

ALASKA LEGISLATURE COMMITTEE BILL FILES - 1987 - 1988 8879

CSHB 547

403

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C S H B

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SENATE COMMITTEE REPORT

FURTHER

4/19/88

DATE TURNED INTO OFFICE 5/6/88

Mr. President:

FINANCE Committee considered CSHB 547 (FIN) am
investment and management of certain state funds; efd

and recommended

replace with SCS CS HB 547 (Fin) same title
 or adopt _____ CS _____ new title

attached amendment(s) and

do pass

do not pass

no recommendation

individual recommendations

further referral to _____

letter of intent adopted _____

Committee attached or adopted fiscal note(s)

new updated or previous

zero DOR fiscal impact

MEMBERS SIGNING DO PASS

OTHER RECOMMENDATIONS

[Signature]
[Signature]
[Signature]
[Signature]
[Signature]

[Signature] NO REC
Chairman signature and recommendation

Committee Backup attached

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)



APR 4 1988 page 1 of 1

5-2059X
Cramer
5/5/88

Original sponsor: Finance Committee

Adopted
5/6/88 am

1 IN THE HOUSE

BY THE FINANCE COMMITTEE

2 SENATE CS FOR 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;

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; or

10 (15) a contract that is a delegation, in whole or in part,
11 of investment powers of the Board of Trustees of the Alaska Permanent
12 Fund Corporation under AS 37.13.

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 AS 37.10.070 is repealed and reenacted to read:

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

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

20 (2) determine the appropriate investment objectives;

21 (3) establish investment policies to achieve the objec-
22 tives; and

23 (4) act only in regard to the best financial interests of
24 the state.

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

28 (c) In this section, "commissioner" means the commissioner of
29 revenue.

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

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

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

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

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

9 (4) invest and reinvest the assets in accordance with this
10 section;

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

13 (6) exercise the powers of an owner with respect to the
14 assets;

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

18 (8) maintain accounting records in accordance with invest-
19 ment accounting principles;

20 (9) engage an independent certified public accountant to
21 conduct an annual audit of the financial condition and investment
22 transactions;

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

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

1 (b) Under this section, the commissioner or the commissioner's
2 designee may

3 (1) delegate investment, custodial, or depository authority
4 on a discretionary or nondiscretionary basis to officers or employees
5 of the state or to independent firms, banks, or trust companies, by
6 designation through appointments, contracts, or letters of authority;

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

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

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

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

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

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

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

1 (9) declare records to be confidential and exempt from
2 AS 09.25.110 and 09.25.120 if the records contain information that
3 discloses the particulars of the business or the affairs of a private
4 enterprise, investor, borrower, advisor, consultant, counsel, or
5 manager.

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

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

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

27 (2) by failure to comply with this section in the adminis-
28 tration of specific responsibilities, enables another person to commit
29 a breach of duty; or

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

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

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

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

13 (2) the person or body provided by law to manage the inves-
14 tments, for investments not subject to AS 14.25.180 or AS 37.10.070.

15 * Sec. 21. AS 37.14.110(a) is amended to read:

16 (a) There is established as a separate endowment trust fund the
17 public school trust fund.

18 * Sec. 22. AS 37.14.110(c) is repealed and reenacted to read:

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

26 * Sec. 23. AS 37.14.140 is repealed and reenacted to read:

27 Sec. 37.14.140. UTILIZATION OF INCOME. The net income of the
28 fund may not be appropriated for a purpose other than the support of
29 the state public school program. The commissioner of revenue shall

1 invest realized net income that has not been appropriated or that has
2 been appropriated but not expended until the income is appropriated
3 and expended.

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

5 Sec. 37.14.160. DUTIES OF THE COMMISSIONER OF REVENUE. The
6 commissioner of revenue is the treasurer of the trust fund created in
7 AS 37.14.110 and shall

8 (1) exercise the powers and duties established in AS 14.-
9 25.180(c);

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

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

14 (4) provide reports to the board established under AS 37.-
15 14.120 on the condition and investment performance of the fund.

16 * Sec. 25. AS 37.14.170 is repealed and reenacted to read:

17 Sec. 37.14.170. INVESTMENTS. The commissioner of revenue is the
18 fiduciary of the trust fund and shall invest the fund to provide
19 increasing net income over long-term periods to the fund's income
20 beneficiaries. The commissioner may invest the money in the fund on
21 the basis of probable total rate of return to promote the long-term
22 generation of income. In managing the trust fund, the commissioner
23 shall

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

26 (2) determine the appropriate investment objectives;

27 (3) establish investment policies to achieve the objec-
28 tives; and

29 (4) act only in regard to the financial interests of the

1 fund's beneficiaries.

