

HB

525

SFIN

FILE

SENATE FINANCE COMMITTEE REPORT

DATE: 3/11/96

FURTHER: SFC REPORTED OUT OF
4/27/96

DATE TURNED INTO OFFICE: 4-27-96

The Finance Committee considered **HOUSE BILL NO. 525**
Relating to permanent fund investments.

and recommends:

- be replaced with _____ CS _____ (_____)
- adopt previous _____ CS _____ (_____)
- attached amendment(s)
- adopt Letter of Intent by _____ Committee
- further referral to the _____ Committee

- Senate Bill:**
- same title
 - new title
- House Bill:**
- same title
 - technical change
 - new: SCR# _____

SIGNING DO PASS	DP	OTHER RECOMMENDATIONS	NR	DNP	AM
<i>[Signature]</i>	✓	<i>[Signature]</i>	✓		
<i>[Signature]</i>	✓	<i>[Signature]</i>			
<i>[Signature]</i>	✓				
Co-Chair: <i>[Signature]</i>	✓	Co-Chair: <i>[Signature]</i>			
Co-Chair: <i>[Signature]</i>		Co-Chair: <i>[Signature]</i>	✓		

NEW FISCAL NOTE(S):

Department	Date	Zero	Fiscal

PREVIOUS FISCAL NOTE(S):*

Department	Date	Zero	Fiscal
#1 DOR (APFC)	7/28/96	0	

APPROPRIATION -- no fiscal note

*include fiscal notes accompanying Governor's bill

FISCAL NOTE

No. 1

Bill Version: HB 525

(H) Publish Date: 3/6/96

Revision Date: _____ Dept. Affected: Revenue
 Title: An Act designating certain permissible investments BRU: APFC
 by the Alaska Permanent Fund Corporation... Component: APFC
 Sponsor: House Finance
 Requestor: House Finance COMPONENT SERIAL NO. 109

Expenditures/Revenues: (Thousands of Dollars)

	FY 97	FY 98	FY 99	FY 00	FY 01	FY 02
OPERATING EXPENDITURES						
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 EXPENDITURES						
CHANGE IN REVENUES ()						

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1007 GF/Mental Health						
Other						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY96) cost \$ _____

POSITIONS:

FULL-TIME					
PART-TIME					
TEMPORARY					

ANALYSIS: (Attach a separate page if necessary)

(See attached memorandum dated February 27, 1996 from Byron I. McIatt to the members, House Finance Committee.)

Prepared by: Byron I. McIatt, Executive Director Phone: (907) 465-2047
 Division: Alaska Permanent Fund Corporation Date: 2/27/96
 Approved by Commissioner: [Signature] Date: 2/27/96
 Agency: Department of Revenue

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Alaska Permanent Fund Corporation
P.O. Box 25500 Juneau, Alaska 99802-5500
(907) 465-2047

MEMORANDUM

DATE: February 27, 1996

TO: Members, House Finance Committee

FROM: Byron I. Mallott
Executive Director

SUBJECT: Projected Effects of Passage of HB 525, Relating
to Permanent Fund Investments

The purpose of the bill is straight forward: to give the Board of Trustees an opportunity to earn more income for the Permanent Fund over the long term by allowing the Board to allocate a higher percentage of the Fund's assets to equities and to lower-level investment-grade debt securities.

The benefits of the bill, hopefully, will be expressed in increased dollars earned by your Permanent Fund in future years. Exactly how much additional income will be generated by these proposed changes is dependent on how the financial markets perform in the future, but the following analysis provides an illustrative example.

Permanent Fund Equities at Market Value

<u>Current Holdings</u>	<u>Maximum under HB 525</u>	<u>Difference</u>
\$8.665 billion	\$9.336 billion	\$671 million

If the Trustees were to allocate the maximum 50% to equities (given the Fund's current \$18.7 billion market value), they would be increasing the Fund's percentage holdings of an asset class which has an expected total return over the next five years ranging from 9.5% for U.S. large cap stocks, to 10.2% for non-U.S. stocks to 10.5% for U.S. small cap stocks. Simultaneously, the Fund would be decreasing its percentage holdings in an asset class with an expected total return over the next five years of 6.8% (fixed income). The difference in annual return for \$671 million earning 9.5% instead of 6.8% is \$2,300,000.

