

ALASKA LEGISLATURE COMMITTEE BILL FILES - 1987 - 1988 8879

HB 547

399

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**HOUSE COMMITTEE REPORT**

Date referred: 3/23/88

FURTHER REFERRALS:

DATE: 4/8/88

The Finance Committee has considered HB 547

"An Act relating to the investment and management of certain state funds; and providing for an effective date."

**RECOMMENDS:**

- replace with CS HB 547 (Fin.) [ ] the same title
- attached amendment(s) [ ] a new title
- do pass
- do not pass
- no recommendation
- individual recommendations
- additional referral to the \_\_\_\_\_ Committee

**ADOPTS:** [ ] \_\_\_\_\_ letter of intent

**ATTACHES NEW FISCAL NOTE(S):**

- fiscal impact [ ] same as previous fiscal note published \_\_\_\_\_
- zero fiscal note [ ] same as previous zero fiscal note published \_\_\_\_\_
- zero with analysis

**SIGNING DO PASS:**

ADAMS Al Adams

POURCHOT Bob Pourchot

LARSON Don Larson

FRANK Don Frank

BOXER Max Boxer

GULL Pete Gull

WALLIS Kip Wallis

**SIGNING OTHER RECOMMENDATIONS:**

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

Al Adams  
Chairman's signature

FISCAL NOTE

REQUEST:

Revision Date: \_\_\_\_\_ Agency Affected: Department of Revenue  
 Title: Investment & Management of BRU: Treasury  
Certain State Funds  
 Sponsor: House Finance Components: \_\_\_\_\_  
 Requestor: House Finance

EXPENDITURES/REVENUES: (Thousands of Dollars)

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

FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL						

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS: Attach a separate page for analysis.

Prepared By: Milt Barker MB  
 Division: Treasury

Phone: 465-2350  
 Date: March 30, 1988

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

Date: 3/31/88

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

RECEIVED

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LEGISLATIVE FINANCE

465-5111

Original sponsor: Finance Committee

1 IN THE HOUSE

BY THE FINANCE COMMITTEE

2 CS FOR HOUSE BILL NO. 547 (Finance)

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 FIFTEENTH LEGISLATURE - SECOND SESSION

5 A BILL

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

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

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

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

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

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

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

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

26 (1) maintaining the accounts of the system;

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

9 (1) grants;

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

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

15 (4) contracts for medical doctors and dentists;

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

18 (6) disposals under AS 38.05;

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

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

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

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

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

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

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

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

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

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

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

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

17 (2) determine the appropriate investment objectives;

18 (3) establish investment policies to achieve the objec-  
19 tives; and

20 (4) act only in regard to the best financial interests of  
21 the state.

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

25 (c) In this section, "commissioner" means the commissioner of  
26 revenue.

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

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

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

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

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

6           (4) invest and reinvest the assets in accordance with this  
7 section;

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

10          (6) exercise the powers of an owner with respect to the  
11 assets;

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

15          (8) maintain accounting records in accordance with invest-  
16 ment accounting principles;

17          (9) engage an independent certified public accountant to  
18 conduct an annual audit of the financial condition and investment  
19 transactions;

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

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

27          (b) Under this section, the commissioner or the commissioner's  
28 designee may

29           (1) delegate investment, custodial, or depository authority

1 on a discretionary or nondiscretionary basis to officers or employees  
2 of the state or to independent firms, banks, or trust companies, by  
3 designation through appointments, contracts, or letters of authority;

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

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

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

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

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

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

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

27 (9) declare records to be confidential and exempt from  
28 AS 09.25.110 and 09.25.120 if the records contain information that  
29 discloses the particulars of the business or the affairs of a private

1 enterprise, investor, borrower, advisor, consultant, counsel, or  
2 manager.

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

11 (d) In exercising investment, custodial, or depository powers or  
12 duties under this section, the commissioner or a designee of the  
13 commissioner is liable for a breach of a duty that is assigned or  
14 delegated under this section, or under AS 14.25.180, AS 14.40.400(b),  
15 AS 37.10.070, AS 37.14.110(c), 37.14.160, 37.14.170, or AS 39.35.030.  
16 However, the commissioner or the commissioner's designee is not liable  
17 for a breach of a duty that has been delegated to another person if the  
18 delegation is prudent under the applicable standard of prudence set  
19 out in statute or if the duty is assigned by law to another person,  
20 except to the extent that the commissioner or designee

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

24 (2) by failure to comply with this section in the  
25 administration of specific responsibilities, enables another person to  
26 commit a breach of duty; or

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

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

6 (f) In this section, "commissioner of revenue" or "commissioner"  
7 means

8 (1) the commissioner of revenue for investments under  
9 AS 14.25.180 or AS 37.10.070; or

10 (2) the person or body provided by law to manage the  
11 investments, for investments not subject to AS 14.25.180 or AS 37.-  
12 10.070.

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

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

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

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

25 (1) [(A) THAT] a lawsuit has been filed or is threatened  
26 that [WHICH] challenges the corporate existence of the issuer or its  
27 power to issue the bonds or to levy taxes to pay the bonds or other-  
28 wise prevents a [THE] statement to the effect that no litigation is  
29 threatened or pending that affects the validity of the bonds;

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

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

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

12           (a) There is established as a separate endowment trust fund the  
13 public school trust fund. .

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

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

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

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

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

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

4           (1) exercise the powers and duties established in AS 14.-  
5 25.180(c);

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

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

10           (4) provide reports to the board established under AS 37.-  
11 14.120 on the condition and investment performance of the fund.

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

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

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

22           (2) determine the appropriate investment objectives;

23           (3) establish investment policies to achieve the objec-  
24 tives; and

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

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

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

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

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

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

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

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

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

- 21 (1) maintain the accounts of the system;
- 22 (2) make payments for the various purposes specified;
- 23 (3) submit periodic reports or statements of account that  
24 are needed;
- 25 (4) issue a statement of account to an employee requesting  
26 it showing the amount of the employee's contributions to the system;
- 27 (5) as soon as possible after the close of each fiscal  
28 year, and not later than six months after the close of each fiscal  
29 year, send to the governor, the legislature, and the board an annual

1 statement on the operations of the system containing

2 (A) a balance sheet;

3 (B) a statement of income and expenditures for the  
4 year;

5 (C) a report on an actuarial valuation of its assets  
6 and liabilities;

7 (D) [REPEALED

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

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

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

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

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

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

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

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

29 Sec. 44.83.386. INVESTMENT OF FUND. The Department of Revenue

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

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

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

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

21 \* Sec. 35. This Act takes effect immediately under AS 01.10.070(c).  
22  
23  
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HB 547  
Amendment Proposed by the Department of Revenue

1. Amend page 11, lines 6 and 7 to read:

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

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

or

(2) other persons or bodies as provided by law in the case of investments not subject to AS 14.25.180 or AS 37.10.070."

