

HB

261

<TARGET><BILL>HB 261</BILL><SUBJECT>HB
261</SUBJECT><COMM>HEDC29</COMM></TARGET>



THE STATE
of **ALASKA**
GOVERNOR BILL WALKER

Department of Revenue

COMMISSIONER'S OFFICE

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February 11, 2016

The Honorable Wes Keller, Chair
House Education Committee
State Capitol Building
Juneau, AK 99801

Dear Representative Keller:

The Department of Revenue (DOR) respectfully requests that HB 261, "An Act relating to the investment, appropriation, and administration of the public school trust fund; and providing for an effective date," be scheduled in the House Education Committee at your earliest convenience.

The purpose of this legislation is to modify how the public school trust fund under AS 37.14.110 is administered to generate monies that support the State's public school program. The proposed bill will establish a percent of market value (POMV) approach.

Your favorable consideration of this request is appreciated. If you need any additional information, please contact Jerry Burnett, Deputy Commissioner for the Department of Revenue at 907-465-3669.

Sincerely,

A handwritten signature in blue ink, appearing to read "Randall J. Hoffbeck".

Randall J. Hoffbeck, Commissioner

Cc: Darwin Peterson, Legislative Director, Office of the Governor
Jerry Burnett, Deputy Commissioner, Department of Revenue

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Governor Bill Walker
STATE OF ALASKA

January 18, 2016

The Honorable Mike Chenault
Speaker of the House
Alaska State Legislature
State Capitol, Room 208
Juneau, AK 99801-1182

Dear Speaker Chenault:

Under the authority of Article III, Section 18, of the Alaska Constitution, I am transmitting a bill relating to the investment, appropriation, and administration of the public school trust fund (AS 37.14.110).

The bill proposes to modify how the public school trust fund under AS 37.14.110 is administered to generate monies that support the State's public school program. Under current law, the net income from the fund is made available for appropriation to support public schools. To facilitate appropriations of income, the public school trust fund is invested and administered in a manner that distinguishes between principal and income. As treasurer of the fund, the Commissioner of Revenue has responsibilities related to administration and reporting of the fund.

Under the proposed bill, a percent of market value (POMV) approach will be established. First, on July 1 of each year, the Commissioner of Revenue will determine the monthly average market value of the fund for the previous three years. Under the POMV approach, five percent of the rolling three-year average of monthly market values will be available for appropriation to support public schools. The modified investment standard in the proposed bill maximizes the total return on investments derived from both capital appreciation and income. Furthermore, this POMV approach will provide a more stable and predictable revenue source for the State to support public schools. The investment standard also should encourage maximum total return on investments, and yet provide a conservative and stable return for the future.

The substantive provisions in the proposed bill will not take effect until after a court provides instructions that the proposed modifications to the public school trust statutes do not violate the State's trust duties. This provision recognizes the need to wait for resolution of pending litigation respecting the public school trust fund.

The current approach to administering the trust fund arises from a 1915 Act of Congress (48 U.S.C. § 353 (repealed 1959)) from which the public school trust fund originates. The 1915 Act required

The Honorable Mike Chenault
Transmittal Public School Trust Fund
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the Territory of Alaska to retain principal as a permanent fund. Only income generated by the fund was available to support public schools. These trust management provisions should not generally apply because the 1915 Act was repealed in the Alaska Statehood Act, excepting as applied to one section of land (48 U.S.C. prec. §21). The contingent effective date will resolve any questions about the modified approach to administering the public school trust fund and protect the State from additional breach of trust claims.

I urge your prompt and favorable action on this measure.

Sincerely,

A handwritten signature in blue ink that reads "Bill Walker". The signature is written in a cursive style with a large initial "B" and a long, sweeping underline.

Bill Walker
Governor

Enclosure

Fiscal Note

State of Alaska
2016 Legislative Session

Bill Version:	HB 261
Fiscal Note Number:	1
(H) Publish Date:	1/19/2016

Identifier: DOR-TRS-11-16-15
 Title: INVEST/APPROP/ADMIN PUB SCHOOL TRUST
 FUND
 Sponsor: RLS BY REQUEST OF THE GOVERNOR
 Requester: Governor

Department: Department of Revenue
 Appropriation: Taxation and Treasury
 Allocation: Treasury Division
 OMB Component Number: 121

Expenditures/Revenues

Note: Amounts do not include inflation unless otherwise noted below. (Thousands of Dollars)

	FY2017 Appropriation Requested	Included in Governor's FY2017 Request	Out-Year Cost Estimates					
			FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022
OPERATING EXPENDITURES								
Personal Services								
Travel								
Services								
Commodities								
Capital Outlay								
Grants & Benefits								
Miscellaneous								
Total Operating	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Fund Source (Operating Only)

None								
Total	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Positions

Full-time								
Part-time								
Temporary								

Change in Revenues								
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Estimated SUPPLEMENTAL (FY2016) cost: 0.0 *(separate supplemental appropriation required)*
(discuss reasons and fund source(s) in analysis section)

Estimated CAPITAL (FY2017) cost: 0.0 *(separate capital appropriation required)*
(discuss reasons and fund source(s) in analysis section)

ASSOCIATED REGULATIONS

Does the bill direct, or will the bill result in, regulation changes adopted by your agency?
 If yes, by what date are the regulations to be adopted, amended or repealed?

