

LEGISLATIVE FINANCE - HOUSE / SENATE FINANCE COMM. FILES 8879

HB 581 cont. 553

144

The Honorable John Binkley
April 25, 1990
Page 3

I hope I have answered your questions on these matters. Please understand that these remarks are my own and do not necessarily represent the views of my board. I would be pleased to respond if you have further inquiry.

Sincerely,



David A. Rose
Executive Director

DAR:vs

Enclosure: Audited expenses

cc: Board of Trustees

716

AS 14.25.180	Teachers Retirement System
AS 14.40.400	University of Alaska Endowment
AS 14.42.200 - 210	Student Loan Fund
AS 18.56.095	Mortgage Insurance Fund AHFC
AS 22.25.048	Judicial Retirement System
AS 26.05.228	Alaska National Guard and Naval Militia Retirement System
AS 37.10.070	General Fund
AS 37.14.110	Public School Fund
AS 37.14.160	
AS 37.14.170	
AS 37.14.200 - 210	Alaska Childrens Fund
AS 39.30.095	Group Health and Life Benefits
AS 39.30.175	Supplemental Benefits System
AS 39.35.080	Public Employee Retirement System
AS 39.45.030	Deferred Compensation

STATE OF ALASKA
DEPARTMENT OF REVENUE

OFFICE OF THE COMMISSIONER

5/6/90
Binkley
STEVE COWPER, GOVERNOR
hand out

P.O. BOX 5
JUNEAU, ALASKA 99811-0400
PHONE: (907) 465-2300
TELEFAX: (907) 465-2389

April 27, 1990

The Honorable John Binkley
Alaska State Senate
P.O. Box V
Juneau, AK 99811

Dear Senator Binkley:

This letter is to make some observations about the letter of April 25 sent to you by Dave Rose of the Alaska Permanent Fund.

Firstly, I want to thank you for your efforts on the trust investment issues. The leadership that you and other other legislators have demonstrated is appropriate and timely. I appreciate your attention to the details as well as the larger issues in these important and urgent questions.

The Legislature is in a position now to initiate a process that will serve the public and our trust beneficiaries - retirement, SBS and the other funds - into the foreseeable future. I ask for your continued help in this.

Turning to the points in the letter of April 25:

Open meeting law -

Open meetings are necessary. The investment corporation will meet this requirement.

Administrative procedures act -

The trust investment corporation should be exempt from the provisions of this act as they apply to rule making and dispute resolution. This law is designed to bring a uniform set of procedures to government agencies. Many specific exemptions exist throughout government to meet specific needs. This is one.

State procurement act -

At present Treasury's investment functions are exempt from the procurement act - but so are the investment functions of the Permanent Fund. The legislation approved by the House and the Senate State Affairs Committee would provide additional exemptions to increase the competitive ability of the trust corporation. The corporation would adopt procedures to effect this.

The Honorable John Binkley
April 27, 1990
Page 2

Board appointments -

The only board appointments that are not directly appointed by the governor are the two professional investor members of the board. The board is given the latitude to select people in the areas most needed. This is in concert with the trust nature of the board's responsibility.

Appointment of staff -

holding the chief executive officer responsible is the simple and best way for the board to work. The CEO should be required to hire and manage staff. If the board wants or needs board approval for filling key slots, they can and will make this clear to the CEC. This testimony was provided by me to the Senate State Affairs Committee.

Combining the Retirement Funds with the Permanent Fund -

We have discussed this before. The main problems, as I see them, are a loss of management focus, which will affect priorities and loss of the public sense of the purpose for the Permanent Fund. The Permanent Fund is a unique Alaska institution. It is not a pension fund.

General fund management -

Under CS HB 580 general fund management would be retained at Treasury unless the Governor acting through the commissioner decided to contract with the investment corporation, or with some other public or private agency, to carry out particular functions. The Governor has this authority now. As for "pulling" the General Fund into the Investment Corporation, I think that the example of Texas shows that many operations, including Treasury or the Permanent Fund, could avail themselves of the Federal Reserve access through the investment corporation without surrendering their identities.

Appropriate controls -

CSHB 580 provides carefully tailored exemptions from general standards, such as the personnel act, the procurement code, and the administrative procedures act. These all exist, in various forms, in the particular statutes for special purpose organizations. For example, the Permanent Fund is exempt from the personnel code and much of the procurement code. The Department of Revenue is exempt from various parts of the Administrative Procedures Act. The Alaska State Housing Authority is exempt from the procurement code.

The honorable John Binkley
April 27, 1990
Page 3

If we want these special purpose organizations to do their special jobs on behalf of the public, they need the operational authority to do so.

In this case, very high standards of accountability and performance are placed on the board and the investment corporation as a whole. Not only is the operation subject to Legislative Audit and reporting requirements, but the board members have personal financial liability. The organization is subject to meeting the standards of the banking examiner. There is explicit standing for beneficiaries to require, through the courts if necessary, that the investment corporation and board meet the strict fiduciary standard set out in the law. No other public organization has to meet these standards under Alaska law today.

Timely action -

The Legislative Budget and Audit committee has made clear the need for attention now. Establishing a board and charging the people on it to begin work promptly is the best way to make sure this process is continued in an orderly fashion. I believe that a delay will negatively affect the interests of all state employees, including both SBS and retirement system beneficiaries.

The notion that action should be delayed on the grounds that there is an election that will result in a new Legislature and Governor is a new one to me. Continuity is a major reason for the very change we are seeking. While a new Governor would have the authority to change all boards and other appointments, that is rarely done. The letter hints that "specific individuals" are looking for a "resting spot". I do not know who these people are. Perhaps the names could be supplied.

It is true that when the Permanent Fund was created that several of the staff moved from Treasury to the Fund. That worked out well for the Fund, but it was the decision of the Executive Director and the board as to whom they hired. The new organization would also make its own decisions.

I hope my comments are useful.

I look forward to working with you to bring these issues to a successful conclusion this session.

Sincerely,



Hugh Malone
Commissioner

HM:m11
90-99

CC DAVE ROCK

5/6/90

Alaska Association of Assessing Officers Proposed Amendments to
HB 580

All proposed amendments on pages 6 and 7 of the bill:

Page 6, line 27: Deletion of the phrase "at any time" as language which is unnecessary for the exemption from taxation to attach; and to clarify that the exemption only attaches to property when it is owned by the corporation (i.e. not to property in private ownership which was previously owned by the corporation)

Page 6, line 29: Deletion of the phrase "and assessments" because it would also apply to special assessments, such as paving, sewer, etc. from which property of the corporation should not be exempted.

Page 6, line 29: Addition of the phrase "unless otherwise provided by law" to clarify that agencies such as AHFC, which do pay property taxes, do not become exempt by having property managed by the corporation.

Page 7, lines 1 & 2: Deletion of phrase "and assessments"; same reasoning as Page 6, line 29 deletion.

AMENDMENT TO SCS HB 580 (State Affairs)

Page 7, - lines 2 - 16: Delete all language.

5/6/90
DOR
Amendment
Malone
to SCS (SA)

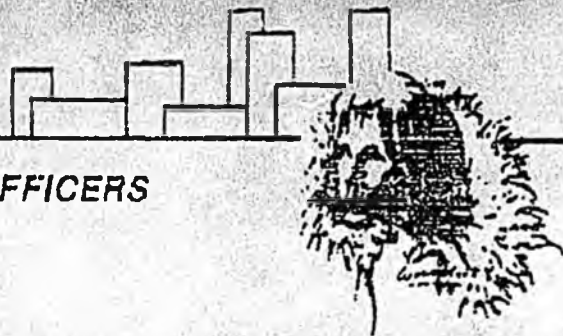
(REMOVES SURETY REQUIREMENT)

REASON: The fiduciaries are under an obligation to make adequate provision for surety already.