2. Page 15 after line 13 insert:

"(8) report to the board concerning the condition and administration of the system and distribute the reports to the members of the system."

3. Page 15, line 19 to read:

"in AS 14.25.035(d) and AS 14.25.180."

Public Employees' Retirement Board

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

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

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

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

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

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

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

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

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

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

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

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

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

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

DATED this 7 day of April, 1988.

PUBLIC EMPLOYEES' RETIREMENT BOARD

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

Teachers' Retirement Board

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

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

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

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

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

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

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

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

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

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

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

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

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

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

DATED this 7 day of April, 1988.

TEACHERS' RETIREMENT BOARD

BY   
Charles Arteaga, Chair

HOUSE BILL 547

Investment and Management of Certain State Funds

## CONTENTS

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- D. Schematic of HB 547
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- F. Department of Revenue Memorandum Regarding HB 547
- G. Willkie, Farr & Gallagher Memoranda
- H. Department of Revenue "General Investment Policies"
- I. Mercer, Meidinger, Hansen "PERS and TRS Financial Projections"
- J. Department of Revenue Memorandum Regarding Alaska State Trust Company

HOUSE BILL 547

INVESTMENT AND MANAGEMENT OF CERTAIN STATE FUNDS

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

\*\*\*\*\*

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

House Bill 547  
Investment and Management of Certain State Funds

EXECUTIVE SUMMARY

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

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

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

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

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

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

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

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

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

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

#### Goals of the Legislation

There are two principal goals HB 547 would help achieve:

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

#### Need for the Legislation

The legislation is needed because:

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

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

#### Financial Effects of the Legislation

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

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

#### Main Provisions of HB 547

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

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

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

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

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

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

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

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

HB 547  
Bill Analysis

Teachers Retirement System

- Section 1 Removes an ambiguity about the commissioner of revenue's fiduciary role for the retirement fund by recognizing the board's role as limited to administration of the system.
- Section 2 Redefines responsibility for reports furnished to the board so that the commissioner of administration provides reports on the condition and administration of the system, and the commissioner of revenue provides reports on the condition and performance of the retirement fund.
- Section 3 Expressly establishes the Teachers' Retirement Trust fund and adds the requirement for an annual independent audit of the system.
- Section 4 Clarifies that the commissioner of revenue is the fiduciary manager of the retirement fund. Imposes duties on the commissioner relating to investment of retirement funds in general, including
- (a) to establish investment policies and objectives based on the then current and probable future structure of the system's assets and liabilities; and
  - (b) to act only in the interests of the fund's beneficiaries.
- Authorizes investment without regard to generation of income, that is, permits emphasis on capital gains, if appropriate, recognizing the long-term nature of the fund's liabilities and without regard to the distinction between principal and income, recognizing, in theory, that the principal, as well as the income, will ultimately be paid out in benefits.
- References another section of statutes (AS 37.10.071) for specification of investment powers and duties generally applicable to all funds.

### University of Alaska

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

### University of Alaska Fund

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

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

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

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

### Alaska Student Loan Corporation

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

### Alaska Medical Facility Authority

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

### Alaska Housing Finance Corporation

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

### Judicial Retirement System

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

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

Military Retirement System

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

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

Public Contracts

Section 18 Excludes the commissioner of revenue's delegations of investment powers from state procurement code procedures.

State Treasury

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

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

Investment Powers and Duties

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

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

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

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

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

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

### Municipal Bonds

#### Section 21

Eliminates authority of commissioner of revenue to purchase debt of Alaska municipalities except when litigation forestalls issuance.

### Public School Trust Fund

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

### Investment Officers

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

### State Group Health and Life Insurance

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

### Public Employees Retirement System

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

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

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

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

Power Development Fund (Alaska Power Authority)

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

Enterprise Development Fund (Alaska Industrial Development and Export Authority)

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

Repealers

Section 34 Alaska State Building Authority (ASBA)

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

Medical Indemnity Corporation of Alaska (MICA)

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

Veterans Revolving Loan Fund

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

Sale of Bond Investments

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

Public School Fund Advisory Board

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

State Investment Officers

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

Public Employees Retirement System

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

Small Business Revolving Loan Fund

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

Historical District Loan Fund

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

1 IN THE HOUSE

BY THE FINANCE COMMITTEE

2

HOUSE BILL NO. 547

3

IN THE LEGISLATURE OF THE STATE OF ALASKA

4

FIFTEENTH LEGISLATURE - SECOND SESSION

5

A BILL

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

9 (1) grants;

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

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

15 (4) contracts for medical doctors and dentists;

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

18 (6) disposals under AS 38.05;

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

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

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

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

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

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

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

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

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

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

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

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

17 (2) determine the appropriate investment objectives;

18 (3) establish investment policies to achieve the objec-  
19 tives; and

20 (4) act only in regard to the best financial interests of  
21 the state.

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

25 (c) In this section, "commissioner" means the commissioner of  
26 revenue.