2 * Sec. 26. AS 39.25.110 is amended by adding a new paragraph to read:
3 (25) investment officers in the Department of Revenue.

4 * Sec. 27. AS 39.30.095(a) is amended to read:

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

13 * Sec. 28. AS 39.30.095(d) is amended to read:

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

20 * Sec. 29. AS 39.35.020 is amended to read:

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

25 (1) maintain the accounts of the system;
26 (2) make payments for the various purposes specified;
27 (3) submit periodic reports or statements of account that
28 are needed;

29 (4) issue a statement of account to an employee requesting

1 it showing the amount of the employee's contributions to the system;

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

6 (A) a balance sheet;

7 (B) a statement of income and expenditures for the
8 year;

9 (C) a report on an actuarial valuation of its assets
10 and liabilities;

11 (D) [REPEALED

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

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

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

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

23 (8) report to the board concerning the condition and admin-
24 istration of the system and distribute the report to the members of
25 the system. [REPEALED]

26 * Sec. 30. AS 39.35.080 is repealed and reenacted to read:

27 Sec. 39.35.080. DUTIES OF THE COMMISSIONER OF REVENUE. The
28 commissioner of revenue is the treasurer of the system and the fidu-
29 ciary of the fund. The commissioner has the same powers and duties

1 established under this chapter in regard to the fund as are provided
2 in AS 14.25.035(d) and 14.25.180.

3 * Sec. 31. AS 44.83.386 is amended to read:

4 Sec. 44.83.386. INVESTMENT OF FUND. The Department of Revenue
5 shall invest the money in the fund in accordance with AS 37.10.070,
6 37.10.071, and 37.10.075. The Department of Revenue shall provide
7 money in the fund to the authority only after costs have been incurred
8 or amounts in the fund have been otherwise obligated under contracts
9 for the acquisition and construction of a project. Amounts that have
10 been obligated, but for which costs have not yet been incurred, may be
11 segregated by the Department of Revenue or transferred to the author-
12 ity only with the prior approval or agreement of the commissioner of
13 revenue. Income [INTEREST] received on money that is segregated or
14 transferred under this section must be deposited in the general fund.

15 * Sec. 32. AS 44.88.155(c) is amended to read:

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

22 * Sec. 33. AS 18.55.375; AS 21.88.210(d); AS 26.15.060; AS 37.10.079,
23 37.10.080; AS 37.14.130(3); AS 39.25.120(c)(13); AS 39.35.110; AS 45.95.-
24 030, 45.95.040(b); and AS 45.98.050(b) are repealed.

25 * Sec. 34. This Act takes effect immediately under AS 01.10.070(c).
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STATE OF ALASKA
1988 LEGISLATIVE SESSION

Bill Version: CSHB 547 (FIN)
Publish Date: HOUSE 4/11/88

FISCAL NOTE

REQUEST:

Revision Date: _____
Title: Investment & Management of
Certain State Funds
Sponsor: House Finance
Requestor: House Finance

Agency Affected: Department of Revenue
BRU: Treasury
Components: _____

EXPENDITURES/REVENUES: (Thousands of Dollars)

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OPERATING						
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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

APR 4 1988 page 1 of 1

Original sponsor: Finance Committee

1 IN THE HOUSE BY THE FINANCE COMMITTEE

2 CS FOR HOUSE BILL NO. 547 (Finance) am
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 Agricultura¹ 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;

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; or

10 (15) a contract that is a delegation, in whole or in part,
11 of investment powers of the Board of Trustees of the Alaska Permanent
12 Fund Corporation under AS 37.13.

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

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

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

20 (2) determine the appropriate investment objectives;

21 (3) establish investment policies to achieve the objec-
22 tives; and

23 (4) act only in regard to the best financial interests of
24 the state.

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

28 (c) In this section, "commissioner" means the commissioner of
29 revenue.