This specific provision may give the impression that other holdings do not require surety.

Also, the specifics in this section may limit or rule out certain forms of surety that may be the same or better.

5/6/90



ALASKA ASSOCIATION OF ASSESSING OFFICERS

Date: May 3, 1990
To: Chrystal Smith, AML
From: Steve Van Sant, Mickey Keller, A.A.A.O. *[Signature]*
Subject: CSHB 580 *[Signature]*

As requested, we have reviewed CSHB 580 and offer the following concerns:

Sec. 37.10.280 - EXEMPTION FROM TAXATION

Line 23. There are three words contained in this section which appear redundant and at the same time confusing. "...at any time..." which addresses the ownership of property by the corporation and consequently, the exemption from taxation. These words are not necessary for the exemption to attach and we would request that they be deleted from the bill. The confusion which they add could initiate the exemption from taxation property owned by private individuals which at one time was owned by the corporation. We do not believe that is the intent of the bill, however, it could be misconstrued as such.

Line 25 and Line 27.

This section attempts to exempt property from taxation, however, the words "...and assessments..." are used in both lines of this section. It is unclear to us what the intent is, however, it is our opinion that the term "assessment" as used here is intended to mean the assessed values which are placed on property by the assessor's offices. In many municipalities, this term is also used in conjunction with special assessments, such as paving assessments, sewer and water assessments, etc. In our opinion, the municipalities would not endorse this concept of exempting properties from these special assessments. Therefore, we ask that the terms "...and assessments..." be deleted in both instances.

Line 25.

There are certain state agencies such as AHFC which, by statute, do pay property taxes. It appears that these agencies may have the corporation manage property which would become exempt. Therefore, we would like to add the following to the end of the first sentence: "...are exempt from all taxes in the state unless otherwise provided by law."

Thank you for this opportunity to voice our concerns. Should we be able to assist you on any matters relating to taxation, please don't hesitate to call on us.



Alaska Public Employees Association **APEA**

State Headquarters: 340 N. Franklin, Juneau, AK 99801 (907) 586-2334
FEDERATION OF STATE EMPLOYEES/AFT/AFL-CIO

April 26, 1990

Honorable Albert P. Adams
PO Box V
Juneau, AK 99811

APR 30 1990

Dear Senator *Adams:*

The Alaska Public Employees Association urges the prompt resolution of the problems regarding the various state retirement funds, as well as other funds for which the state is responsible.

At the present time, we see CSHB580 (FIN) am, which passed the House April 23, as the most expeditious vehicle. It should be noted that a similar bill CSSB197 (SA) is currently residing in Senate Finance.

Our initial concern about the make up of the Board and the appointees who would represent the Teachers Retirement, Public Employees Retirement and the Supplemental Benefits System have been satisfied at this time.

We do believe, however, that the professional investor members should serve under the same conditions as the public sector members and that the permitting of monthly fees of up to \$1000 are unwarranted. They should be pleased to represent the private sector as a contribution to the common good of the state.

As you well know, time is very limited so we would urge you to expedite the passage of this legislation.

Sincerely,

Margaret Branson

Margaret Branson
Lobbyist

MB/kg

*Sent to all
Senators.*

UNIVERSITY OF ALASKA SOUTHEAST
School of Education, Liberal Arts and Science

1170 Glacier Highway • Juneau, Alaska 99801

The Honorable Senator
Rick Uehling Co-Chair
Senate Finance
Rm. 516, Capitol
P.O. Box V
Juneau, Ak. 99811

April 16, 1990

Dear Senator Uehling,

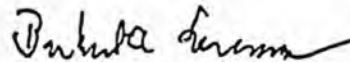
the Faculty Senate of the University of Alaska Southeast passed unanimously a motion in support of then Senate Bill 509 which proposed the establishment of an Alaska State Trust Company. Since the faculty senate acted on the motion, committee action resulted in CSSB 197 State Affairs, now pending before your committee.

Since most of the concept of the previous bill is now contained in CSSB197 State Affairs, the faculty of this institution would like to express its support for this Committee Substitute. In addition, we would like to let you know that we informed the Faculty Senates at Anchorage and Fairbanks of our action. It is likely that you will be informed of their actions as well.

Should you have any further questions in this matter, please feel free to have your staff contact me at my office number # 789-4403.

Thank you for your consideration.

Sincerely,



Dr. Barbara Sorensen
Associate Professor of Economics

Senator John Binkley, Co-Chairman
Senate Finance Committee
P.O. Box V
Juneau, Alaska 99811

Honorable Senator Binkley,

This is to urge you and your committee to give serious consideration and passage of SCS-HB 580 (State Affairs) in this session of the Legislature, if at all possible.

This legislation is badly needed in order to preserve and properly manage the funds dedicated and deposited for future benefits of some 27,000 employees who have participated in creating these funds.

The Board of the Public Employees Retirement System has endorsed the concept of a separate Alaska Trust Company in formal sessions and again urges you to act favorably on this at this session.

C. R. "Steve" Hafling
C. R. "Steve" Hafling
Chairman
Alaska Public Employees
Retirement Board

CORRECTION

**THIS DOCUMENT
HAS BEEN REPHOTOGRAPHED
TO ASSURE LEGIBILITY**



Alaska Public
Employees Association **APEA**

State Headquarters: 340 N. Franklin, Juneau, AK 99801 (907) 586-2334
FEDERATION OF STATE EMPLOYEES/AFT/AFL-CIO

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As you well know, time is very limited so we would urge you to expedite the passage of this legislation.

Sincerely,

Margaret Branson
Lobbyist

MB/kg

*Sent to all
Senators.*



NEA-ALASKA

AFFILIATED WITH THE NATIONAL EDUCATION ASSOCIATION

5/6/90
Malone
DOR
Handwritten

Don Oberg, President

Mary Lou Brent
Vice-President
Box 11122
Fairbanks, Alaska 99708

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FAX: (907) 456-2159

Judy Sale
NEA Director
3510 Kennerly Court
Kenai, Alaska 99511

May 2, 1990

Paul Jarr
Region I Director
PO Box 3470
Ketchikan, Alaska 99901

TO: Senators Binkley and Uehling, Co-Chairs, and members of the Senate Finance Committee.

Deedie Sorenson
Region I Director
4413 Sunlit Dr
Juneau, Alaska 99801

FROM: Don Oberg, President

Beverly Good
Region II Director
Box 344
Copper Center, Alaska 99573

RE: CSHB 580 (FIN)
CSSB 197 (SA)

DeWayne Craig
Region III Director
4420 Forest Dr. J.A.
Kenai, Alaska 99511

After careful consideration of the above-mentioned legislation we conclude the Alaska State Investment Corporation will improve the management of the Public Employees' Retirement System, the Teachers' Retirement System, the Supplemental Benefits System, and other state retirement systems.

Myra Poage
Region IV Director
Box 171
Nome, Alaska 99762

Please lend your support for this legislation.

Marilyn Rosene
Region IV Director
Box 1171
Dillingham, Alaska 99576

cc: Hugh Malone, Commissioner
Alaska Department of Revenue

Mike Warner
Region IV Director
PO Box 72
Nome, Alaska 99763

Sally Smith, Director
Department of Administration
Division of Retirement and Benefits

Claudia Douglas
Region V Director
PO Box 74417
Fairbanks, Alaska 99707

TRS Retirement Board

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Region V Director
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OB/H580s197/dl

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Region VI Director
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Leona Mounds
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Anchorage, Alaska 99504

Pamela Reynolds
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Carolyn Tolson
Region VII Director
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Hank Harrison
Region VIII Director
Box 111125 5 Station
Anchorage, Alaska 99511

RECEIVED
ALASKA DEPARTMENT OF REVENUE
MAY 3 1990
COMMISSIONER'S OFFICE

UNIVERSITY OF ALASKA SOUTHEAST
School of Education, Liberal Arts and Science

11120 Glacier Highway • Juneau, Alaska 99801

The Honorable Senator
Rick Uehling Co-Chair
Senate Finance
Rm. 516, Capitol
P.O. Box V
Juneau, Ak. 99811

April 16, 1990

Dear Senator Uehling,

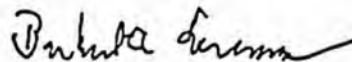
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Should you have any further questions in this matter, please feel free to have your staff contact me at my office number # 789-4403.