Impact of Increasing Permanent Fund Holdings of A- and Baa-Rated Corporate Debt Securities

Given the \$8.2 billion market value of the Fund's fixed-income portfolio as of January 31, 1996, the Trustees would have to increase the Permanent Fund's holdings in A-rated paper by \$240 million and Baa-rated paper by \$480 million to equal the percentage weighting in these investment-grade securities held in the corporate component of the Lehman Brothers Government/Corporate Index.

(Note: This is very much the type of flexibility being sought in this legislation. The Trustees would like to be able, through the Fund's in-house investment staff and/or the new external fixed-income managers, to take advantage of investment opportunities in this component of the investment-grade corporate universe, if and when they arise.)

In any event, if the Fund were to purchase the A-and Baa-rated paper as indicated above, and if future fixed-income returns were to equal the average historical returns for the period 1991-1995, the Fund would earn an additional 39 basis points on the increased A-rated securities (11.14% for A vs. 10.75% for AA) and an additional 111 basis points on the Baa-rated securities (11.86% for Baa vs. 10.75% for AA).

Increase in "A"	\$240 million	x	39 bp	=	\$936,000
Increase in "Baa"	\$480 million	x	111 bp	=	<u>\$5,328,000</u>
					\$6,264,000

The combined potential increase in income from increased holdings of equities and lower-rated investment grade corporate debt securities, given the above assumptions, would thus total \$8,564,000 (\$2,300,000 in stocks plus \$6,264,000 in bonds). Over five years, that total increase in income would amount to more than \$40 million.

It should be noted, of course, that increased opportunities for return also bring increased risks. Increased percentage holdings of equities and debt securities in investment grades below AA could lead to more volatile annual returns in the short term. The Trustees believe, however, that the slight increase in risk is manageable in the short term, and will provide meaningful returns in the long term

House Bill 525
February 27, 1996
Page 3

Finally, it should also be noted that the Trustees view this legislation as remedial because, even with these changes in investment authorization, the allowable asset allocation of the Fund essentially tracks the current median of the plan sponsor universe. In order to compete effectively in the financial markets of the 21st century, it may be necessary to seek additional legislative authorization to optimize future Permanent Fund risk and returns.

HOUSE BILL NO. 525

IN THE LEGISLATURE OF THE STATE OF ALASKA

NINETEENTH LEGISLATURE - SECOND SESSION

BY THE HOUSE FINANCE COMMITTEE BY REQUEST

Introduced: 2/21/96

Referred: Finance

A BILL

FOR AN ACT ENTITLED

1 "An Act designating certain permissible investments by the Alaska Permanent
2 Fund Corporation in taxable municipal or state debt securities and corporate debt
3 securities; changing the allocation limits on domestic and nondomestic government
4 and corporate securities, nondomestic corporate promissory notes, domestic and
5 nondomestic corporate stocks, and taxable government debt securities; and
6 providing for an effective date."

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

8 * Section 1. AS 37.13.120(g)(7) is amended to read:

9 (7) domestic corporate debt securities that are rated investment grade
10 [A OR BETTER] by a nationally recognized rating service, or nondomestic corporate
11 debt securities of comparable quality;

12 * Sec. 2. AS 37.13.120(g)(19) is amended to read:

13 (19) taxable municipal or state debt securities that are rated investment

1 grade [A OR BETTER] by a nationally recognized rating service;

2 * Sec. 3. AS 37.13.120(i) is amended to read:

3 (i) The fund may at no time own more than five percent of the voting stock
4 of a corporation. Domestic stocks, except for bank and insurance company stocks,
5 must be listed at the date of purchase on an exchange registered with the Securities
6 and Exchange Commission. At the time of each investment, the aggregate investment
7 of the fund in each stated category of investment may not exceed the following stated
8 percentage of the total investments of the fund:

9 (1) mortgages under (g)(13) of this section - 15 percent;

10 (2) real estate investments under (g)(16) of this section - 15 percent;

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

13 (4) [SECURITIES OF NONDOMESTIC GOVERNMENTS,
14 NONDOMESTIC GOVERNMENT AGENCIES, AND NONDOMESTIC
15 CORPORATIONS UNDER (g)(7), (17), AND (18) OF THIS SECTION,] domestic
16 and nondomestic corporate stocks under (g)(14) and (18) of this section [, AND
17 SHORT-TERM NONDOMESTIC CORPORATE PROMISSORY NOTES UNDER
18 (g)(8)(B) OF THIS SECTION] - ~~50~~ percent [; 40%]

19 (5) DOMESTIC CORPORATE DEBT SECURITIES THAT ARE
20 RATED A AND NONDOMESTIC CORPORATE DEBT SECURITIES OF
21 COMPARABLE QUALITY UNDER (g)(7) OF THIS SECTION, AND TAXABLE
22 MUNICIPAL OR STATE DEBT SECURITIES THAT ARE RATED A UNDER
23 (g)(19) OF THIS SECTION - FIVE PERCENT].