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

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

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

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

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

9 (4) invest and reinvest the assets in accordance with this
10 section;

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

13 (6) exercise the powers of an owner with respect to the
14 assets;

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

18 (8) maintain accounting records in accordance with invest-
19 ment accounting principles;

20 (9) engage an independent certified public accountant to
21 conduct an annual audit of the financial condition and investment
22 transactions;

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

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

1 (b) Under this section, the commissioner or the commissioner's
2 designee may

3 (1) delegate investment, custodial, or depository authority
4 on a discretionary or nondiscretionary basis to officers or employees
5 of the state or to independent firms, banks, or trust companies, by
6 designation through appointments, contracts, or letters of authority;

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

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

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

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

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

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

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

1 (9) declare records to be confidential and exempt from
2 AS 09.25.110 and 09.25.120 if the records contain information that
3 discloses the particulars of the business or the affairs of a private
4 enterprise, investor, borrower, advisor, consultant, counsel, or
5 manager.

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

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

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

27 (2) by failure to comply with this section in the adminis-
28 tration of specific responsibilities, enables another person to commit
29 a breach of duty; or

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

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

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

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

13 (2) the person or body provided by law to manage the inves-
14 tments, for investments not subject to AS 14.25.180 or AS 37.10.070.

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

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

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

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

27 (1) [(A) THAT] a lawsuit has been filed or is threatened
28 that [WHICH] challenges the corporate existence of the issuer or its
29 power to issue the bonds or to levy taxes to pay the bonds or

1 otherwise prevents a [THE] statement to the effect that no litigation
2 is threatened or pending that affects the validity of the bonds;

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

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

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

14 (a) There is established as a separate endowment trust fund the
15 public school trust fund.

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

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

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

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

1 and expended.

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

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

6 (1) exercise the powers and duties established in AS 14.-
7 25.180(c);

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

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

12 (4) provide reports to the board established under AS 37.-
13 14.120 on the condition and investment performance of the fund.

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

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

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

24 (2) determine the appropriate investment objectives;

25 (3) establish investment policies to achieve the objec-
26 tives; and

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

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

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

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

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

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

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

18 * Sec. 30. AS 39.35.020 is amended to read:

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

- 23 (1) maintain the accounts of the system;
24 (2) make payments for the various purposes specified;
25 (3) submit periodic reports or statements of account that
26 are needed;
27 (4) issue a statement of account to an employee requesting
28 it showing the amount of the employee's contributions to the system;
29 (5) as soon as possible after the close of each fiscal

1 year, and not later than six months after the close of each fiscal
2 year, send to the governor, the legislature, and the board an annual
3 statement on the operations of the system containing

4 (A) a balance sheet;

5 (B) a statement of income and expenditures for the
6 year;

7 (C) a report on an actuarial valuation of its assets
8 and liabilities;

9 (D) [REPEALED

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

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

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

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

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

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

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

1 * Sec. 32. AS 44.83.386 is amended to read:

2 Sec. 44.83.386. INVESTMENT OF FUND. The Department of Revenue
3 shall invest the money in the fund in accordance with AS 37.10.070,
4 37.10.071, and 37.10.075. The Department of Revenue shall provide
5 money in the fund to the authority only after costs have been incurred
6 or amounts in the fund have been otherwise obligated under contracts
7 for the acquisition and construction of a project. Amounts that have
8 been obligated, but for which costs have not yet been incurred, may be
9 segregated by the Department of Revenue or transferred to the author-
10 ity only with the prior approval or agreement of the commissioner of
11 revenue. Income [INTEREST] received on money that is segregated or
12 transferred under this section must be deposited in the general fund.

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

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

20 * Sec. 34. AS 18.55.375; AS 21.88.210(d); AS 26.15.060; AS 37.10.080;
21 AS 37.14.130(3); AS 39.25.120(c)(13); AS 39.35.110; AS 45.95.030, 45.95.-
22 040(b); and AS 45.98.050(b) are repealed.

23 * 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 compensation, 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
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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.

