Inflation-Proofing of \$148 million,⁶ leaves an Income Available for Distribution residual of \$248 million.

The difference between the two residuals is \$282 million, which has since earned interest of about \$54 million, for a total of about \$335 million.

The statute calls for only the residual from "Income available for distribution" to be transferred to the earnings reserve account, or \$248 million. Instead, the entire "net income" residual of \$530 million was retained in the earnings reserve account. The statutory confusion has resulted in the disposition of over \$300 million taking place without due legislative consideration. The policy consequences are to increase the size of the dividend and keep money out of the general fund which should be there as a matter of constitutional requirement. A clarification of the statute is warranted to establish legislative intent.

Treatment of Royalty Litigation Interest Earnings - - 8(g) or Dinkum Sands and North Slope Royalty Funds

When funds placed in escrow during royalty litigation generate interest earnings, should the interest that eventually goes to the Permanent Fund be treated upon receipt by the Corporation as principal or as earnings? If the latter, the money representing the interest component would be distributable and available for appropriation. As oil revenues dwindle in the future, the availability or non-availability of royalty litigation interest earnings will have significant fiscal and possible program implications for the state. Legal proceeds from both the North Slope Royalty and Dinkum Sands cases may be large, as much as \$2.3 billion. Of that combined total, approximately \$386

⁶ The statutes do not speak to subtracting Inflation-Proofing from Income Available for Distribution, but from Net Income. The practice, however, is as represented in the example. If one relies solely on the statutory construction, the numbers never add up.

million of interest earnings would go to the Permanent Fund, along with \$385 million in principal. The table below presents maximum distributions based on the "best of all possible worlds" outcomes for the state. Noteworthy is that interest earnings now rival the principal amount in both cases.

Maximum Possible Distributions to Permanent Fund of Dinkum Sands and North Slope Royalty-related Proceeds*

Dinkum Sands

\$ 194,797,625	Bonuses	244,126,432	Bonus Interest
<u>990,991</u>	Rents	<u>1,167,879</u>	Rent Interest
\$ 195,788,616	Total Rents/Bonuses	245,294,311	Total Interest

North Slope Royalty Case

\$ 131,249,721	RIV Deficiencies	101,117,831	RIV Interest
<u>58,286,680</u>	RIK Deficiencies	<u>39,747,053</u>	RIK Interest
\$ 189,516,401	Total Deficiencies	140,864,884	Total Interest

		<u>Principal</u>	<u>Interest</u>
Dinkum Sands	\$	195,788,616	245,294,311
North Slope		<u>189,516,401</u>	<u>140,864,884</u>
Total	\$	385,305,017	386,159,195
<hr/>			
Total Permanent Fund Distributions	\$	771,464,212	

* Dinkum Sands proceeds calculations based on Minerals Management Service data of 12/31/89; North Slope Royalty proceeds calculations based on estimated deficiencies plus interest as of 3/90; Heller Partnow, and Condon.



Alaska Permanent Fund Corporation

P.O. Box 4-1000 Juneau, Alaska 99802-4100

(907) 465-2047

MEMORANDUM

DATE: April 25, 1991

TO: Senator Rick Halford
Chairman, Senate Judiciary Committee

FROM: David A. Rose 
Executive Director

SUBJECT: Proposed Amendments to CS SB 39 (L&C)

The following amendment is recommended by the Alaska Permanent Fund Corporation for the Committee's consideration.

Amendment #1: Change lines 5-24 of Sec. 10, page 4 to read as follows:

(4) certificates of deposit and term deposits of federally chartered savings and loan associations in Alaska [THAT MAY BE READILY SOLD IN A SECONDARY MARKET AT PRICES REFLECTING FAIR VALUE OR] that are fully secured at all times as to payments of principal and interest as described in (m) of this section;

[(5) CERTIFICATES OF DEPOSIT AND TERM DEPOSITS OF STATE CHARTERED SAVINGS AND LOAN ASSOCIATIONS IN ALASKA THAT MAY BE READILY SOLD IN A SECONDARY MARKET AT PRICES REFLECTING FAIR VALUE OR THAT ARE FULLY SECURED AT ALL TIMES AS TO PAYMENTS OF PRINCIPAL AND INTEREST AS DESCRIBED IN (M) OF THIS SECTION;]