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

25 (o) For purposes of (g) of this section, "investment grade" means a Standard
26 & Poor's Corporation rating BBB or better, or Moody's Investors Service, Inc., rating
27 of Baa or better, including a rating with a "+" or "-" designation or other variations
28 that occur within these ratings, or a comparable rating by another nationally recognized
29 rating organization.

30 * Sec. 5. This Act takes effect immediately under AS 01.10.070(c).

FISCAL NOTE

Revision Date: _____ Dept. Affected: Revenue
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 by the Alaska Permanent Fund Corporation... Component: APFC
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 Recuestor: House Finance COMPONENT SERIAL NO. 109

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Estimate of any current year (FY96) cost \$ _____

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

(See attached memorandum dated February 27, 1996 from Byron I. Mallott to the members, House Finance Committee.)

Prepared by: Byron I. Mallott, Executive Director
 Division: Alaska Permanent Fund Corporation
 Approved by Commissioner: [Signature]
 Agency: Department of Revenue

Phone: (907) 465-2047
 Date: 2/27/96
 Dcte: [Signature]

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Alaska Permanent Fund Corporation
P.O. Box 25500 Juneau, Alaska 99802-5500
(907) 465-2047

MEMORANDUM

DATE: February 27, 1996

TO: Members, House Finance Committee

FROM: Byron I. Mallott
Executive Director

SUBJECT: Projected Effects of Passage of HB 525, Relating
to Permanent Fund Investments

The purpose of the bill is straight forward: to give the Board of Trustees an opportunity to earn more income for the Permanent Fund over the long term by allowing the Board to allocate a higher percentage of the Fund's assets to equities and to lower-level investment-grade debt securities.

The benefits of the bill, hopefully, will be expressed in increased dollars earned by your Permanent Fund in future years. Exactly how much additional income will be generated by these proposed changes is dependent on how the financial markets perform in the future, but the following analysis provides an illustrative example.

Permanent Fund Equities at Market Value		
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(Note: This is very much the type of flexibility being sought in this legislation. The Trustees would like to be able, through the Fund's in-house investment staff and/or the new external fixed-income managers, to take advantage of investment opportunities in this component of the investment-grade corporate universe, if and when they arise.)

In any event, if the Fund were to purchase the A-and Baa-rated paper as indicated above, and if future fixed-income returns were to equal the average historical returns for the period 1991-1995, the Fund would earn an additional 39 basis points on the increased A-rated securities (11.14% for A vs. 10.75% for AA) and an additional 111 basis points on the Baa-rated securities (11.86% for Baa vs. 10.75% for AA).

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February 27, 1996
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Finally, it should also be noted that the Trustees view this legislation as remedial because, even with these changes in investment authorization, the allowable asset allocation of the Fund essentially tracks the current median of the plan sponsor universe. In order to compete effectively in the financial markets of the 21st century, it may be necessary to seek additional legislative authorization to optimize future Permanent Fund risk and returns.

REPRESENTATIVE
TERRY MARTIN
CHAIRMAN
BUDGET & AUDIT COMMITTEE
MEMBER
HOUSE FINANCE COMMITTEE

Alaska State Legislature



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JAN 15 - MAY 15 465-3783
STATE CAPITOL
JUNEAU, AK 99801-1182
HOME 333-6990
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ANCHORAGE, AK 99504

SPONSOR STATEMENT HB 525

An Act designating certain permissible investments by the Alaska Permanent Fund Corporation in taxable municipal or state debt securities and corporate debt securities; changing the allocation limits on domestic and nondomestic government and corporate securities, nondomestic corporate promissory notes, domestic and nondomestic corporate stocks, and taxable government debt securities; and providing for an effective date.