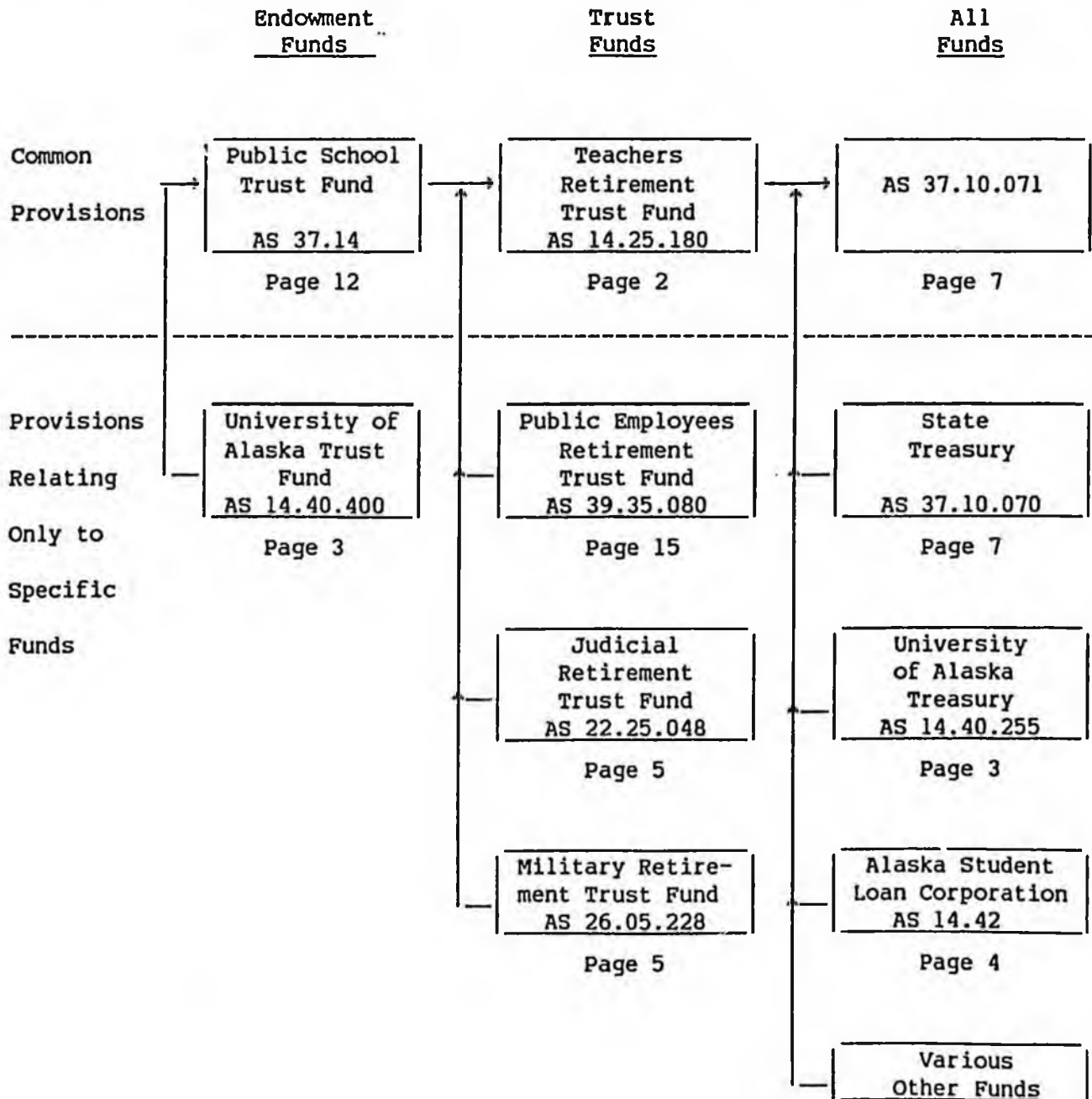
In place of the Procurement Code, regulations would be adopted to provide that contractor selection be on a competitive basis; most contracts for investment management services are subject to independent periodic performance evaluation, which would normally be the basis for their continuation or termination; 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.²

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. 406. 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

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

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

HOUSE BILL 507

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

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.

HOUSE BILL 547

Investment and Management of Certain State Funds

CONTENTS

- A. Executive Summary
- B. House Bill 547
- C. Bill Analysis
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- E. Resolutions of the Public Employees' and Teachers' Retirement Boards relating to HB 547
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- G. Willkie, Farr & Gallagher Memoranda
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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. One of the significant financial effects of HB 547 would be the limitation of the State's potential liability as a trustee by virtue of the steps taken in the bill to assure observance of fiduciary duties.

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 legal 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 impair rather than facilitate prudent investment and diversification.

Elimination of legal lists means that investment guidelines will not be cast in stone and incapable of timely response to changes in the financial markets. 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

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.

Main Provisions of HB 547

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 of 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. Broaden investment authority;

Making an upgraded rule of prudence the guide for permissible investments:

- 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 and other institutional funds which operate under a legal list has become a small minority. Corporate and union pensions 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; current compensation levels jeopardize the statutory requirement that State funds be invested with the judgment and care which an institutional investor would exercise; and
5. exempt professional services contracts which are delegations of investment authority from the State Procurement Code; contracts for investment management are subject to independent periodic performance evaluation; competitive selection is required by fiduciary duty 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 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 blanket authority of commissioner of revenue to purchase debt of Alaska municipalities. The amendment would permit such purchase when litigation forestalls issuance. Purchase of Alaska municipal debt would also be authorized under general investment powers contained in the bill if such purchase met the standards of prudence.