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

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

- 1                   (1) act as official custodian of cash and investments by  
2                   securing adequate and safe custodial facilities for them;  
3                   (2) receive all items of cash and investments;  
4                   (3) collect and deposit the principal of and income from  
5                   owned or acquired investments;  
6                   (4) invest and reinvest the assets in accordance with this  
7                   section;  
8                   (5) receive and spend appropriations to cover the cost of  
9                   the exercise of duties under this section;  
10                   (6) exercise the powers of an owner with respect to the  
11                   assets;  
12                   (7) perform all acts, not prohibited by this section,  
13                   whether or not expressly authorized, that the commissioner considers  
14                   necessary or proper in administering the assets;  
15                   (8) maintain accounting records in accordance with invest-  
16                   ment accounting principles;  
17                   (9) engage an independent certified public accountant to  
18                   conduct an annual audit of the financial condition and investment  
19                   transactions;  
20                   (10) enter into and enforce contracts or agreements con-  
21                   sidered necessary, convenient, or desirable for the investment pur-  
22                   poses of this section; and  
23                   (11) when choosing to acquire or dispose of investments,  
24                   secure competitive national or international market rates or prices,  
25                   or the equivalence of those rates or prices in the judgment of the  
26                   commissioner.  
27                   (b) Under this section, the commissioner or the commissioner's  
28                   designee may  
29                   (1) delegate investment, custodial, or depository authority

1 on a discretionary or nondiscretionary basis to officers or employees  
2 of the state or to independent firms, banks, or trust companies, by  
3 designation through appointments, contracts, or letters of authority;

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

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

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

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

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

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

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

27 (9) declare records to be confidential and exempt from  
28 AS 09.25.110 and 09.25.120 if the records contain information that  
29 discloses the particulars of the business or the affairs of a private

1 enterprise, investor, borrower, advisor, consultant, counsel, or  
2 manager.

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

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

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

24 (2) by failure to comply with this section in the  
25 administration of specific responsibilities, enables another person to  
26 commit a breach of duty; or

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

1 (e) The state shall defend and indemnify the commissioner or an  
2 officer or employee of the state against liability under (d) of this  
3 section to the extent that the alleged act or omission was performed  
4 in good faith and was prudent under the applicable standard of  
5 prudence.

6 (f) In this section, "commissioner" means the commissioner of  
7 revenue.

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

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

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

17 (2)] the bond counsel nominated by the issuing political  
18 subdivision in connection with the original offer for sale of the  
19 bonds certifies that

20 (1) [(A) THAT] a lawsuit has been filed or is threatened  
21 that [WHICH] challenges the corporate existence of the issuer or its  
22 power to issue the bonds or to levy taxes to pay the bonds or other-  
23 wise prevents a [THE] statement to the effect that no litigation is  
24 threatened or pending that affects the validity of the bonds;

25 (2) [AS TO LITIGATION REFERRED TO IN (1) OF THIS SUB-  
26 SECTION, (B) THAT] as a consequence of the filing of the suit, the  
27 bonds cannot be sold or can only be sold at interest rates substan-  
28 tially in excess of the interest rates the municipality would  
29 otherwise reasonably expect to pay; [,] and

1                   (3) [(C) THAT,] in the opinion of counsel [,] the  
2 municipality is or will be pursuing all available means to establish  
3 the validity of the bonds so that the lawsuit will be ultimately  
4 determined so as to permit the delivery of the bonds with the  
5 statement as to litigation referred to in (1) of this subsection.

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

7                   (a) There is established as a separate endowment trust fund the  
8 public school trust fund.

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

10                   (c) The commissioner of revenue shall determine the net income  
11 of the fund in accordance with investment accounting principles and in  
12 a manner that preserves the distinction between principal and income  
13 and that excludes capital gains or losses realized on principal. The  
14 principal of the fund and the capital gains or losses realized on  
15 principal shall be perpetually retained in the fund for investment  
16 purposes.

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

18                   Sec. 37.14.140. UTILIZATION OF INCOME. The net income of the  
19 fund may not be appropriated for a purpose other than the support of  
20 the state public school program. The commissioner of revenue shall  
21 invest realized net income that has not been appropriated or that has  
22 been appropriated but not expended until the income is appropriated  
23 and expended.

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

25                   Sec. 37.14.160. DUTIES OF THE COMMISSIONER OF REVENUE. The  
26 commissioner of revenue is the treasurer of the trust fund created in  
27 AS 37.14.110 and shall

28                   (1) exercise the powers and duties established in  
29 AS 14.25.180(c);

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

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

5           (4) provide reports to the board established under  
6 AS 37.14.120 on the condition and investment performance of the fund.

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

8           Sec. 37.14.170. INVESTMENTS. (a) The commissioner of revenue  
9 is the fiduciary of the trust fund and shall invest the fund to pro-  
10 vide increasing net income over long-term periods to the fund's income  
11 beneficiaries. The commissioner may invest the money in the fund on  
12 the basis of probable total rate of return to promote the long-term  
13 generation of income. In managing the trust fund, the commissioner  
14 shall

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

17           (2) determine the appropriate investment objectives;

18           (3) establish investment policies to achieve the objec-  
19 tives; and

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

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

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

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

25           (a) The commissioner of administration shall establish the group  
26 health and life benefits fund as a special account in the general fund  
27 to provide for group life and health insurance under AS 39.30.090 and  
28 39.30.160. The commissioner shall maintain accounts and records for  
29 the fund. The fund consists of employer contributions, employee

1 contributions, appropriations from the legislature, and income [INTER-  
2 EST] earned on investment of the fund as provided in (d) of this  
3 section.

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

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

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

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

16 (1) maintain the accounts of the system;  
17 (2) make payments for the various purposes specified;  
18 (3) submit periodic reports or statements of account that  
19 are needed;

20 (4) issue a statement of account to an employee requesting  
21 it showing the amount of the employee's contributions to the system;

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

26 (A) a balance sheet;  
27 (B) a statement of income and expenditures for the  
28 year;

29 (C) a report on an actuarial valuation of its assets

1 and liabilities;

2 (D) [REPEALED

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

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

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

11 (7) engage an independent certified public accountant to  
12 conduct an annual audit of the system's accounts and the annual report  
13 of the system's financial condition and activity. [REPEALED]

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

15 Sec. 39.35.080. DUTIES OF THE COMMISSIONER OF REVENUE. The  
16 commissioner of revenue is the treasurer of the system and the fidu-  
17 ciary of the fund. The commissioner has the same powers and duties  
18 established under this chapter in regard to the fund as are provided  
19 in AS 14.25.180.

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

21 Sec. 44.83.386. INVESTMENT OF FUND. The Department of Revenue  
22 shall invest the money in the fund in accordance with AS 37.10.070,  
23 37.10.071, and 37.10.075. The Department of Revenue shall provide  
24 money in the fund to the authority only after costs have been incurred  
25 or amounts in the fund have been otherwise obligated under contracts  
26 for the acquisition and construction of a project. Amounts that have  
27 been obligated, but for which costs have not yet been incurred, may be  
28 segregated by the Department of Revenue or transferred to the  
29 authority only with the prior approval or agreement of the

1 commissioner of revenue. Income [INTEREST] received on money that is  
2 segregated or transferred under this section must be deposited in the  
3 general fund.