A joint meeting of the Legislative Budget and Audit Committee and the Revenue Subcommittee of the House Finance Committee was held on February 7 to examine why the state's PERS, TRS and SBS funds were performing better than the Permanent Fund. It was revealed at the hearing that 90 percent of the performance difference was due to the difference in portfolio makeup between the funds. While the state's retirement funds have to follow only the prudent investor rule in their investment decisions, the Permanent Fund is bound by statutes which restrict types of investments purchased, and amounts which can be invested in specific areas. Consequently, the retirement funds have the flexibility to take advantage of market changes, where the Permanent Fund does not. Specifically, the Permanent Fund is restricted in the amount of equities it may purchase. Also, the Permanent Fund must hold very high ratings of fixed income investments, further reducing the possible return on those investments. The equities market has been performing very well recently and the retirement funds have taken advantage of the situation by increasing their equity holdings. The Permanent Fund currently cannot do this.

At the February 7 joint hearing, Chairman Terry Martin told the Permanent Fund's Executive Director and members of the Board of Trustees that his committee would be happy to present legislation providing more flexibility in



the Fund's investment strategy. The Board of Trustees discussed the matter and presented the following draft legislation which allows more flexibility by making minor changes in two categories of investment. These changes should allow the Permanent Fund to take better advantage of current and changing market situations, and earn more for the Fund. This is also important for the state's financial picture, considering that a one percent increase in Permanent Fund earnings currently amounts to approximately \$152 million.

The proposal for changes to AS 37.13.120 consists of:

- Eliminating the restriction against investing in BBB-rated (investment grade) bonds;
- Eliminating the limitation to five percent for investing in A-rated bonds; and
- Excluding foreign bonds from the category which restricts investment in equities and foreign bonds to 50 percent or less (so that a full 50 percent can be invested in equities, not just 45 percent, as is the case now).



Alaska Permanent Fund Corporation

P.O. Box 25500 Juneau, Alaska 99802-5500

(907) 465-2047

MEMORANDUM

DATE: March 12, 1996

TO: Members, Senate Finance Committee

FROM: Byron I. Mallott *BIM*
Executive Director

SUBJECT: HB 525: Relating to Permanent Fund Investments

The purpose of the bill is straight forward: to give the Board of Trustees an opportunity to earn more income for the Permanent Fund over the long term by allowing the Board to allocate a higher percentage of the Fund's assets to equities and to lower-level investment-grade debt securities. It passed the House unanimously, without opposition last week.

The benefits of the bill, hopefully, will be expressed in increased dollars earned by your Permanent Fund in future years. Exactly how much additional income will be generated by these proposed changes is dependent on how the financial markets perform in the future, but the following analysis provides an illustrative example.

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A- and Baa-Rated Corporate Debt Securities**