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)).

House Bill 547
Investment and Management of Certain State Funds

INTRODUCTION

HB 547 is a comprehensive revision of Department of Revenue investment statutes. The department invests all state funds, excluding funds of independent corporations.

The bill focuses on trust funds, which include retirement and endowment funds. Trust funds carry a greater weight of care because they are for the benefit of other persons. Fiduciary duties and standards of care for trusts have been elaborated under common law, statutory law such as ERISA (the Employee Retirement Income Security Act), and case law pursuant to statutory provisions.

One of the bill's major changes puts fiduciary duties and standards into Alaska law, both clarifying and elevating them. One significant financial effect of HB 547 would be to limit the State's potential liability as trustee by providing guidance and personal liability for observance of fiduciary duties.

The other major change is the broadening of permissible investments. HB 547 places investment authority under the elevated standards of care contained in the bill, eliminating the narrow legal 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 deregulation and evolution of securities markets in recent years, legal lists now impair rather than facilitate prudent investment and diversification.

Elimination of legal lists means that investment guidelines will not be cast in stone and incapable of timely response to changes in financial markets. The enhancement of investment returns that can be expected by moving away from inflexible statutory guidelines can be of great financial benefit to the State, municipalities, and trust fund beneficiaries.

The legislation has been reviewed by the Department of Law and Willkie, Farr & Gallagher, investment counsel to the state. HB 547 contains Willkie Farr's recommendations on liability for fiduciary duties.

The bill has been endorsed by resolutions of the Public Employees' and Teachers' Retirement boards. The Department of Revenue supports passage of HB 547.

Goals of the Legislation

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.

Main Provisions of HB 547

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 of 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. Broaden investment authority by:

Making an upgraded rule of prudence the guide for permissible investments:

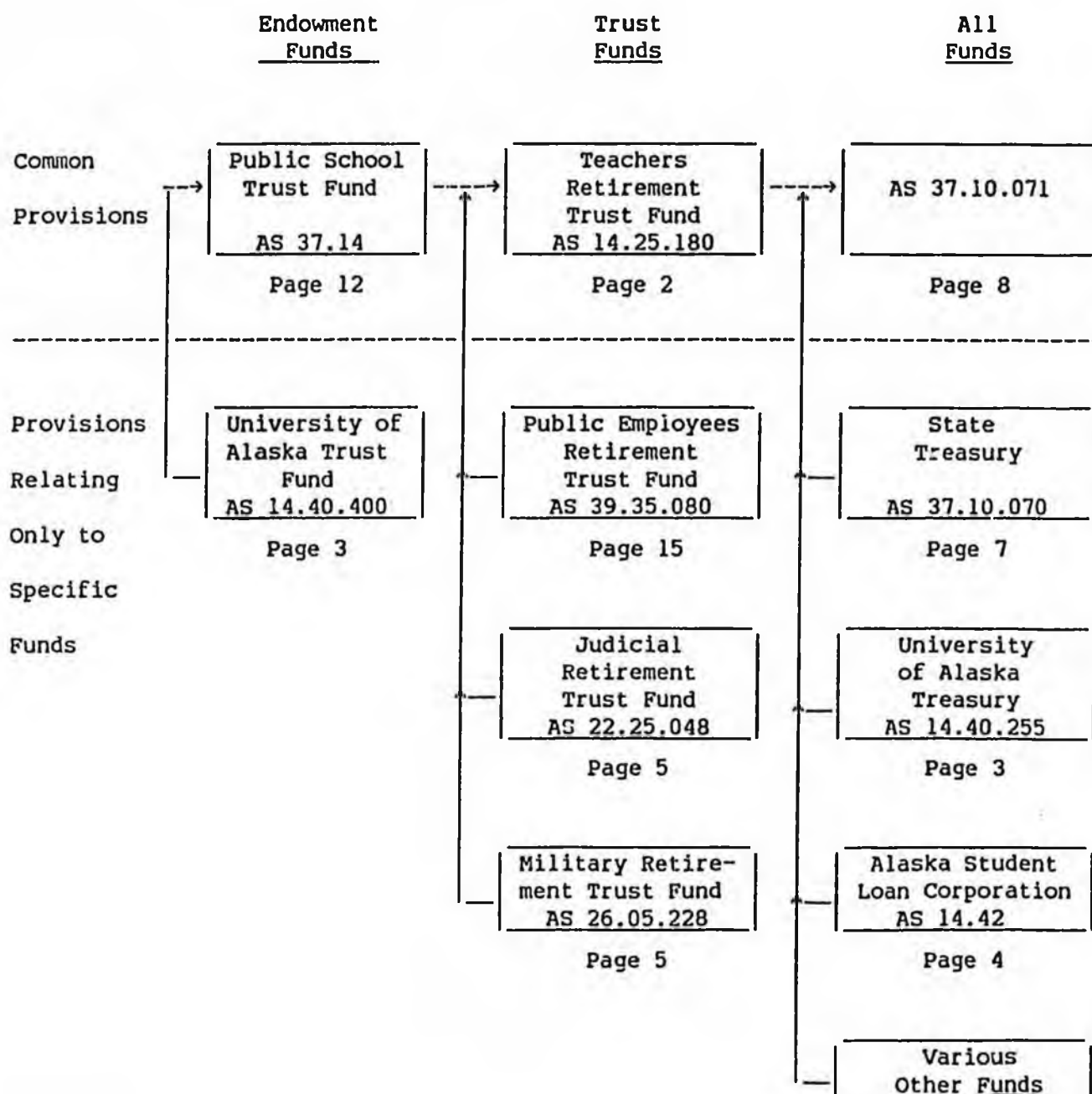
- a. decrease risk by permitting greater diversification, subject to the rule of prudence; and,
- b. maximize earnings by permitting greater concentration in the highest yielding assets, subject to the rule of prudence.