(6) certificates of deposit and term deposits of mutual savings banks in Alaska [THAT MAY BE READILY SOLD IN A SECONDARY MARKET AT PRICES REFLECTING FAIR VALUE OR] that are fully secured at all times as to payments of principal and interest as described in (m) of this section;

(7) fixed-term certificates of indebtedness of federally insured credit unions in Alaska [THAT MAY BE READILY SOLD IN A SECONDARY MARKET AT PRICES REFLECTING FAIR VALUE OR] that are fully secured at all times as to payments of principal and interest as described in (m) of this section;

Purpose: (1) Deletes references to readily available secondary markets for certificates of deposit of Alaska savings and loan associations, mutual savings banks and credit unions because such markets do not exist. (2) Deletes reference to state-chartered savings and loan associations in Alaska because such S&Ls do not exist.

Certificates of deposit (and/or certificates of indebtedness) of federally-chartered S&Ls in Alaska, Alaska mutual savings banks and federally-chartered credit unions in Alaska would continue to be authorized investments for the Permanent Fund so long as they are fully secured as under current law.




Alaska Permanent Fund Corporation
P.O. Box 4-1000 Juneau, Alaska 99802-4100
(907) 465-2047

MEMORANDUM

DATE: February 20, 1991

TO: Senator Pat Pourchot
Co-Chairman, Senate Finance Committee

FROM: David A. Rose 
Executive Director

SUBJECT: Proposed Amendments to CS SB 39 (L&C)

First, please find attached copies of:

* A letter to me from Representative Larson dated February 15 with an attached memorandum from Milt Barker of his staff which propose two amendments to CS SB 39 (L&C).

* My response to that letter dated February 20, 1991. I have reviewed the two proposed amendments and I have no objection to them. I do not agree, however, with Mr. Barker's comment that the current method of inflation-proofing over-compensates for inflation.

* A copy of a memorandum from Bill Means of my staff addressing the issue of expanding the Corporation's authorized list of investments to allow the purchase of A-rated corporate bonds. The Corporation supports this change.

Second, I would like to request that you include a change to the Permanent Fund's Management Act to exempt completely the Corporation from the procurement code. I suggest language similar to that which you propose in SB 18 for the Alaska State Pension Corporation. The arguments that you apply to the new corporation apply to the Alaska Permanent Fund Corporation as well. I recognize this is a bit of a change from my earlier position on this matter, but my staff informs me that there are indeed good reasons for the exemption.



Alaska Permanent Fund Corporation

P.O. Box 4-1000 Juneau, Alaska 99802-4100

(907) 465-2047

MEMORANDUM

DATE: February 20, 1991

TO: Representative Ron Larson
Chairman, Legislative Budget & Audit Committee

FROM: David A. Rose *DR*
Executive Director

SUBJECT: Proposed Amendments to CS SB 39 (L&C)

I have reviewed your letter dated February 15 and the attached memorandum regarding CS SB 39 (L&C). I have no objection to the two proposed amendments. I do not agree, however, with Mr. Barker's comment that the current method of inflation-proofing over-compensates for inflation.

Proposed Amendments to
Committee Substitute for Senate Bill No. 39 (Labor and Commerce)

Amendment #1: Amend Sec. 1, page 2, lines 1 and 2 to read:

(3) interest earned on money described in (1) and (2) of this subsection while the money is held in trust, escrow, or otherwise before receipt of the money by the state;

Purpose: to avoid requiring deposit of interest earned on such money for the few days it is in the State's general fund, before transfer to the permanent fund. No change from the status quo.