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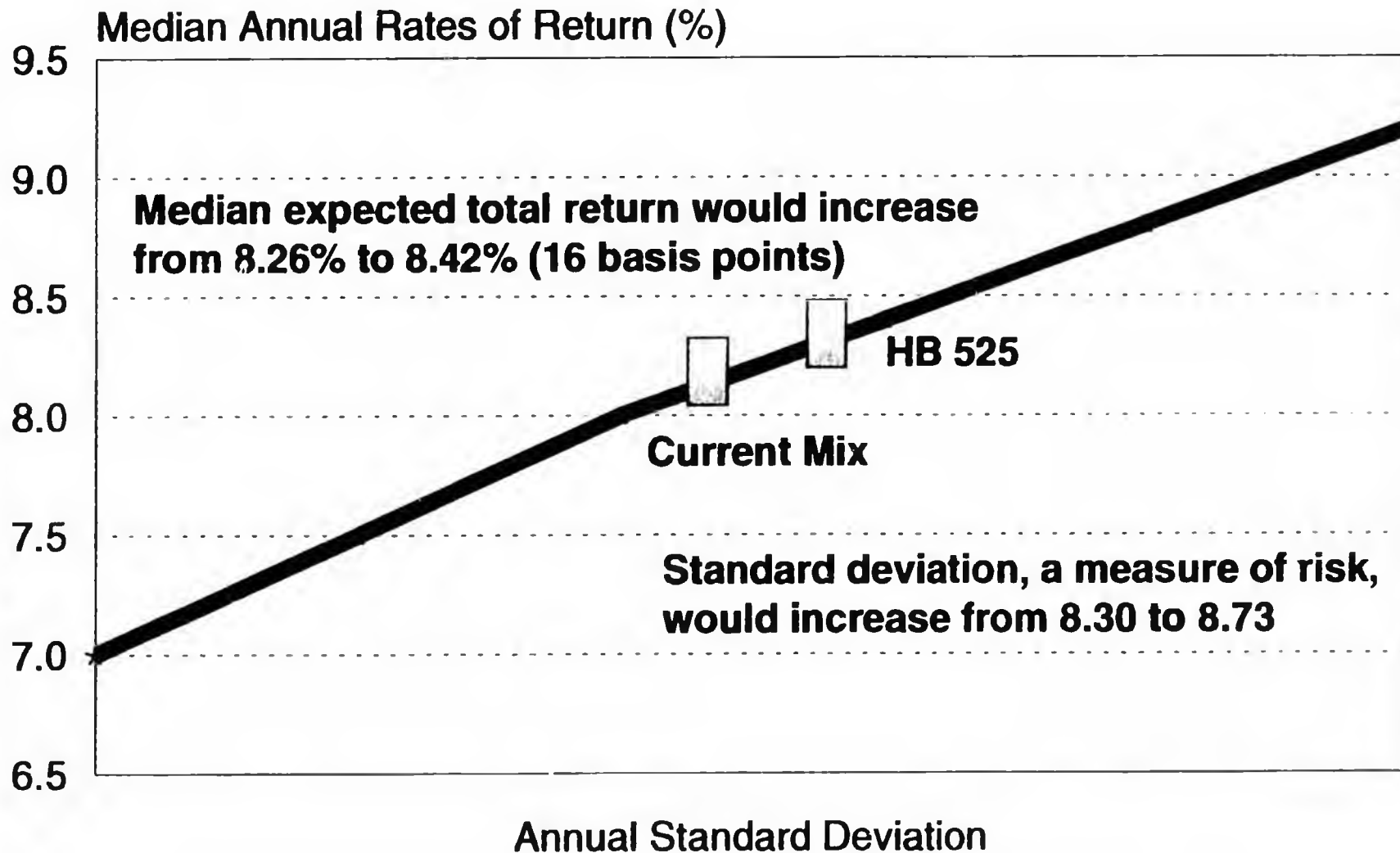
It should be noted, of course, that increased opportunities for return also bring increased risks. Increased percentage holdings of equities and debt securities in investment grades below AA could lead to more volatile annual returns in the short term. The Trustees believe, however, that the slight increase in risk is manageable in the short term, and will provide meaningful returns in the long term

House Bill 525
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Page 3

Finally, it should also be noted that the Trustees view this legislation as remedial because, even with these changes in investment authorization, the allowable asset allocation of the Fund essentially tracks the current median of the plan sponsor universe. In order to compete effectively in the financial markets of the 21st century, it may be necessary to seek additional legislative authorization to optimize future Permanent Fund risk and returns.

Impact of House Bill 525

Efficient Frontier/Asset Mix Risk & Return



REPRESENTATIVE
TERRY MARTIN
CHAIRMAN
BUDGET & AUDIT COMMITTEE
MEMBER
HOUSE FINANCE COMMITTEE

Alaska State Legislature



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355 DONNA DRIVE, #11
ANCHORAGE, AK 99504

SECTIONAL ANALYSIS

HB 525

Proposing changes to the statute which describes how Permanent Fund monies may be invested, to allow the Corporation more flexibility to take advantage of changing market situations.

Section 1.

Amends AS 37.13.120(g)(7) to allow investment in "investment grade" domestic corporate debt securities (bonds) by the Permanent Fund. The current statute allows investment only in A-rated or better bonds. Investment grade is from BBB to AAA (Standard and Poor's Corporation rating service). The bill allows the Fund to invest in BBB-rated bonds, which is currently not allowed.

Section 2.

Amends AS 37.13.120(g)(19) to allow investment in "investment grade" taxable municipal or state debt securities (bonds) by the Permanent Fund. The current statute allows investment only in A-rated or better bonds. Investment grade is from BBB to AAA (Standard and Poor's Corporation rating service). The bill allows the Fund to invest in BBB-rated bonds, which is currently not allowed.

Section 3.

Amends AS 37.13.120(i) to remove foreign bonds from a category containing foreign bonds and domestic corporate stocks. This action increases the limit of investment by the Permanent Fund on domestic corporate stocks to 50 percent, compared to the previous 45 percent. This section also eliminates the five percent limitation for investment in A-rated bonds.



Section 4.

Adds a new subsection to AS 3.900 which defines (for the purposes of this (g) of this section) "investment grade" and the commonly used domestic corporate bond rating system.

Section 5.

Allows for the act to take effect immediately upon passage.