The number of pension and other institutional funds which operate under a legal list has become a small minority. Corporate and union pensions 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; current compensation levels jeopardize the requirement that State funds be invested with the judgment and care which an institutional investor would exercise; and
5. exempt professional services contracts which are delegations of investment authority from the State Procurement Code; contracts for investment management are subject to independent periodic performance evaluation; competitive selection is required by fiduciary duty and the rule of prudence.

Schematic
of
CS HB 547 (Finance) am

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.



STATE OF ALASKA

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<input type="checkbox"/> Approval	<input type="checkbox"/> Note & Return	
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<input type="checkbox"/> Comment	<input type="checkbox"/> Return as Requested	
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<input type="checkbox"/> For Your File	<input type="checkbox"/> For Your Information	
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FROM: Mail Station 0400	Department Revenue	Division Treas
By Alouia	Date 4/21	

To the Reader:

The enclosed "Memorandum Concerning the State of Alaska Legislative Proposals Regarding Commissioner of Revenue's Investment Powers and Duties" is a review by Willkie, Farr & Gallagher, investment counsel to the state, on contract to the Department of Law, of draft legislation and other materials.

The recommendations of Willkie, Farr & Gallagher on liability and indemnification for breaches of fiduciary duty have been incorporated in HB 547 and subsequent House versions of the bill. These recommendations can be found in the Executive Summary on pages 4 and 5 and in the body of the Memoranda on pages 47 through 61.

Alaska Department of Revenue

MEMORANDA CONCERNING THE STATE OF ALASKA
LEGISLATIVE PROPOSALS REGARDING
COMMISSIONER OF REVENUE'S INVESTMENT POWERS AND DUTIES

WILLKIE FARR & CALLAGHER
One Citicorp Center
153 East 53rd Street
New York, New York 10022

March 1, 1988

WILLKIE FARR & GALLAGHER

New York
Washington, DC
London
Paris

M E M O R A N D U M

TO: State of Alaska Department of Revenue
FROM: Willkie Farr & Gallagher
RE: Executive Summary of WF&G Memorandum Examining
Legislative Proposals Regarding Commissioner of
Revenue's Investment Powers and Duties
DATED: March 1, 1988

Introduction

This Memorandum is designed to serve as an Executive Summary of the content of the attached Memorandum from Willkie Farr & Gallagher to the State of Alaska Department of Revenue (the "Investment Proposals Memorandum"). The Investment Proposals Memorandum examines the legal issues relevant to, and the rationale for, certain changes proposed by the Commissioner of Revenue of the State (the "Commissioner") to be made to the statutory framework currently governing investments made with the monies of certain public funds established by the State of Alaska (the "Funds"). For convenience, the discussion set out below follows the same organizational structure used in the Investment Proposals Memorandum. Section I thus sets out the legal background of each of the legislative proposals (the "Bill") prepared by the Commissioner. Section II summarizes issues related to the Bill proposals, but not covered by the express terms of the Bill. Section III summarizes the separate proposal to establish an independent trust company. Capitalized terms not otherwise defined in this Memorandum have the same meanings that they do in the Investment Proposals Memorandum.