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

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

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

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

STATE OF ALASKA  
DEPARTMENT OF REVENUE

M E M O R A N D U M

TO: The Honorable Hugh Malone  
Commissioner  
Department of Revenue

FROM: Milton B. Barker MB  
Deputy Commissioner  
Treasury Division

DATE: March 30, 1988

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

Goals of the Legislation

There are two principal goals HB 547 would help achieve:

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

Need for the Legislation

Evidence of the need for such legislation is that:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

#### Financial Effects of the Legislation

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

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

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

Funds Subject to the Legislation

The funds under management by the State are:

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

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

Trust Funds

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

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

property is a beneficiary.

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

#### Retirement Funds

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

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

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

Endowment Funds

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

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

Main Provisions of HB 547

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

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

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

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

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

2. strengthen accountability;

Discussion: four main steps the legislation would take are:

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

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

3. repeal statutory investment lists;

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

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

Some of the problems with a legal list are:

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

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

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

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

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

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

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

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

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

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

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

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

The Honorable Hugh Malone  
March 30, 1988  
Page 11

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

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

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

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

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

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

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

4. provide for competitive compensation for investment staff;

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

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

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

The Honorable Hugh Malone  
March 30, 1988  
Page 13

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

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

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

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

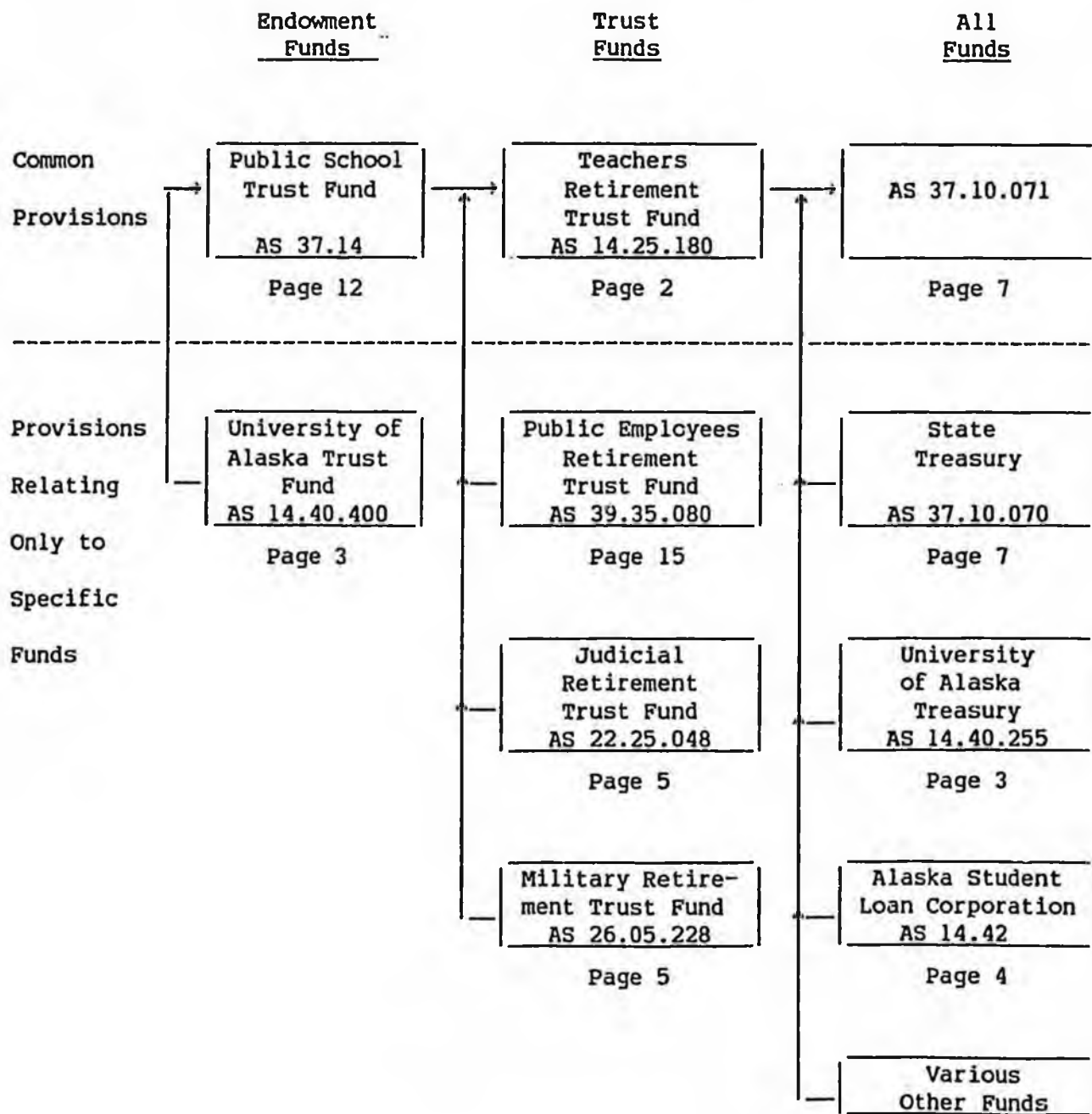
In place of the Procurement Code, regulations would be adopted to provide that contractor selection be on a competitive basis; most contracts for investment management services are subject to independent periodic performance evaluation, which would normally be the basis for their continuation or termination;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

MBB/gb

Attachment

Schematic  
of  
HB 547

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



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

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

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

THOMPSON and REED, JJ., concur.



BAKER BOYER NATIONAL BANK, Appellant,

v.

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

No. 6404-2-III.

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

May 15, 1986.

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

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

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

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

Green, C.J., filed dissenting opinion.