Thank you for your consideration.

Sincerely,



Dr. Barbara Sorensen
Associate Professor of Economics

TEACHERS' RETIREMENT SYSTEM BOARD

April 27, 1990

Charlie Arteaga, Chairperson
Teachers' Retirement System Board
1439 Millar
Ketchikan, Alaska 99901
225-6776

Senate State Affairs Committee
Senator Rick Uehling, Chairperson

RE: CSHB 530

Dear Senator Uehling and Committee members,

Once again I urge your support of legislation which creates the Alaska State Investment Corporation. It is the position of the Teachers' Retirement System (TRS) Board that this legislation is desirable and necessary. It is also the TRS Board's desire that any legislation creating an investment board have sufficient constituency representation, we favor an investment board which has approximately 40% constituency representation.

The TRS Board is in opposition to any legislation which would permit the Permanent Fund Corp. to invest retirement fund monies. We believe that an Independent corporation, with adequate constituency representation, is the best and most honest approach to maximize investment returns for our members. Divergent investment philosophies and on going political volatility surrounding the Permanent Fund does not provide a safe haven for retirement funds.

It is my hope that your committee takes quick and positive action on these concerns and moves to assure quick passage of legislation which will improve our members' retirement fund.

Thank you for your attention and time on this matter.

Sincerely,



C. Arteaga, Chairperson
TRS Board

Senator John Binkley, Co-Chairman
Senate Finance Committee
P.O. Box V
Juneau, Alaska 99811

Honorable Senator Binkley,

This is to urge you and your committee to give serious consideration and passage of SCS-HB 580 (State Affairs) in this session of the Legislature, if at all possible.

This legislation is badly needed in order to preserve and properly manage the funds dedicated and deposited for future benefits of some 27,000 employees who have participated in creating these funds.

The Board of the Public Employees Retirement System has endorsed the concept of a separate Alaska Trust Company in formal sessions and again urges you to act favorably on this at this session.

C. R. "Steve" Hafling
C. R. "Steve" Hafling
Chairman
Alaska Public Employees
Retirement Board



ALASKA STATE EMPLOYEES ASSOCIATION

The Honorable John Binkley

April 27, 1990

RE: Investment of Retirement Funds - CSHB 580

Dear Senator Binkley:

The Alaska State Employees Association (ASEA/AFSCME Local 52) strongly supports the idea of placing responsibility for managing state trust and retirement funds with an entity outside state government. Many retirement funds are managed by a separate board of trustees. This practice insures that the funds remain outside the political sphere and guarantees the best return on the investment. Having individuals knowledgeable of investment practices also allows for the best return on investments.

We have studied several different pieces of legislation on this subject, and the approach we prefer is embodied in the committee substitute for HB 580.

The most recent version of this bill provides for nine voting members. Of the nine, four are not covered by TRS, PERS, or SBS and two are essentially representatives of the state as an employer. This leaves three of the nine as representatives of employee plan participants.

While it is particularly important to us that PERS and SBS participants are on the board, we would like to see employee participants comprise more than one-third of the voting directorship.

We also favor having an even number of voting members, as this encourages consensus. Major decisions on investment policy should not be made by a simple majority.

The dilution of plan participants' representation on the board can be alleviated by placing the commissioners of Administration and Revenue as non-voting members, as was the case in earlier versions of the bill. This gives the board the benefit of the commissioners' insight while avoiding the practice or appearance of politicizing the work of the Board of Directors.

The number of voting directors can be further reduced to six by eliminating one of the two public members from voting status.

Yours truly,

Fredric R. Dichter
ASEA Business Manager



Inlandboatmen's Union of the Pacific

MARINE DIVISION — INTERNATIONAL LONGSHOREMEN'S & WAREHOUSEMEN'S UNION

NATIONAL OFFICE • 2700 FIRST AVENUE, ROOM 211 • SEATTLE, WASHINGTON 98121 • 206-448-4736



April 26, 1990

Senator Tim Kelly
Alaska State Legislature
P.O. Box V
Juneau, AK 99811

Dear Senator Kelly:

The Inlandboatmen's Union of the Pacific, Alaska Region, supports creation of the ALASKA STATE INVESTMENT CORPORATION (CSHB 580). We strongly urge your passage of this legislation.

Public employees in Alaska work many years in dedicated public service. They should be secure in the knowledge their retirement is protected and properly managed when they finally reach retirement. Their pension monies should not be commingled with other funds managed by the Permanent Fund. Pension monies must be managed and accounted for separately with the proper fiduciaries.

We urge your support and passage on this important legislation before the end of the session.

Sincerely,

INLANDBOATMEN'S UNION OF THE PACIFIC
Marine Division of the International
Longshoremen's & Warehousemen's Union, AFL/CIO


Michael Wilson
Regional Director, Alaska Region

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STATE OF ALASKA

THE LEGISLATURE

BUDGET AND AUDIT COMMITTEE

AUDIT DIVISION
P.O. BOX W
JUNEAU, ALASKA 99811-3300

May 15, 1989

SUMMARY OF: A Special Report on the Department of Revenue, Division of Treasury, Portfolio Management, State Investment Officers, April 14, 1989.

PURPOSE OF THE REPORT

In accordance with Title 24 of the Alaska Statutes and a special request of the Legislative Budget and Audit Committee, this report was prepared to determine:

1. The purpose for requesting premium pay for four investment officer positions in the Department of Revenue, Treasury Management's FY 90 budget.
2. The reasons for allowing the State Investment Officer IV to work at home.

ISSUES ANALYSIS

1. What is the department's justification for budgeting premium pay in Treasury Management's FY 90 budget request?

According to the deputy commissioner of the Department of Revenue, the reason for budgeting \$100,000 under the "premium pay" heading was to provide a vehicle to increase employee compensation paid to the four state investment officers within the Portfolio Management section. These amounts were added to the detailed budget documents by the department and represent the estimated increase necessary to bring investment officers' compensation levels to competitive levels offered to investment officers managing similar investments.

The department does not intend on compensating these employees with "premium pay." Actual revisions to state investment officer compensation that the Division of Treasury plans to make would be based on an independent evaluation of compensation levels by a professional consulting firm in the employee compensation field. It is likely that a contract to conduct this evaluation will be awarded in FY 90.

2. What is the department's justification that allows the State Investment Officer IV (SIO IV) to work at home?

In response to a November 21, 1988 prohibition to smoking in the Juneau State Office Building where the Division of Treasury is located, the SIO IV, a heavy smoker with no intention to quit smoking at that time, indicated he would retire. As an alternative, the SIO IV was allowed to perform his job duties at home. The following enumerates the reasons that the department provided us to support their decision which allows the SIO IV to work at home.

- A. The department had difficulties recruiting for the position currently occupied by the SIO IV. These difficulties prompted the department to consider alternatives that might avoid an extended vacancy in the State's most important investment officer position.
- B. The department believed it would be detrimental at that time for the Portfolio Management section of the Division of Treasury to lose a valued employee whose job performance is considered excellent.
- C. The department believed that fiduciary responsibilities investing state funds required retaining the SIO IV as the chief investment officer.
- D. It is expected that the SIO IV plans to retire soon. As such, this working situation is temporary. The department would have reconsidered their decision if it meant that an employee would be working out of his/her home on a permanent basis.