Section I: Background of the Bill Proposals

A. Establishment and Designation of Certain Funds as Trusts

The Bill clarifies the legal status of the Funds by expressly establishing separate funds for the deposit of the assets of the Retirement Systems and Endowment Funds and specifically designating those Funds as trusts. Trust designation establishes the basic fiduciary responsibility of the Treasurer, as trustee of the Funds, to segregate the assets

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of the Funds from all other monies under the Commissioner's control and to earmark those assets as trust property. The Bill, by specifically conferring trust status, may provide a basis for liability in the event of loss resulting from the commingling of assets. It may also encourage in those responsible for administration of plan assets a sense of duty toward plan beneficiaries, by providing a framework for them to discharge that duty.

B. Designation of the Commissioner as a Fiduciary of the Funds and Requirement to Act Only in the Interest of Beneficiaries.

The Bill expands statutory guidance with respect to proper behavior toward trust property and beneficiaries by expressly designating the Commissioner as a "fiduciary" of certain of the Funds and by requiring the Commissioner to act "only in regard to the best financial interests" (or long-term interests, in the case of the Endowment Funds) of Fund beneficiaries. Under common law, two primary duties flow from the "fiduciary" relationship: a duty to act prudently in the administration of the trust and a duty of loyalty to trust beneficiaries. The duty of loyalty requires a trustee to administer the trust solely in the interest of its beneficiaries; a trustee is prohibited from self-dealing, favoring certain beneficiaries over others, and dealing with trust property for the benefit of third parties. The Bill proposal incorporates and expands upon this common law duty of loyalty. Guidance as to the parameters of permissible behavior under the Bill may be found by looking to case law interpreting the "exclusive purpose" rule contained in the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), which is generally similar in intent to the Bill's "only in the financial interest" standard.

C. Repeal of Legal Lists and Implementation of a New Rule of Prudence.

The Bill repeals the current statutes' "legal list" restrictions, which are limitations on the Commissioner's investment authority as to type of investments that may be held by a Fund and, in some instances, as to maximum percentage or dollar amount of Fund assets that may be invested in particular instruments. The legal lists serve to restrict investment choices, lessen investment performance, and preclude investments that, when viewed in the context of a Fund, would clearly be deemed prudent by an institutional investor. In addition to repealing the legal list provisions, the Bill imposes a stringent statutory obligation requiring the Commissioner to act with "professional" prudence by exercising

the judgment and care of an institutional investor managing large investments under a trust relationship. This standard appears to require that the Commissioner, as fiduciary, exercise the care and skill of a sophisticated professional investor whose knowledge and ability is substantially greater than that expected of an ordinarily prudent layman. A court would, therefore, in interpreting the provisions of the Bill, in all probability, look to the regulations and case law construing ERISA as the body of law governing the conduct of private, professional institutional investors. The significance of the State's adopting an ERISA-type approach to prudence, especially in conjunction with repeal of the legal list statutes, is that it would permit a much larger universe of investments to be considered in investing the monies of the Funds, thereby benefiting Fund beneficiaries.

D. Authorization to Delegate Responsibilities

The Bill authorizes the Commissioner expressly to delegate his investment, custodial and depository authority with respect to the Funds to officers or employees of the State or to independent firms, banks or trust companies. This proposal is a necessary corollary to the fiduciary duty of prudence. The cases construing ERISA's prudent man rule suggest that the Commissioner, in seeking to meet the prudent institutional investor rule, has an affirmative duty to obtain competent professional assistance by hiring qualified employees or by entering into contracts with qualified outside professionals. The Bill's proposal serves to emphasize this general duty of delegation and to provide a framework for the discharge of that duty.

E. Establishment of Reporting and Statutory Auditing Requirements

The Bill requires the Commissioner to cause periodic reports on the condition and investment performance of certain of the Funds to be prepared and furnished to the board overseeing the operation of those Funds. In addition, annual audits of the Funds must be conducted by an independent firm of public accountants. This, in large part, reflects current practice. The Commissioner's reporting and auditing proposal, which is comparable to reporting requirements under ERISA, should facilitate the Commissioner's fulfilling his fiduciary obligations toward the Funds.