1. Trusts ⇨217.3(6)

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

2. Trusts ⇨217.3(6)

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

3. Appeal and Error ⇨758.1

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

4. Trusts ⇨262

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

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

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## Amendments

P.L. 99-514, § 1805(c)(1):

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

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

P.L. 98-369, § 75(a):

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

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

## Subchapter D—Deferred Compensation, Etc.

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

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

## Subpart A—General Rule

- Sec. 401. Qualified pension, profit-sharing, and stock bonus plans.  
Sec. 402. Taxability of beneficiary of employees' trust.  
Sec. 403. Taxation of employee annuities.  
Sec. 404. Deduction for contributions of an employer to an employees' trust or annuity plan and compensation under a deferred-payment plan.  
Sec. 404A. Deduction for certain foreign deferred compensation plans.  
Sec. 405. Employees of foreign affiliates covered by section 3121(l) agreements.  
Sec. 407. Certain employees of domestic subsidiaries engaged in business outside the United States.  
Sec. 408. Individual retirement accounts.  
Sec. 409A. Qualifications for tax credit employee stock ownership plans.

## [Sec. 401]

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

## [Sec. 401(a)]

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

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

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

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

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

## Sec. 401

Public Employees' Retirement Board  
Resolution Regarding Legislation Relating  
to the Commissioner of Revenue's  
Investment Powers and Duties

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

WHEREAS, the PERS Board has reviewed and considered draft legislation for an Act entitled "An Act relating to the Commissioner of Revenue's investment powers and duties, and providing for an effective date." (the "Legislation");

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

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

WHEREAS, the Legislation strengthens accountability for investment of the fund by:

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

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

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

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

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

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

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

BE IT HEREBY RESOLVED by the PERS Board that the Board supports introduction, passage, and enactment into law of legislation containing substantially the same provisions as the draft Legislation.

DATED this 13<sup>th</sup> day of November, 1987.

PUBLIC EMPLOYEES' RETIREMENT BOARD

By 

James "Pat" Wellington  
Vice-Chairman

Teachers' Retirement Board

Resolution Regarding Legislation Relating  
to the Commissioner of Revenue's  
Investment Powers and Duties

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

WHEREAS, the TRS Board has reviewed and considered draft legislation for an Act entitled "An Act relating to the Commissioner of Revenue's investment powers and duties, and providing for an effective date." (the "Legislation");

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

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

WHEREAS, the Legislation strengthens accountability for investment of the fund by:

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

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

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

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

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

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

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

BE IT HEREBY RESOLVED by the TRS Board that the Board supports introduction, passage, and enactment into law of legislation containing substantially the same provisions as the draft Legislation.

DATED this 12th day of November, 1987.

TEACHERS' RETIREMENT BOARD

By Dorothy Wells  
Dorothy Wells, Chairman

# MY TURN

## Funding state employee salaries

By Rep. NILO KOPONEN

The House majority supports the collective bargaining process, but we've had a firestorm of criticism lately.

A group of us urged that \$41 million be restored in the House budget to pay for anticipated personnel costs. However, a majority of members felt that while they supported collective bargaining, the inclusion of a specific sum was itself a violation of that process because it prejudged the result. So we included the following intent statement in the budget supporting the collective bargaining process and requesting that the administration submit a supplementary appropriation or the necessary amount.

"The legislature continues to support the collective bargaining process established for state employees and believes that employee compensation should be established as a result of the collective bargaining process and not the legislative budget process. It is the intent of the legislature that for all bargaining units for which the level of salaries, benefits or work rules have not been agreed for FY 88, the level of personal service funding in this budget shall not be construed to establish any specific level of salaries benefits, or work rule costs. In the event that the prod-

uct of collective bargaining negotiations results in a requirement for additional personal services funds above what is included in this budget, the Office of the Governor shall present a supplemental appropriation request to the second session of the 15th Alaska Legislature for consideration."

It is important to note that by this statement, this legislature is binding itself to act in the next session. People have forgotten that, prior to the Sheffield administration, the legislature habitually underfunded the personal services section of the budget, not by 10 percent, but by as much as 40 percent! This was called "Freemanizing," after Oral Freeman of Ketchikan, who as finance chair would deduct five months worth of salaries and benefits from each year's budget as a means of maintaining tighter control over the various state agencies.

When the legislature reconvened each January, the first task was to review the performance of the various state programs. These were then fine-tuned, budgets readjusted, and a supplementary budget passed to cover the final five months of the fiscal year.

This process also speeded up the writing of the next year's budget and tended to short circuit the House-

Senate game of "chicken" that led to such long legislative sessions in the early '80s.

One objection to inclusion of the supplement was that without an identified funding source, the money would have to come from the general fund, and therefore from the money allocated to school districts, municipalities, and the university campuses. Many of these are themselves in the midst of collective bargaining negotiations and, thus, would find their personnel budgets cut by more than 10 percent. By putting in a specific dollar amount to show our support for state employee collective bargaining, we would be adversely affecting the process in cities, school districts and community colleges.

So the task became to find a usable, flexible funding source. In the closing minutes of caucus debate I remembered that the Teachers Retirement System had been used for a similar purpose in the distant past.

Actuaries assure us that the 93 percent full funding of TRS is well above the amount needed to cover the retirement cost for teachers in the system. Likewise, the Public Employees Retirement System (PERS) is approximately 103 percent fully funded. Much of the overcapitalization seems to represent deposits made in the past by or

on behalf of temporary employees who were ineligible for retirement or many other benefits. There is considerably in excess of \$41 million available from the PERS fund as a loan or one-time-only withdrawal (it would not sustain a continued draw, but could be used as a transitional measure or to pay one-time personnel claims.)

I proposed that the finance or rules committee amend an available bill to provide authorization for the administration to borrow the necessary money from PERS. Such withdrawals would not be allowed to draw down the PERS balance below the 95 percent funding ratio.

My attempt was frustrated, however, since it appears the PERS system, although created by law, not contract, is complicated by contractual "strings" that go beyond protecting the fund.

Ultimately, the fate of this issue depends upon our ability to raise sufficient revenue. If we don't agree to pay our way, the impact on public employee jobs, as well as salaries will be more severe than currently contemplated.

\*\*\*\*\*

: Nillo Koponen, a Democrat, represents Fairbanks in the Alaska Legislature.