Auditor's Comments

We question whether the best interests of the State are being met by allowing the SIO IV, a key supervisory position regarding state investment, to work in a location other than where the investments are being managed. There exists an appearance that effective management and professionalism is lacking in the investment of state assets that exceeds \$4.8 billion.

In our opinion, the department should take action to reestablish the work location of the SIO IV position back in the office. In order to accomplish that, the department should make it a priority to recruit for candidates to fill the SIO IV position. In addition, the department should obtain adequate evidence confirming the SIO IV will retire once a person is found to fill the position.

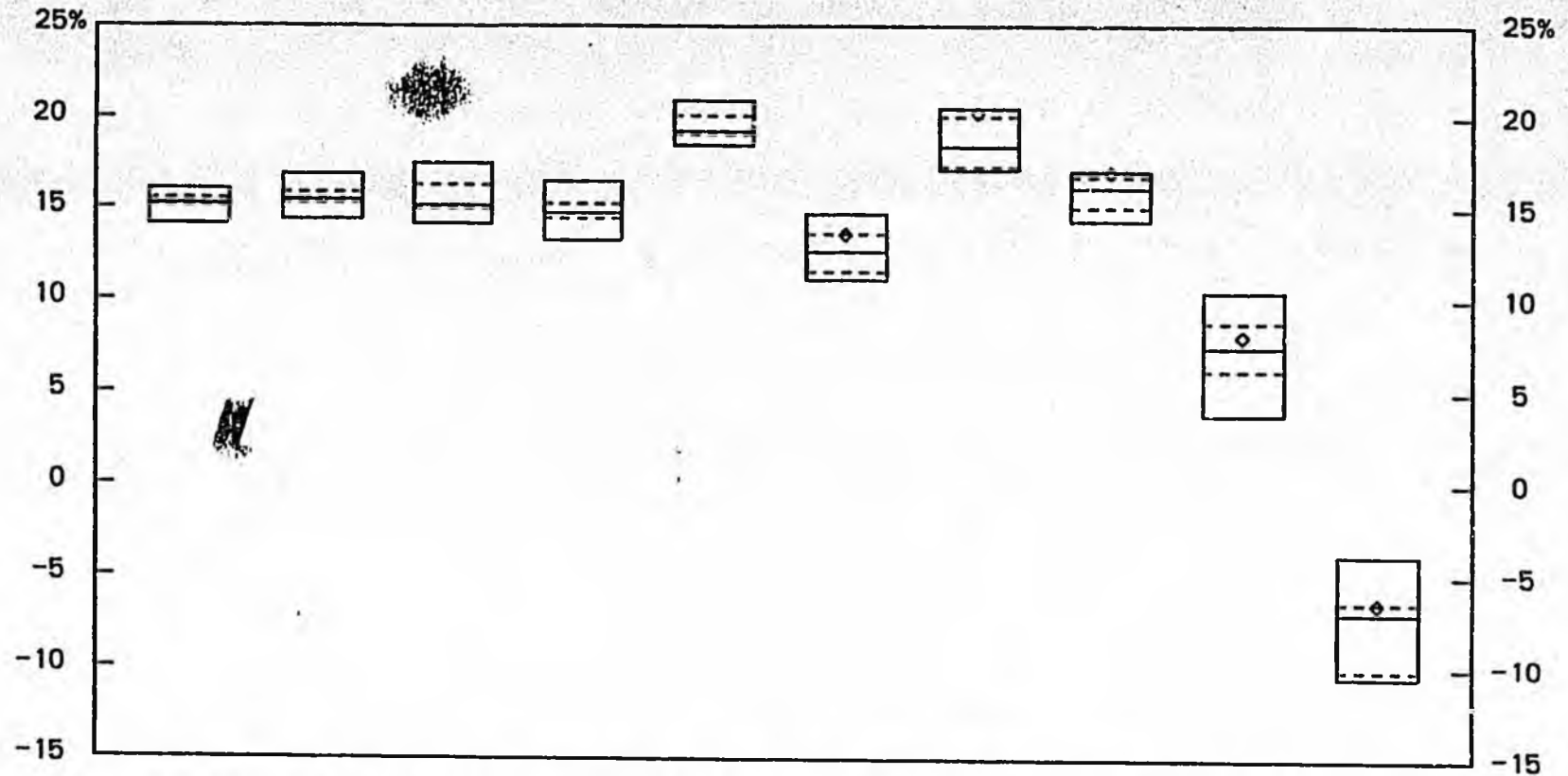


STATE PLAN REPORT

ALASKA PERMANENT FUND CORP.
JUNEAU, AK
ALASKA PERMANENT-COMBINED FUND
JUNE 30, 1988

FUNDS EVALUATION SERVICES

**STATE RETIREMENT PLANS
EQUITIES: ANNUALIZED RATES OF RETURN
FOR PERIODS ENDING JUNE 30, 1988**



	1979-88	1980-88	1981-88	1982-88	1983-88	1984-88	1985-88	1986-88	1987-88	1988
5TH PERCENTILE	16.0	16.9	17.5	16.5	20.9	14.7	20.5	17.1	10.4	-3.8
25TH PERCENTILE	15.5	15.9	16.3	15.2	20.1	13.6	20.0	16.8	8.8	-6.4
MEDIAN	15.2	15.5	15.1	14.7	19.2	12.7	18.4	16.1	7.5	-7.0
75TH PERCENTILE	15.1	15.3	14.9	14.5	19.1	11.6	17.3	15.1	6.2	-10.1
95TH PERCENTILE	14.1	14.4	14.2	13.2	18.5	11.1	17.1	14.3	3.8	-10.5
PLAN M1937 RANK						13.6 28	20.3 12	17.0 6	8.1 32	-6.4 30
S&P 500 INDEX RANK	16.3 3	16.6 8	16.5 15	15.9 10	21.3 3	14.6 6	20.0 26	16.5 43	7.9 38	-6.9 49

going to happen, you would think that is, when the award would be given, not years later," said Stephen Schroeder, 45, who received the majority of his \$35,000 prize in 1988, eight years after it was initially considered.

"Before the award was approved, I had been on the road briefing the highest Department of Defense officials, including four-star generals and admirals, about how the system was working," said Schroeder, whose computerized identification of parts in inventory saved the Navy millions.

Please see Back Page, AWARDS

The council recommended that people daily eat five or more half-cup portions of fruits and vegetables and a minimum of six portions of starches such as breads, cereals and beans. The recommendations would roughly double the average amounts of these eaten by Americans. The council also said it found no proof that calcium of dietary guidelines. This is the first time that a committee of the National Research Council, the working arm of the National Academy of Sciences, has made such definitive dietary recommendations.