Amendment #2: Amend Sec. 15, page 8, lines 26 and 27 to read:

(2) [OR BY A PLEDGE AS COLLATERAL OF] obligations of the state or instrumentalities of the state that are rated at least "A" by a major bond rating service and have a demonstrated secondary market [,WHICH INVESTMENTS OR OBLIGATIONS HAVE VALUE AT LEAST EQUAL TO THE FACE VALUE OF THE CERTIFICATE OF DEPOSIT]:

and amend Sec. 16, page 9, lines 6 and 7 to read:

(n) Investments or obligations pledged as collateral under (m) of this section must have value at least equal to the face value of the certificate of deposit. The board may require substitution of collateral in order to ensure continued satisfaction of the requirements set out in (m) of this section.

Purpose: to correct a drafting error that would otherwise narrow the applicability of the requirement that collateral equal the value of certificates of deposit. No change from the status quo.



Alaska Permanent Fund Corporation

P.O. Box 4-1000 Juneau, Alaska 99802-4100

(907) 465-2047

MEMORANDUM

DATE: February 19, 1991

TO: David A. Rose
Executive Director

FROM: *William L. Means*
William L. Means
Chief Investment Officer

SUBJECT: Investment Statutes

Alaska Statute 37.13.120(g)(8) limits investments in domestic corporate bonds to those "domestic corporate debt securities that are rated AA or better by a nationally recognized rating service...". During the past decade, the amount of those securities rated AA or higher has contracted steadily as a portion of total investment grade (BBB or better) bonds available to institutional investors. The First Boston Corporation estimates that AAA and AA rated bonds currently comprise only 42% of total investment grade bonds outstanding. That means that the Permanent Fund is excluded from 58% of the investment grade corporate bond market.

Enlarging the Permanent Fund's parameters to include A rated bonds would permit the Fund to earn a higher rate of return on its corporate bond portfolio, while participating in a significant portion of the investment grade bond market in which most pension funds and other institutional investors are quite active. In addition, the Permanent Fund would be able to purchase those bonds which would likely be candidates for bond rating upgrades during periods of economic recovery. However, while enlarging the scope of the investment statutes to include A rated bonds is to be recommended, in my opinion, BBB rated bonds should not be included since the next lower grade would put these bonds in the "junk" category.



Alaska State Legislature

HOUSE OF REPRESENTATIVES

Official Business

P.O. Box V
State Capitol
Juneau, Alaska 99811

Representative Ronald L. Larson
P.O. Box V
Juneau, Alaska 99811

February 15, 1991

Dave A. Rose, Executive Director
Alaska Permanent Fund Corporation
P.O. Box 4-1000
Juneau, Alaska 99802


Dear Mr. Rose,

I plan to provide the enclosed February 14, 1991 memorandum on CSSB 39 to the Budget and Audit Committee at its next meeting.

I would be happy to provide the Committee at the same time any comments you may have regarding the memorandum. In case you wish to attend the meeting, I will notify you when it is scheduled.

I would expect to offer any amendments the Committee feels are needed in the House Finance Committee.

Sincerely,


Ronald L. Larson
State Representative

RECEIVED

FEB 20 1991

ALASKA PERMANENT
FUND CORPORATION

ATTACHMENT I

AS 37.13.120 (m)

"(m) Certificates of deposit or the equivalent instruments that are not of a quality that may be readily sold in a secondary market at prices reflecting fair value must be secured by a pledge as collateral of investments authorized for the Alaska permanent fund under (g)(1), (2), (8), or (12) - (17) of this section or by a pledge as collateral of obligations of the state or instrumentalities of the state that are rated at least "A" by a major bond rating service and have a demonstrated secondary market, which investments or obligations have value at least equal to the face value of the certificate of deposit. The board may require substitution of collateral in order to ensure continued satisfaction of the requirements set out in this subsection."

"Permanent Fund Policy Issues", Division of Policy, Office of Management and Budget, April 1990, page 10 excerpt.