Juneau Empire

5-18-87

FY 87 Reduction in Public Employees' and Teachers Retirement Systems Employer Contributions  
as a Result of 1986 Revision of Actuarial Assumptions

	Payroll \$	Original Contribution Rate	Original Contributions \$	Revised Contribution Rate	Revised Contributions \$	Reduction in Employer Contributions	
						\$	%
<b>Public Employees'</b>							
State	467,426,593	14.45%	67,543,143	11.84%	55,343,308	12,199,835	18.06
Municipalities, University, and Other Employers	<u>443,625,262</u>	13.20	<u>58,546,434</u>	9.33	<u>41,410,399</u>	<u>17,136,035</u>	29.27
Total System	911,051,855	13.84	126,089,577	10.62	96,753,707	29,335,870	23.27
<b>Teachers'</b>							
Employers		9.09	35,427,092	6.88	26,813,904	8,613,188	24.31
State Match		9.09	<u>35,427,092</u>	6.88	<u>26,813,904</u>	<u>8,613,188</u>	24.31
Total System	389,736,986	18.18%	70,854,184	13.76%	53,627,809	17,226,376	24.31
Total Both Systems	1,300,788,841	15.14%	196,943,761	11.56%	150,381,516	46,562,246	23.64

Source: Division of Retirement and Benefits, Department of Administration

# MEMORANDUM

## State of Alaska

DEPARTMENT OF LAW

TO: Milton B. Barker  
Deputy Commissioner  
Department of Revenue

DATE: August 4, 1987

FILE NO: 663-88-0052

TELEPHONE NO: 465-3600

THRU:

SUBJECT: Foreign Investments

FROM: Robert M. Maynard *RMM*  
Assistant Attorney General  
Department of Law

You have asked for our opinion on whether the standards that apply to particular types of trust investments by AS 14.25.-180(b) and AS 39.35.110(a) apply also to foreign investments which are also particular types of investments authorized by subsections (23) and (24) of those sections. You have previously received an opinion dated April 12, 1982 from the law firm of Debevoise & Plimpton which state that the conditions stated in subsections (1) through (22) of those sections dealing with other particular types of investments do not, by implication, apply to the investments authorized by subsections (23) and (24).

We agree with that particular conclusion. This agreement, however, does not necessarily extend to other matters passed upon by the Debevoise opinion. In particular, we have concerns with the conclusion reached by that firm that the requirement in AS 14.25.180(c) and AS 39.35.110(b), that stocks must be listed on a U.S. exchange, does not apply to foreign stocks. By its terms, this restriction would apply to foreign stocks. The Debevoise opinion implies a legislative intent that that restriction not apply, for a number of reasons. If that question had been initially asked of us, we may have reached a different conclusion. We would recommend that you seek clarifying legislation authorizing the actions taken in reliance on the Debevoise opinion.

RMM:nb

STATE OF ALASKA  
DEPARTMENT OF REVENUE

M E M O R A N D U M

TO: Ann Geohegan  
Personnel Assistant  
Division of Administrative Services

FROM: Milt Barker MB  
Deputy Commissioner  
Treasury Division

DATE: June 19, 1987

RE: State Investment Officer IV

This memo requests the establishment of a new class in the State Investment Officer series, a State Investment Officer IV. The class would be established at a range 30. Attached are proposed class specifications for all classes in this series.

The State Investment Officer IV class would assure that professional expertise, experience, and judgement is exercised in the establishment of overall investment policy and in the comprehensive management of the investments of the State. These investments now exceed \$4.5 billion.

Fiduciary responsibilities for funds of this magnitude require professional management with respect to the total fund and the allocation of fund assets to different classes of investments. Moreover, State statutes require that State funds be invested with "the judgement and care . . . which an institutional investor of ordinary prudence, discretion, and intelligence exercises in the management of large investments." The institutional investor standard as opposed to the prudent man standard connotes professional management.

Existing class specifications for this series (attached) do not provide for determination of overall fund policy, asset allocation, and related responsibilities.

The State Investment Officer IV class should be established at a range 30. Even at this level, the compensation will not be competitive with that offered to the higher calibre professionals in field of investment management. The range 30, step A salary is \$71,880 per year. By comparison,

1. salaries of West Coast chief investment officers for state retirement systems are, on the whole, substantially higher:

- a. the Investment Manager for the California Public Employees' Retirement System receives a base salary of \$125,000 plus a bonus of up to \$25,000 the first year of employment, \$50,000 the second year, and \$75,000 the third year;
  - b. the chief investment officer for the Oregon Public Employees' and Teachers' Retirement Systems receives a salary of \$55,000;
  - c. the Executive director of the Washington State Investment Board receives \$90,000;
2. the average salary for chief investment officers of corporate pension plans with over \$200 million in assets was \$72,200 in 1985 with an average bonus of \$16,600 according to "Corporate Pension Funds 1986," a survey published by Greenwich Associates;
  3. the average salary for chief investment officers of corporate pension plans with over \$1 billion in assets was \$95,400 in 1985 with an average bonus of \$25,700 according to a survey of the 350 largest U.S. corporate pension plans by Buck Pension Fund Consultant, Inc.; this survey corroborates the Greenwich survey and demonstrates the effect of pension fund size on compensation: Buck survey respondents with pension assets less than \$500 million received an average salary of \$75,100 and an average bonus of \$15,700;
  4. the average salary for senior portfolio managers of investment management companies managing assets over \$1 billion was \$92,800 in 1986 with an average bonus of \$38,600 according to a survey by Callan Investment Institute of investment management organizations managing \$10 million or more in tax-exempt assets; the average salary for West Coast firms was \$73,800 with a bonus of \$19,800; however, the West Coast average includes firms with all sizes of assets under management;
  5. salaries for the Alaska Permanent Fund Corporation's three investment officers are \$85,308, \$84,216, and \$83,664; all are listed as 27J's; however, this is not on the same scale as the State partially-exempt schedule and at least one officer would not qualify for J step on the basis of longevity under the State system.

All of the above comparisons with the exception of the Permanent Fund need to be adjusted for Alaska's cost of living differential to be valid. Even without such adjustment, the proposed range 30 compensation can be seen to be significantly below that of other professionals in the field.

Ann Geohegan  
June 19, 1987  
Page 3

The \$16,000 to \$19,000 higher salary for the proposed State Investment Officer IV relative to the existing State Investment Officer III is insignificant in comparison to the higher investment returns that can be achieved from the retention or attraction of even marginally superior or more experienced personnel.

A strong case can be made that, in order to fulfill its fiduciary duties, the State must elevate and maintain the compensation of its fund managers at competitive levels. The related fact that the salary for this position would be paid principally from retirement fund assets should reinforce the rationale and equity in establishing compensation at a competitive level for this position.