Why this fiscal note differs from previous version:

Initial version

Prepared By: Pamela Leary
 Division: Treasury
 Approved By: Jerry Burnett
 Agency: Department of Revenue

Phone: (907)465-2350
 Date: 11/16/2015 01:00 PM
 Date: 11/16/15

FISCAL NOTE ANALYSIS

STATE OF ALASKA
2015 LEGISLATIVE SESSION**Analysis**

This bill proposes to modify how the Public School Trust fund is administered. Rather than distinguish between two funds, principal and income, whereby the income of the principal fund is moved to the income fund to support the state's public school program, the funds would be combined into one fund with a new POMV revenue calculation approach to determine funds available for the public school program. The POMV (percent of market value approach) proposed would identify 5% of the monthly average market value of the fund for the previous three fiscal years at June 30 as available for appropriation for use in supporting the state's public school program. No additional costs would be incurred by the Treasury as a result of the proposed bill.

Why SB 146 (and HB 261) are bad for Alaska's School Children.

SB 146 (and its House counterpart HB 261) were introduced by the Governor on January 19, 2016. SB 146 (and HB 261) responds to claims brought against the State for breach of fiduciary duties in managing Alaska's public school trust fund.

These bills relate to the investment, appropriation, and administration of the Alaska public school trust fund.

Summary of bill proposal.

The bill responds to claims brought against the State for breach of fiduciary duties in managing the public school trust fund. It takes the very unusual action of immunizing the commissioner of revenue and others serving as fiduciaries for the trust from liability for negligent breach of those fiduciary duties.

It combines the trust principal and income accounts into one fund account. Five percent of the newly combined funds is appropriated annually for funding support of the public schools and to pay for costs of administration by the revenue department. The commissioner of revenue is directed to invest the new fund to provide increasing returns from capital appreciation.

This bill will take effect only if the court in *CAPSL v. State of Alaska*, Case No. 1JU-13-582 CI, rules that this law does not violate trust duties under AS 13.36.05

Discussion

Congress in 1915 reserved for Alaska's school children sections 16 and 36 in every township *when surveyed*. Had Congress's intent been kept, more

than 23,000,000 acres of Alaska would have been available and dedicated to provide financial support for Alaska's schools. Instead, both the Territory of Alaska and its successor trustee, the State of Alaska, failed to take reasonable steps to have those lands reserved for Alaska's children and at present there is barely 180,000 acres of land in the school trust (<1% of that originally intended)

A citizen's group, "CAPSL" – Citizens Alliance for the Protection of School Lands – has brought suit in the Alaska Superior Court alleging that there has been a breach of trust duties and seeks an order holding the State in breach of its trust obligations and requiring it to place those lands, or where unavailable, provide *in lieu* land, to restore the school lands trust. *CAPSL vs. State of Alaska*, Case No. 1JU-13-582 CI)

The lawsuit intends to accomplish three things:

First, it would maintain the rule of law – there would be an independent trustee (similar to the Alaska Mental Health Trust), that has an absolute duty of loyalty to the public school lands trust.

Second, it would provide a significant amount of land that could be developed to provide support for Alaska's schools – especially, programs designed to improve outcomes through innovation and especially working with younger children with the intent of helping meet the greatest academic need of every Alaska public school student.

Third, it would take lands that otherwise would be subject to competing interests from many stakeholders and set them aside to be actively managed and developed in ways that best meet the obligations of the trust to provide ongoing support for Alaska's schools. Developing Alaska's lands to support its public schools is a win for the State and a win for Alaska's school children as represented by CAPSL.

It is in the context of the existing and ongoing *CAPSL* litigation against the State of Alaska that SB 146 and its House counterpart HB 261 need to be reviewed:

There are three major defects in this bill. First, it immunizes the State as trustee for negligent or even intentional mismanagement of the school lands trust, so long as the delegation by the state to that manager was initially “prudent”. This effectively gives the State a pass on what is a widely understood and agreed upon legal duty of undivided loyalty and places the school lands trust fund at risk of mismanagement as there is no legal incentive for the State to provide continuing oversight.

Second, it combines the trust principal (Fund 1066) with the Investment Earning Account (Fund 34012). This destroys the integrity of both funds. For example, accounting records would no longer distinguish between the two accounts. In addition, it allows the withdrawal of five percent (5%) of the new principal/investment earning fund each year effectively allowing a withdrawal which will diminish the principal and ultimately result in the liquidation of the entire trust.