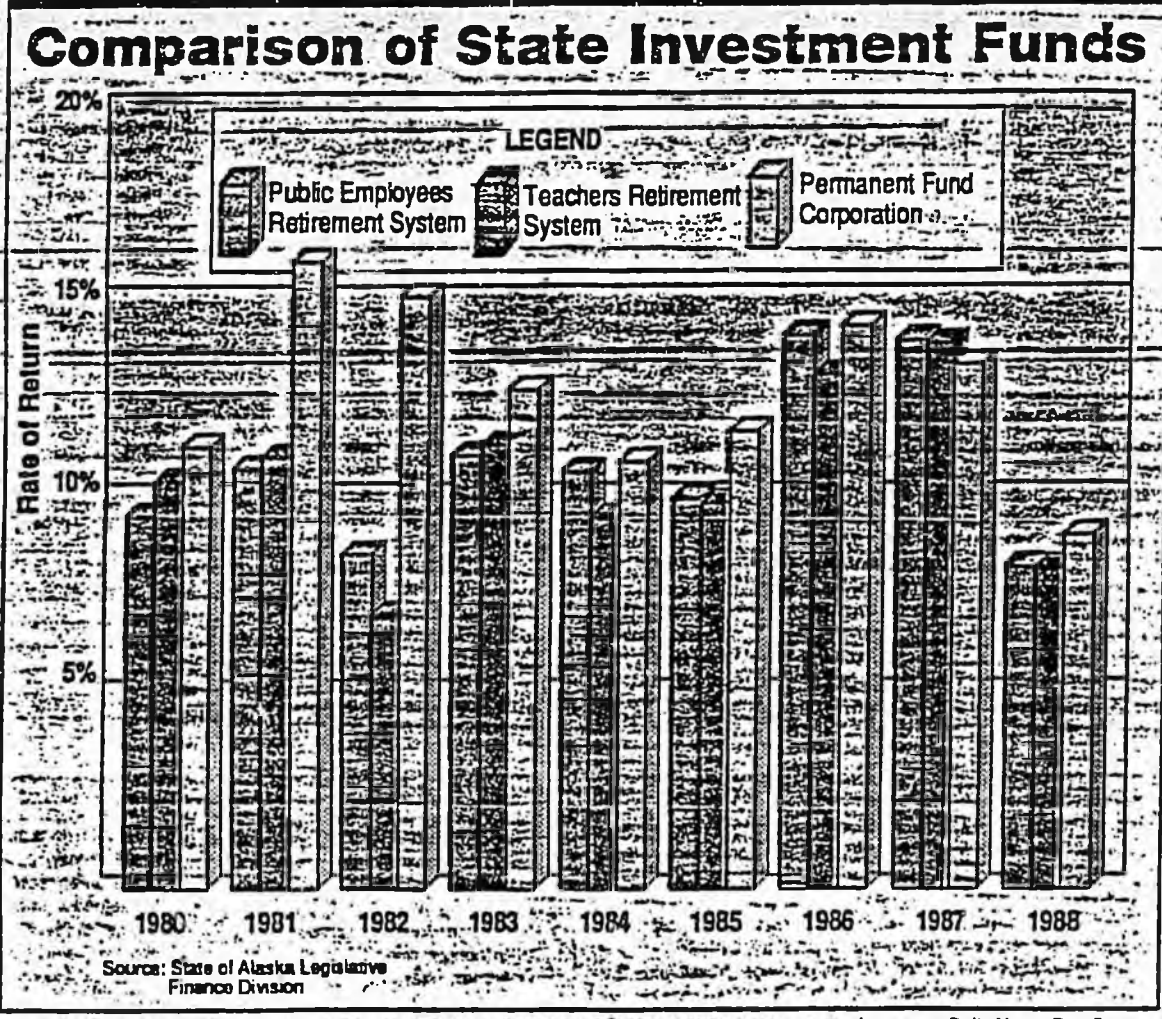
"Many people may be confused by the vast amount of

Please see Back Page, DIET

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Anchorage Daily News/ Dee Boyles

State's handling of retirement fund gets a close look

By GEORGE FROST
Daily News reporter

A state-run retirement fund meant to ensure the golden years of about 27,000 government employees and teachers costs three times as much to administer as the Alaska Permanent Fund but consistently earns less on its investment portfolio, a legislative analyst says.

During this budget year, it will cost about \$7.4 million to manage the \$9.1 billion permanent fund portfolio and \$10.4 million to manage the \$3.8 billion retirement fund portfolio, according to a preliminary study by Cameron Kashani, an analyst in the legislative finance division.

But Kashani's analysis, performed at the request of legislators considering a transfer of investment authority away from the state Department of Revenue, is just one slice of a large and many-layered financial onion.

One layer at a time, the retirement system is being peeled back by legislative auditors, the revenue department and critics who allege the state has lost millions of dollars through unsound stock investments.

The state Department of Revenue is in charge of managing and investing the huge

Please see Back Page, RETIREMENT

Investors want pensions in Permanent Fund portfolio

LEGISLATION transferring Alaska's \$3.5 billion pension and teachers' pension permanent Fund Corp. was being discussed in the Senate. The pension funds for which management costs have come under fire for excessive management costs.

Last week the Legislative Budget and Audit Committee directed legislative auditors to investigate the performance of the Public Employees Retirement System and Teachers' Retirement System funds. Sen. John Binkley, R-Bethel, said he proposed the legislation to begin a dialogue on the issue. He said he doesn't expect the bill to pass this year. "I think we should hold some hear-

ings and get some questions answered," agreed Senate President Tim Kelly, who signed on as a co-sponsor of the bill. Sen. Drue Pearce, R-Anchorage and another co-sponsor of the measure, said the retirement funds are not in any danger, but "everybody who puts money into the Public Employees Retirement System and Teachers Retirement System ought to be concerned." "It looks as though the performance

of those two funds are below the permanent fund's," said Binkley. He said it also appears the state is duplicating efforts by having one set of investment officers in the Treasury Division and another at the permanent fund. Anchorage stockbroker Dennis Waldock researched the performance of the two funds and found them wanting. He said his research showed the pension fund's rate of return is among the worst

of the industry. Revenue Commissioner Hugh Malone disagrees with Waldock, saying that the pension funds' performance appears to be close to that of the Permanent Fund. Malone acknowledged management costs are higher than the Permanent Fund, but he attributed that to a greater share of the pension fund money being invested in stocks and foreign investments.

Revenue Commissioner says those higher administrative costs are justified by a more aggressive investment strategy.

C.R. Halling, chairman of the Public Employees Retirement System for 20 years, sees no problem. "My first opinion is there is no crisis. I don't think a little blip is anything to get worried about."

But Dennis Waldock, a Paine Webber Inc. stockbroker who has orchestrated criticism of Malone, claims that the fund has been among the worst performers in the country and the state has used deceptive accounting practices to keep everybody confused.

Waldock admits he has a very large axe to grind in pressing for change in the management of the retirement system. He began digging up information and firing off memos in December, shortly after Malone announced he wanted to bypass Alaska-based stockbrokers and deal directly with Wall Street discount brokers.

The local office of Paine Webber earned about \$100,000 in commissions last year from the retirement funds, and Waldock and other brokers here don't want to lose that income, he said. Malone put the Wall Street policy on ice for a year while he studied whether it would save money or not.

After intense lobbying by Waldock, legislation to transfer the retirement funds to the stewardship of permanent fund managers was introduced this week by Sen. Johnie Binkley, R-Bethel, and two other GOP senators.

"It seems as though, from preliminary figures, that the return on investment is a lot less than the permanent fund corporation, when it should be greater," Binkley said.

The permanent fund was created by voters in 1976 to save some of the state's oil wealth, and it has a more conservative policy geared to greater investments in government securities.

To help sort out the true numbers, Sen. Arliss Sturgulewski requested a legislative audit to see how well the funds have performed. She also wants to study how the legislature can gain more oversight of those investments.

Kashani found that the state's cost of investing the retirement system portfolio almost doubled between 1988 and 1989, from \$5.54 million to \$10.45 million, although that is a budgeted, not an actual number.

Dollar for dollar, it costs more than three times as much to manage the retirement program as the permanent fund, he said.

What does this higher cost buy? During the last nine years, only once — in 1987 — did the revenue department's investments outstrip the permanent fund, he said.

"We are not running a gold-plated operation that is more expensive than the permanent fund at all," said Deputy Revenue Commissioner Milt Barker.

According to Barker, it should cost three times as much, dollar for dollar, because the Revenue Department is a much more active

retirement funds is driven by the fees paid to private investment houses, which got more than \$8 of every \$10. The retirement funds also pay out high fees for foreign stock purchases, forbidden for now to permanent fund managers, he said.