MB/mem  
Enclosure

## STATE OF ALASKA

### AN ANALYSIS OF THE EFFECT OF INVESTMENT RESTRICTIONS ON PERFORMANCE

In order to ascertain the impact of the investment restrictions placed on the Public Employees Retirement System and the Teachers Retirement System we have compared the performance of these two funds since inception, against the International Securities Fund (ISF), the International Commingled Fund managed by Citibank N.A. free of investment restrictions, together with two of the major industry benchmarks, namely the WM Median Portfolio Performance and the Morgan Stanley Capital International EAFE Index. An analysis of divergencies in performance will indicate to what degree the investment restrictions placed on the Alaska funds have constrained or enhanced performance.

#### PERFORMANCE: SINCE INCEPTION

The performance of the Alaska funds against the benchmark since October 1983 is shown overleaf. For most of this period, the Alaska funds performed very much in line with ISF, with two short exceptions. The first was in the period October 1983 to June 1984. A divergence in return is to be expected in the early months of a portfolio as the initial stock positions are purchased and the fund carries a high level of cash. The impact to the cash positions are clearly evident as the portfolios underperformed ISF upto March 1984 in a period of rising markets and outperformed ISF between March 1984 and June 1984 when markets fell. Hence it is reasonable to assume that the restrictions placed on the investment of the Alaska funds did not have a significant effect on performance in this period.

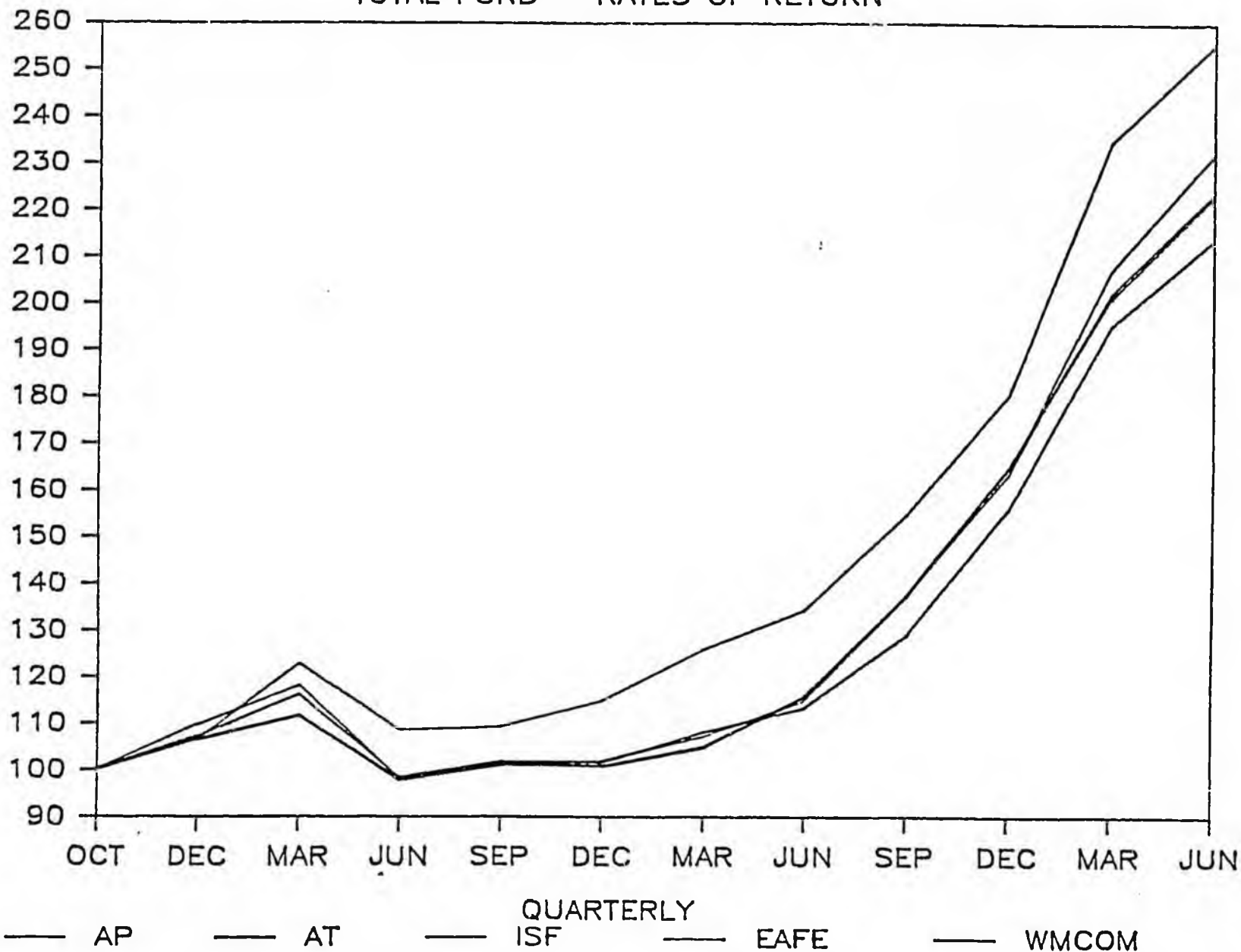
Between June 1984 and December 1985 the performance of the Alaska funds closely matched that of ISF. Over this period all three funds outperformed the WM Median performance. This would indicate that until December 1985 the investment restrictions did not have a material impact on the performance achieved by the Alaska funds in comparison to other funds managed by Citibank N.A. and the international equity investment industry in general.

#### 1986

The second period of performance deviation has occurred in 1986, when the Alaska funds underperformed ISF, but achieved higher returns than the WM Median portfolio. In order to ascertain whether this shortfall in performance was due to the investment restrictions, it is necessary to break down the performance, ultimately to individual stock performance. Our analysis is based on the figures provided by WM Computer Services for the first two quarters of 1986. WM Computer Services breakdown performance according to the contributions made by currency, market weighting (investment strategy) and investment selection (stock selection). These figures are shown in Table I, and when compounded produce the total portfolio return.

# THE STATE OF ALASKA

TOTAL FUND - RATES OF RETURN



The figures presented in Table I show that in terms of currency and investment selection, the performance of the two Alaska funds was very similar to that of ISF. Therefore the market selection was consistent for all three funds. However the figures for stock selection are significantly higher for ISF than for the Alaska funds, particularly in the first quarter.