The 1915 enabling act by Congress specifically prohibited spending of the principal of the public school lands trust and the proceeds from any land sales or lease. Congress understood and ordered that only earnings from the fund could be used for public schools. Congress did this because even by 1915 it was understood that even “perpetual” school land trusts could be wiped out by uncontrolled spending.

Here is what the revenue department states on its web site about the use of trust fund monies:

The principal of the fund, and all capital gains/losses thereon, are perpetually retained in the fund (AS 37.14.110) and the remaining net income of the fund must be used for the state public school program (AS 37.14.140). Net income that may be spent is maintained in a separate Income Fund from the Principal Fund.

Combining the funds and drawing directly from the principal is contrary to the 1915 Act’s intention and the entire concept of providing “perpetual”

funding. Removing five percent each year will be sure to eventually result in a principal balance of zero.

In *Kaysulie vs. State of Alaska* the State of Alaska was found to have breached its trust duties. SB 146 (and HB 261) as proposed confirm the State is aware that it is violating its current trust duties, hence the effort to immunize itself from the normal obligations placed on every other trustee.

Finally, SB 146 (and HB 261) contain very unusual conditional language. Because the State is well aware that this bill would most likely face significant legal challenges as it both provides for legal immunity for ordinary trustee responsibilities *and* allows the trust to be wiped out by withdrawals in excess of earnings, the bill, if passed, only takes effect *if*:

“a court of competent jurisdiction enters a final judgment on the merits that is no longer subject to appeal that provides instruction to the state under AS 13.36.035 or other trust common law that enactment and implementation of this Act does not violate trust duties of the state regarding grants of land for the benefit of public schools made in Section 6(k) of the Alaska Statehood Act.”

Knowing that this law stands statutory and common law trust duties on its head, the State conditions the effective date of this Act on explicit court approval. Alaskans who want to assure that public schools have adequate funding in perpetuity should not support the changes proposed in SB 146 (and HB 261). They are bad public policy and bad for Alaska's school children.

We recommend that no action be taken on SB 146 (and HB 261) and that they be allowed to die in this session.

*This analysis prepared by the Citizens Alliance Protecting School Lands.
February 24, 2016*

*alacaps113@gmail.com
Lynn Hohl Seward*

Janet Ogan

From: Matt Blattmachr <mblattmachr@alaskatrust.com>
Sent: Wednesday, March 02, 2016 11:23 AM
To: Janet Ogan
Subject: FW: Matthew Blattmachr - Alaska Trust Company - Land Trust Bill
Attachments: HB261 Sponsor Statement.pdf; HB261 ver A.pdf

Janet,

The Representative has been a good friend of the Alaska trust industry, we are happy to be a good friend in return.

My understanding of the attached bill is that it is a proposal to change how distributions are calculated from the public school trust fund. While this is the first change, the more significant change is likely how the trust assets would be invested if this bill were approved. Under the current rules, the assets are likely invested to generate maximum income, rather than for maximum growth, since "income" is what can be distributed/spent. Assets invested for income generation typically do not leave much, if any, room for capital appreciation/long-term growth. Therefore, investing for income is beneficial in the short-term, but detrimental in the long-term.

This proposal would allow for the assets to be invested for maximum appreciation/growth rather than for pure income generation, which helps the fund maintain its "real" value over time. This would better align the interests of our current generation/schools with that of our future generations/schools. The conversion from income to POMV is similar to a "unitrust" conversion in the personal trust world. Alaska has a statute regarding unitrust conversions and it is 13.38.300.

Please note, due to the change in how distributions would be calculated, the amount available to be spent may change. Depending on how this affects the amount available for spending/distribution, one could always look to modify the POMV formula. For example, if the State wanted to distribute less than the proposed bill would allow, one could change the formula from five percent of the rolling-three year average to three percent of that average. The reverse is also true.

In regard to the differences between a trust and an endowment, I offer the following explanation. There are many kinds of trusts, one of which can be an endowment. Endowments typically have language that requires the principal/corpus amount of the fund to remain intact while the investment income can be spent for the designated purpose of the specific endowment (e.g. school, charity, etc.). The public school fund trust is an endowment and a trust.

Please let me know if you have any questions at all or if we can be of any help with future matters.

Best,

Matthew Blattmachr, CFP®

Vice President & Trust Officer



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From: Janet Ogan [mailto:Janet.Ogan@akleg.gov]
Sent: Wednesday, March 02, 2016 10:20 AM
To: Matt Blattmachr <mblattmachr@alaskatrust.com>
Subject: RE: Matthew Blattmachr - Alaska Trust Company - Land Trust Bill

Matt, I appreciate your willingness to give us some guidance on this bill. It has been assigned to our Education Committee. As I said we have very limited knowledge on trust issues, therefore we look forward to your comments and direction.