As for the disputes over performance, Barker's numbers show the retirement funds averaged a 14.8 percent return between 1985 and 1988 compared to 18.3 percent for the permanent fund. Malone, who also sits on the permanent fund board of directors, explained the lower returns as part hangover from earlier investments into Alaska commercial real estate and other poor policies.

And the permanent fund, with about 80 percent of its money in securities, was able to ride the waves of short-term government bonds that followed changes in interest rates, he said.

Malone said that transferring the retirement programs to the permanent fund may save a few hundred thousand dollars, but not enough to jeopardize either fund by mixing different investment strategies.

The permanent fund has to earn large amounts of cash each year to pay dividends to Alaskans and protect the fund from inflation, Malone said, and thus invests heavily in short-term securities. The retirement funds, however, aim for larger and longer-term gains primarily through the stock market.

Both funds were battered in the October 1987 stock market crash, although the retirement funds, with one-third invested in common stocks, were hit harder.

Waldock said the "politicians" at the Revenue Department had blundered far worse during the panic-racked month when stocks nose-dived. While the permanent fund and many other funds were selling off stock prior to the September peak of the Dow Jones index, the retirement fund was buying big — increasing its market position by \$181 million and purchasing more stock into October, he said.

Waldock also charged that the Revenue Department has used deceptive accounting practices to make its foreign stock investments more attractive. He pointed to a financial disclaimer by the accounting firm of Ernst and Whinney, incorporated into the state's financial statements.

The accountants said the Revenue Department was not using accepted accounting principles in reporting more than \$100 million of gains from its investments in foreign stocks, and actually should have reported gains of only about \$5 million.

Although Malone acknowledged his differences with Ernst and Whinney, he said the financial note was not significant.

Malone defended the department's deferred reporting on foreign stock activity, saying it's more accurate to record gains and losses in foreign stocks when the money was converted to U.S. dollars, not when the transactions were actually made, as required of private investment funds.

assistance for health restructuring of our health coverage for children who noted that the current budget deficit of investment in child

"The fiscal policies short-changed kids," too many of, America's deficit status, and on by public policymakers alarming trends."

As a first step in the health of American children endorsed a bill co-sponsored by Waxman, D-Calif., to bring the level of pre-

Under the proposal 1991 could, for example, be 10 percent above the federal poverty level — and still be a \$10,674.85 per capita level, and a

AWARDS:

Continued from Page

"If you understand the system's a bureaucracy everything has to go so many checks and balances, you understand it takes so long, electronics technicians the U.S. Naval Air Station at North Island, Diego. "But award money so late is an antic."

Representatives Navy and the Office Personnel Management in Arlington, D.C., said they could not explain the approval took so long.

About 7 percent of federal employees, 169,000 people, suggested in 1987 year for which were available. A man said that the award had jumped about 43,000 of an estimated savings million since the of the Federal Awards Program.

Schroeder is an individual and group have won more than for money-saving tips. Many agree Schroeder's opinion the timing of the

"The whole purpose of the awards is to encourage you learn you are receive \$25,000. You can delay your award off the program senior research John Pearson of Weapons Center Lake, Calif., who was named for a \$25,000 award in 1985 and will receive a final \$15,000 this year.

"Plus, it's true you never really you're going there's always

DIET: Council advises Americans to change their ways

Continued from Page A-1

advice given in many forms about what to eat," said Dr. Arno Motulsky, chairman of the Committee on Diet and Health. "Some may have delayed making changes in their diets until they are more convinced that scientists have reached consensus. We hope our report will help these individuals move from inaction and complacency

The committee said the risk of heart disease could be reduced by at least 20 percent if the public followed the fat and cholesterol guidelines. Americans currently consume 37 percent of their calories as fat. The committee endorsed a reduction to 30 percent — as many other health groups have recommended — but it acknowledged that level is only "moderately" low in fat

and said further reductions would provide additional benefits. The committee also said the risk of cancer of the colon, lung and stomach could be reduced by sharply increasing consumption of fruits and vegetables. The committee's recommendations are far more specific than the recent Surgeon General's Report on Diet and Health.

There's always

5/5/90

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Hm. #:243-8462

WHY WE NEED THE PUBLIC EMPLOYEES AND TEACHERS PENSIONS
TRANSFERRED TO THE PERMANENT FUND

Please accept this as written testimony regarding HB 580.

This is a plea that you consider placing the management of state funds with the proven, accomplished and professional management staff located at the Permanent Fund.

The Department of Revenue appears to be pre-occupied with the form of the investment organization rather than the execution of the investment function itself.

The department has demonstrated a lack of good judgment both in the execution of its management and investment duties as well as in proposing this new organization. What is really frightening is that the same individuals possessing this poor judgment are asking you to race to a decision on this legislation so they can be in charge of setting up the new corporation.

There has been much debate over form and very little about substance. By substance, I mean the execution of the investment function itself.

Investing must be accomplished by professionals who know the business and the people in it. It must be accomplished by professionals who have a proven track record and a consistent investment approach. It must be accomplished by professionals who enjoy what they do and are dedicated to the organization for which they work. Finally, the investment function must be accomplished by professionals who have demonstrated good judgment. In all cases, performance of the investment function by the professionals currently in place at the Permanent Fund is far superior to the alternative of the establishment of a new and untried organization.

Department of Revenue in a self-serving way has chronicled reasons why the Permanent Fund should not manage other funds. Its two-page paper does not discuss the investment function but dwells with the stress which will be placed on the Permanent Fund management. In my view, the Permanent Fund folks are experts at maintaining focus, balance, accountability and a keen awareness of proper fiduciary actions. Since the transfer of functions to the Permanent Fund is accompanied by the transfer of adequate numbers of people and dollar resources, there is no reason to believe that either Permanent Fund or other Fund functions will suffer from a consolidation.

For your information, I have prepared an enclosure which sets forth what, in my opinion, constitutes poor judgment by the people who would be responsible for the new organization, and should be viewed as a "red flag" warning you of the potential for continued mismanagement.

Again, I urge that you consider placing the investment of state funds with the proven, accomplished professionals of the Permanent Fund.

See Exhibit 1.

Some additional reasons for you to question the judgment of the members of the Department of Revenue who would be responsible for the start-up of the Alaska State Investment Corp. are as follows:

1) COST: By using the Permanent Fund which is already in place the state can save between \$2.5 million and \$5 million of savings to the Alaska taxpayer.

The Permanent Fund runs their money at a cost of .0013 or 13 basis points. At present, the PERS + TRS cost .0031 or 31 basis points to run their money. This idea of an Alaska State Investment Corporation will cost at least 40 basis points to run. The savings of \$2.5 million to \$5 million per year with the slowing of Prudhoe Bay and the slow economy could go a long way on helping the image of the Legislature with the public.

2) DEFINED BENEFIT PLAN: This simply means that if for some reason (mismanagement , etc.) there is not enough money to cover the plan that the Alaska Legislature will be called on to make the plan whole.

In the last three years the Revenue Department over stated the return on foreign investment by 1500% - Can you imagine 1500%.

During 1987, while the Permanent Fund was quietly trying to get out of the equity market, the Revenue Department was trying to put an additional \$1 billion dollars in the equity market. During October 1987 the Revenue Department put over \$76 billion in equities between October 1st and October 19th, the day of Wall Streets biggest crash.

Now, look at money. The Department of Administration has investments in Junk Bonds, \$121 million. If you look in the Wall Street Journal, today you will find that those Junk Bonds are now worth between 20 cents and 40 cents on the dollar. This all means that the state will in all probability have a loss of \$73,000,000.

Remember that the State of Alaska is under a Defined Benefit Plan.