**TABLE I**  
**PERFORMANCE Q1**

	<u>Public Employees</u> %	<u>Teachers</u> %	<u>ISF</u> %
Currency	6.6	6.7	6.6
Market Weightings	18.5	18.2	18.9
Investment Selection	-3.0	-3.3	0.3
Total Portfolio	22.6	21.9	27.1

**PERFORMANCE Q2**

	<u>Public Employees</u> %	<u>Teachers</u> %	<u>ISF</u> %
Currency	6.9	6.9	7.0
Market Weightings	2.5	2.5	2.5
Investment Selection	1.0	1.2	2.2
Total Portfolio	10.7	10.9	12.1

Table II shows the performance of the shares held by the Alaska funds and ISF grouped according to country, over Q1 and Q2 of 1986 combined. The market weighting figures relate to the end March asset allocation of the funds and give an impression as to the relative impact of the performance within each country.

**TABLE II**  
**RETURNS BY COUNTRY**  
**31/12/85 - 30/6/86**

	<u>Public Employees</u> %	<u>Teachers</u> %	<u>ISF</u> %	<u>Market Weighting</u> %
United Kingdom	+24.2	+24.0	+36.4	16
France	+35.5	+35.3	+72.0	4
Germany	+6.8	+7.8	+14.8	9
Italy	+84.7	+84.2	+65.4	4
Netherlands	+16.3	+16.3	+20.3	3
Norway	+14.4	+14.3	+15.3	1
Switzerland	+20.3	+19.9	+25.0	4
Sweden	+11.3	+11.2	+25.0	2
Japan	+59.1	+59.2	+59.6	49
Hong Kong	+3.0	+2.8	-6.0	1
Australia	+23.1	+23.1	+27.7	3
Other + Cash	-	-	-	4

100

The figures presented in Table II show that the Alaska funds achieved significantly worse stock selection returns than ISF in three countries, the UK, France and Germany, with Sweden, Switzerland and the Netherlands also contributing to the underperformance.

An analysis of the individual stock holdings within the French, German and UK portfolios show that the main reason for the performance shortfall was the influence of the investment restrictions imposed on the Alaska funds. A definitive study of stock selection is difficult in markets which are actively traded such as the UK. However, a consideration of the most successful investments of the ISF portfolios in France, Germany and the UK illustrates the point.

#### UNITED KINGDOM

The most successful investments in the UK portfolio of ISF over the first six months of 1986 were:-

BBA	+71%
Jaguar	+64%
Amersham International	+33%

The Alaska funds were unable to invest in any of these securities due to incomplete dividend records and in the case of BBA and Amersham International, shareholders funds of below \$100 Million. These three holdings comprised 20% of the UK portfolio at the beginning of the period under consideration, and hence was responsible for some 6% of the 12% performance excess of the ISF UK portfolio.

#### FRANCE

In France the situation was clearer. 50% of the ISF portfolio was invested in four stocks each of which performed significantly in excess of the Alaska French portfolios. These were:-

Michelin	72%
Darty	66%
Thomson CSF	58%
Peugeot Warrants	48%

Only Darty was open to investment for the Alaska funds, the other three securities being excluded by an absence of dividend payments over the last three years.

#### GERMANY

The German portfolio reveals a similar situation. Over 20% of the ISF portfolio was invested in Bayer warrants and Veba warrants, these being excluded from the Alaska portfolios on dividend grounds. Both of these investments were sold during the second quarter contributing approximately 5% of the 7% excess performance achieved by ISF.

#### SUMMARY

The performance of the two Alaska portfolios was broadly in line with that of ISF until early 1986. Although the performance of the Alaska funds in 1986 has been disappointing in comparison to ISF, both funds outperformed the WM Median portfolio over the six months. The deviation in performance was almost entirely due to differences in

stock selection and although small differences are normal between funds, the restrictions placed on the investment powers of the Alaska funds provided the major contribution to this performance shortfall. The two restrictions which were most severe were the requirement of a three year dividend record, prior to the date of purchase and a minimum of \$100 Million in shareholders funds. The first precluded the Alaska funds from taking full advantage of the economic recovery in Europe due to lower interest rates and a lower oil price. The second restriction cited, prevented the Alaska portfolios from investing in small/medium sized growth companies in the UK.

To conclude, the investment restrictions have resulted in a performance shortfall for the Alaska funds in comparison to that achieved by other funds managed by Citibank N.A. However, the difference was not serious enough to cause the Alaska funds to underperform the WM Median fund. The restrictions are unlikely to continue to affect performance to the degree seen in early 1986 where a sharp economic recovery was witnessed. However, the imposition of restrictions reduces the freedom for manoeuvre within markets which will have a negative impact on performance over a long period.

Rudolph Leuthold  
Managing Director

20th October 1986

**J.P. Morgan  
Investment**

Mr J Wilson  
State Investment Officer  
State of Alaska  
Treasury Division  
Pouch SP  
Juneau  
Alaska 99811

U.S.A.

Dear Jim

Re: STATE OF ALASKA - PUBLIC EMPLOYEES FUND - ACCOUNT A 2800  
STATE OF ALASKA - TEACHERS RETIREMENT FUND - ACCOUNT A 2810

I am writing to suggest some changes in the management guidelines of the above accounts which you may want to consider in the forthcoming reviews of restrictions relating to foreign securities (15AAC.114.060).

My first suggestion relates to item (4) which stipulates a combined capital and surplus aggregating at least \$100 million. I have found that this restriction prevents us from participating in a number of issues which proved to be particularly attractive. Many small high growth companies do not satisfy this requirement. This also includes many new equity issues which are often attractively priced at the time of floatation. We find that in the small company universe there are often opportunities for good performance because these stocks escape the attention of managers which concentrate on large capitalisation stocks where documentation is readily available. Since we are making a particular commitment to research we would like to be able to take advantage of opportunities in small stocks.

Secondly, I would like to refer to item (3) which requires that corporations have paid dividends in each of the three years preceding the investment. This limitation bars us from participating in recovery situations which can produce excellent stock market returns. To substantiate the case for removal of the above limitations I have produced a list of companies which appeared attractive but could not be purchased in recent years. This list is enclosed in Appendix I and indicates performance of each stock relative to its local market index.