"(2) Maximizing Deposits: In the past, the Corporation has calculated annual inflation-proofing requirements so as to produce the maximum possible deposit for inflation-proofing each year. The Corporation assumes that the dedicated mineral revenue deposits are included in the fund's principal for the entire fiscal year, when in fact dedicated revenue deposits into the Fund occur continuously throughout the year, and their actual inflation-proofing requirements are less than the inflation-proofing deposits made. With the statute silent on this point, the Corporation has chosen an approach unusual by accounting practices, but designed to produce maximum contributions to the fund's principal. The Corporation sought legislative approval for this approach through Legislative Budget and Audit, albeit after the fact. After one unsuccessful attempt (October 24, 1983 meeting, where action was tabled), Legislative Budget and Audit approved the methodology at its January 12, 1984 meeting. But it remains a matter of policy, not statute nor regulation, and with a different Board of Trustees or Corporation staff, the outcome could be different.



Alaska State Legislature

HOUSE OF REPRESENTATIVES

Official Business

P.O. Box V
State Capitol
Juneau, Alaska 99811

TO: The Honorable Ron Larson
Chairman
Legislative Budget & Audit

FROM: Milt Barker ^{MB}
Investment Oversight Staff

SUBJECT: SB 39 Permanent Fund Technical Amendments

DATE: February 14, 1991

At your request, I have reviewed SB 39 and CSSB 39(L&C), relating to the permanent fund and the Alaska Permanent Fund Corporation. I offer the following comments regarding CSSB 39 (attached):

1. Section 1, page 2, lines 1 and 2.

Proposed paragraph AS 37.13.010(a)(3) provides that the permanent fund principal includes:

"interest earned by the state on money described in (1) and (2) of this subsection before that money is deposited in the fund."

This is meant to permanently establish the policy that interest earnings on amounts due the state pursuant to litigation over royalties, for example Dinkum Sands and Amerada Hess (North Slope royalty litigations), goes to permanent fund principal rather than income.

However clearer language would be:

"interest earned on money described in (1) and (2) of this subsection while the money is held in trust, escrow, or otherwise before receipt of the money by the state".

This language would avoid the possible interpretation that interest earned by the state after the receipt of such money but before deposit in the permanent fund is to be deposited in the permanent fund. Such an interpretation would deposit the few days' earnings on the money while it is in the State's general fund.

The suggested language is essentially the language used

DEPARTMENT OF NATURAL RESOURCES

OFFICE OF THE COMMISSIONER

400 WILLOUGHBY AVENUE
JUNEAU, ALASKA 99801-1796
PHONE: (907) 465-2400
FACSIMILE: (907) 586-2754

February 8, 1991

The Honorable Drue Pearce, Chair
Senate Labor and Commerce Committee
P.O. Box V
Juneau, AK 99811

Dear Senator Pearce:

Subject: SB 39, relating to the permanent fund and the Alaska Permanent Fund Corporation.

Position: The Department of Natural Resources (DNR) is not taking a position on this bill. We are, however, providing information about the bill's effects on department programs.

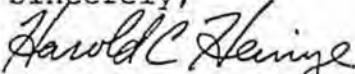
Background: The department's Division of Management is directly involved in the processing of revenues destined for inclusion in the permanent fund, as is the treasury division of the Department of Revenue, and the Department of Administration. When a vendor wires funds directly to the Philadelphia National Bank, the Department of Revenue receives a copy of the transfer, invests the funds, and enters the transaction in the Alaska State Accounting System (AKSAS). The financial services section of the DNR Division of Management determines, through an interface with the Division of Oil and Gas, the percentage of the payment (either 25% or 50%) to be deposited into the permanent fund. Division of Management staff then enters the entire payment into the department's revenue and billing system, and transfers the deposit to the general fund, the permanent fund, and the school fund. Transfers to the permanent fund are currently made twice a month (approximately the 10th and the 27th).

If the vendor sends or brings a check to DNR, staff deposits the check in the First National Bank of Anchorage. The actions described above are then taken.

We estimate this bill may require another 2 to 4 permanent fund transfers per month.

Please let me know if you would like additional information concerning the department's role in revenue transfers to the permanent fund.

Sincerely,


Harold C. Heinze

Commissioner

cc: Committee Members
Senator Pourchot
Bruce Kendall, Legislative Liaison, Office of the Governor
Lee Fisher, Commissioner, Department of Revenue
Millett Keller, Commissioner, Department of Administration