See Exhibit 2 and 3.

3) THE PERMANENT FUND: a few years ago the Legislation was passed, AS 24.20.206, to allow oversight of the Alaska Permanent Fund. If PERS + TRS was moved from the Department of Revenue to The Permanent Fund, the Legislature would have oversight.

If you form an Alaska State Investment Corporation, you will only be duplicating services already in place. If you create the Alaska State Investment Corporation you will need five new employees above the present level.

The Rates of Return at the Permanent Fund are exceptional, and are admired around the world. You will have no guarantee the Rate of Return will be good or exceptional if you form the Alaska State Investment Corporation. The State of Alaska does not need another First Executive Corp.

Staffing at the Permanent Fund is already in place. They are a very talented and dedicated group of people who have a track record envied by all of Wall Street. It is extremely hard to find this type of individual who wants to live in Alaska. It will be very difficult to find similar talented help who will want to move to Alaska, so most likely you will find less talented people working in the Alaska State Investment Corporation. You will already have the Permanent Fund and its staff in place, so why would you possibly want to take a chance with the Alaska State Investment Corporation!

Separation of PERS + TRS from the Permanent Fund is already mandated by Federal Law. The PERS + TRS will not lose their individuality, they will remain as they presently are.

Dennis L. Waldock
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243-8462-Home

DLW:bjr

Enclosures

EXHIBIT 1

DEPT. OF REVENUE
POOR JUDGEMENT

Received an unnecessary "qualified audit opinion" on the fiscal year 1988 audit.

The qualified opinion was not disclosed within the formal, published PERS/TRS Annual Report for 1988.

Allowed its physically fit chief investment officer (a critical position) to spend months at home rather than at his desk in the State Office Building.

Engaged in some "market timing" activities which resulted in buying high and selling low before and after the 1987 crash.

Did not require the independent performance evaluation firm it hired to evaluate total portfolio performance.

Despite concerns at the highest levels of the Executive Branch, independently requested introduction of this legislation which originally:

- * Would have provided five-year contracts (golden parachutes) to staff.
- * Would have permitted the organization to move out-of-state.
- * Would have a majority of the board of directors located out-of-state.
- * Would have paid huge honorariums to the out-of-state Trustees.
- * Would have been exempt from the open meetings act.
- * Would have been exempt from the budget act.
- * Would have been exempt from the procedures act.
- * Would have created a cumbersome and impractical board-staff arrangement in which there would be poor accountability.

S&P'S 500, COMMON STOCK PRICE INDEX 1986 - 1988

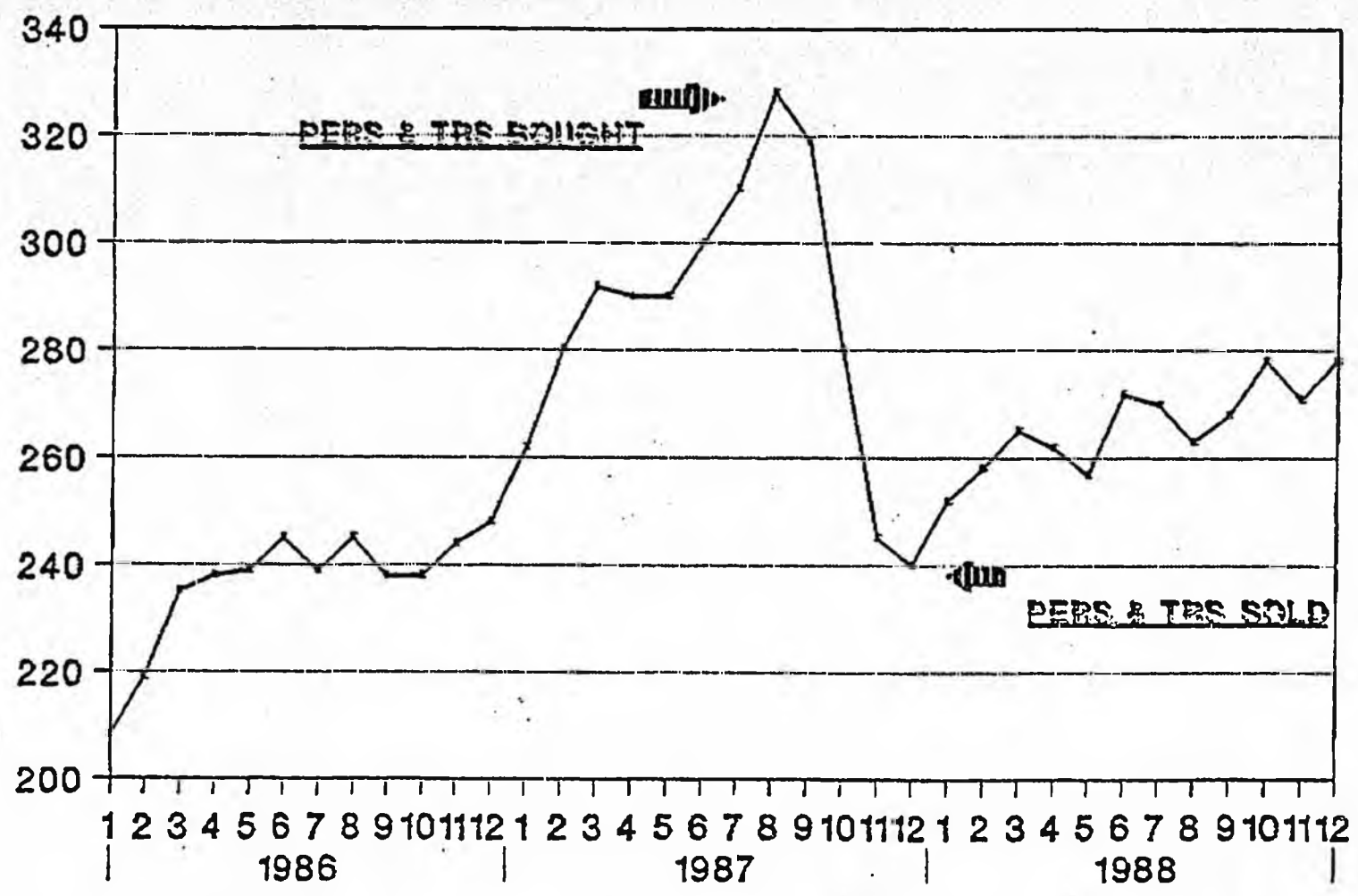


EXHIBIT 2

EXHIBIT 2

the market activity (not new money) of both PERS and TRS (please see exhibit 13 , or my original letter).

Below you will find the stock market activities month by month for both the PERS and TRS and where the Dow Jones was at during the important months leading up to the market crash. The figures with brackets are withdrawals from the market.

DJIA		PERS	TRS
	1987		
	January	0	0
	February	0	0
2226/2286	March	43,895,000	29,858,000
	April	8,655,000	6,111,000
	May	3,710,000	2,817,000
2295/2407	June	24,784,000	11,975,000
	July	6,247,000	3,519,000
2539/2669	August	107,887,000	19,858,000
2549/2701	September	132,316,000	48,729,000
	October	76,413,000	(688,000)
	November	(11,635,000)	(7,442,000)
	December	(7,222,000)	(4,660,000)
	1988		
1879/2037	January	(77,089,000)	(49,909,000)
	February	(4,391,000)	(2,824,000)
	March	(3,450,000)	(2,240,000)
	April	(2,690,000)	(1,738,000)
	May	9,540,000	6,766,000
	June	(251,000)	(163,000)

Please note, during September 1987, one month before the market crash (Dow Jones was at its high) the Retirement Funds increased their market position by \$181,045,000. During October 1987, the month of the crash, PERS increased their market position by \$76,413,000. Remember that the Alaska Permanent Fund sold out a major part of their market position during March 1987.