Section II: Related Issues

A. Federal Income Tax Implications

The Bill's proposal to designate the Retirement Funds as trusts will serve to ensure compliance with the implicit

requirement of Section 401 of the Internal Revenue Code (the "Code") that the assets of public plans be held in trust. In addition, the Bill's proposal that the assets of the Retirement Funds be used only in regard to the financial interests of their beneficiaries should act to ensure compliance with the exclusive benefit rule contained in Section 401(a) of the Code.

B. Liability, Indemnification and Insurance

The increase in the extent of the fiduciary obligations of the Commissioner and his staff under the Bill, raises the issues of: potential liability in the event of breach of those obligations; the extent to which those the Commissioner employs may be indemnified; and the extent to which insurance may be obtained.

(1) Liability

[A] Liability of the State, the Commissioner and State Employees

Although no specific liability provisions are contained in the Bill, the Commissioner and those he employs, as fiduciaries of the Funds, may be potentially liable for breaches of their fiduciary obligations. In addition, the State may be liable for these employee breaches. Although it is unlikely that the State can claim "sovereign immunity" under Alaska case law interpreting that doctrine, employees of the Commissioner may be immune from suit under the broader "official immunity" doctrine. Because immunity may be viewed as inconsistent with the public policy considerations underlying the Bill, the Commissioner should consider amending current law to provide explicitly that a State employee will generally be liable for breach of a fiduciary obligation, unless he acted prudently, in good faith, and within the scope of his employment.

[B] Liability of Service Providers

The Bill does not address the potential liability of third parties for breaches of fiduciary duties, nor does it deal with the potential liability of the Commissioner for the actions of third party service providers. Under an ERISA-type analysis, a third party service provider is liable if that party meets ERISA's broad definition of "fiduciary." Most third parties to which the Commissioner would typically delegate responsibilities for the Funds are likely to fall within the ERISA definition of fiduciary and, thus, under an ERISA analysis, would be potentially liable for breach of fiduciary duty. ERISA's provisions and case law with respect

to co-fiduciary liability, however, suggest that the Commissioner may limit his potential liability for misconduct of third party service providers by diligently selecting those entities and monitoring their services. Because the issue of third party conduct is a significant one, the Commissioner should consider dealing with it by express statute rather than by application of analogous provisions of law.

(2) Indemnification and Insurance

The Bill in its current form contains no specific provision for indemnification of the Commissioner's employees for alleged breach of fiduciary duty. In view of the increased amount of fiduciary obligations that would be imposed on those employees under the Bill, the Commissioner might consider adding indemnification provisions to the Bill. In addition, the Commissioner may wish to consider obtaining insurance covering potential breaches, although we note that a meaningful amount of insurance is currently quite difficult to obtain at acceptable prices.

Section III: Establishment of Independent Trust Company

The Commissioner has presented, in a legislative package separate from the Bill, a proposal to create an independent trust company (the "Trust Company") that would be responsible for the management of the investments and the custody of the assets of the Funds. The proposal to create the Trust Company reflects an attempt to insulate investment of Fund assets from political pressures and to deal with the conflicts of interest inherent in investment management by State officials. Substitution of an independent professional corporation, expert in investment management, for the State as trustee, may reduce the chance of political or administrative factors interfering with the Funds' investing in a manner consistent with the financial interest of Fund beneficiaries.

Although the Trust Company proposal contemplates a fundamental change in the structure of the Funds' investment operations, the proposal is not without some precedent; most notable is the Minnesota retirement system's statutory scheme. Even though the proposal reflects a significant improvement over the Minnesota scheme and similar structures in place outside Alaska, the Commissioner should consider adding to the proposal provisions that (1) clearly specify who would be potentially liable to Fund beneficiaries, and designate those persons as "fiduciaries", and (2) specifically authorize beneficiaries of the Funds to institute appropriate legal actions against the Company for any potential breaches of fiduciary duty, thereby strengthening the accountability of

those individuals responsible for managing the assets of the Funds and ensuring compliance with fiduciary standards imposed under Alaska law.

Conclusion

The Bill, if adopted, should serve to modify and clarify the Commissioner's investment powers and fiduciary obligations under the statutory scheme governing the investment of Fund assets. In general, the Bill's proposals would increase the amount of the Commissioner's investment flexibility and at the same time increase the Commissioner's responsibility and accountability with respect to the Funds' investments. The Trust Company proposal, which reflects a more dramatic form of changing current Alaska law regarding the Funds' investment operations, may serve to insulate Fund investment operations from political pressure, and provide the Funds with skilled, professional investment management.

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