In November 1987, please also note that the bracketed monthly numbers turn negative (dictates withdrawals from the Equity market) and continued through June of 1988, with the exception of May 1988.

In closing I would like to leave you with two lists; one containing reasons for moving the management of PERS & TRS to the Permanent Fund and the other a list of reasons not to move the Retirement Funds from the Treasury Department.

State of Alaska

PUBLIC SCHOOL FUND

Quarter Ending
June 30, 1988

FUND ASSET ALLOCATION
AS COMPARED TO STATE RETIREMENT FUNDS
(at Market Values)

	Quarter 06/30/88		6-30-87		(*) 6-30-86		(*) 6-30-85		(*) 6-30-84		(*) 6-30-83	
	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank
<u>Asset Allocations</u>												
COMMON STOCKS	30.0	62	26.6	75	0.0	100	0.0	100	0.0	100		
BONDS	65.0	31	59.4	31	62.2	37	74.1	1	73.1	1		
MONEY MARKETS & CASH	5.0	83	14.0	30	37.8	1	25.9	1	26.9	1		

STATE RETIREMENT FUNDS OVER \$500 MILLION EACH

COMMON STOCKS	35.1	40.9	37.3	37.0	37.4	29.0
BONDS	56.0	51.2	51.2	53.5	52.4	51.0
MONEY MARKETS & CASH	8.2	10.6	7.0	9.5	10.6	9.8

Prepared under contract by SEI CORPORATION

(*) - Alaska's rates of return prior to FY 1987 were not calculated by SEI CORPORATION.

0780122

State of Alaska

PUBLIC SCHOOL FUND

Quarter Ending
June 30, 1988

DOMESTIC SECURITIES PORTFOLIOS
AS COMPARED TO LARGE RETIREMENT FUNDS
(Annualized Rates of Return at Market Values)

	Quarter 06/30/88		FY 1988		FY 1987		(*) FY 1986		(*) FY 1985		(*) FY 1984		(*) FY 1983	
	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank
<u>SECURITIES PORTFOLIOS</u> (Versus other States)	10.8	55	4.3	18	9.1	70								
<u>SECURITIES PORTFOLIOS</u> (Versus Corporate Funds)	10.8	98	4.3	9	9.1	92								

STATE RETIREMENT FUNDS OVER \$500 MILLION EACH

Percentiles

5th	25.3	7.3	19.8
25th	14.8	3.4	14.2
Median	11.7	2.5	10.3
75th	8.7	0.1	8.4
95th	4.9	-1.1	5.3

CORPORATE RETIREMENT FUNDS OVER \$500 MILLION EACH

Percentiles

5th	27.7	4.6	22.9
25th	21.6	2.3	19.9
Median	19.2	0.8	15.3
75th	15.2	-1.3	13.6
95th	11.7	-3.3	6.1

Prepared under contract by SEI CORPORATION

(*) - Alaska's rates of return prior to FY 1987 were not calculated by SEI CORPORATION.

0780121

State of Alaska

TEACHERS RETIREMENT FUNDQuarter Ending
June 30, 1988

DOMESTIC SECURITIES PORTFOLIOS
AS COMPARED TO LARGE RETIREMENT FUNDS
 (Annualized Rates of Return at Market Values)

	Quarter 06/30/88		FY 1988		FY 1987		(*) FY 1986		(*) FY 1985		(*) FY 1984		(*) FY 1983	
	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank
<u>SECURITIES PORTFOLIOS</u> (Versus other States)	11.7	49	1.6	57	9.3	66	27.6	23	29.4	45	-3.4	84	34.0	69
<u>SECURITIES PORTFOLIOS</u> (Versus Corporate Funds)	11.7	95	1.6	31	9.3	92	27.6	64	29.4	12	-3.4	37	34.0	97

STATE RETIREMENT FUNDS OVER \$500 MILLION EACHPercentiles

5th	25.3	7.3	19.8	33.0	36.4	3.1	46.9
25th	14.8	3.4	14.2	27.1	31.8	0.3	42.7
Median	11.7	2.5	10.3	23.8	28.9	-2.0	39.7
75th	8.7	0.1	8.4	22.7	25.9	-2.7	31.9
95th	4.9	-1.1	5.3	18.2	23.9	-5.6	18.4

CORPORATE RETIREMENT FUNDS OVER \$500 MILLION EACHPercentiles

5th	27.7	4.6	22.9	34.3	30.1	-0.4	55.7
25th	21.6	2.3	19.9	32.4	27.4	-1.9	51.5
Median	19.2	0.8	15.3	29.7	25.5	-5.0	46.0
75th	15.2	-1.3	13.6	25.7	23.8	-6.4	39.9
95th	11.7	-3.3	6.1	20.4	22.1	-8.9	34.6

Prepared under contract by SEI CORPORATION

(*) - Alaska's rates of return prior to FY 1987 were not calculated by SEI CORPORATION.

0780113

EXHIBIT 3

State of Alaska

PUBLIC EMPLOYEES RETIREMENT FUND

Quarter Ending
June 30, 1988

DOMESTIC SECURITIES PORTFOLIOS
AS COMPARED TO LARGE RETIREMENT FUNDS
(Annualized Rates of Return at Market Values)

	Quarter 06/30/88		FY 1988		FY 1987		(*) FY 1986		(*) FY 1985		(*) FY 1984		(*) FY 1983	
	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank
SECURITIES PORTFOLIOS (Versus other States)	10.8	60	2.4	52	9.4	64	26.6	28	28.1	60	-1.2	38	28.5	91
SECURITIES PORTFOLIOS (Versus Corporate Funds)	10.8	98	2.4	23	9.4	91	26.6	69	28.1	19	-1.2	20	28.5	100

STATE RETIREMENT FUNDS OVER \$500 MILLION EACH

Percentiles

5th	25.3	7.3	19.8	33.0	36.4	3.1	46.9
25th	14.8	3.4	14.2	27.1	31.8	0.3	42.7
Median	11.7	2.5	10.3	23.8	28.9	-2.0	39.7
75th	8.7	0.1	8.4	22.7	25.9	-2.7	31.9
95th	4.9	-1.1	5.3	18.2	23.9	-5.6	18.4

CORPORATE RETIREMENT FUNDS OVER \$500 MILLION EACH

Percentiles

5th	27.7	4.6	22.9	34.3	30.1	-0.4	55.7
25th	21.6	2.3	19.9	32.4	27.4	-1.9	51.5
Median	19.2	0.8	15.3	29.7	25.5	-5.0	46.0
75th	15.2	-1.3	13.6	25.7	23.8	-6.4	39.9
95th	11.7	-3.3	6.1	20.4	22.1	-8.9	34.6

Prepared under contract by SEI CORPORATION

(*) - Alaska's rates of return prior to FY 1987 were not calculated by SEI CORPORATION.

078015

Quarter Ending
June 30, 1988

COMMON STOCK PORTFOLIOS
AS COMPARED TO LARGE STATE RETIREMENT FUNDS AND MARKET INDICES
(Annualized Rates of Return at Market Values)

Common Stock Portfolios (Note A)	Quarter 06/30/88		FY 1988		FY 1987		(*) FY 1986		(*) FY 1985		(*) FY 1984		(*) FY 1983	
	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank
ALGER	24.8	80	-13.1	100	8.4	100	48.5	1	27.4	75				
INVESCO	28.2	54	-4.9	22	19.4	85	29.6	100	27.4	75				
LEIFMAN	31.6	30	-3.3	15	26.2	17	35.2	66	31.7	23				
COMPOSITE OF MANAGERS	28.2	51	-6.9	55	17.7	96	37.5	38	28.8	63	-15.1	100	67.3	7

STATE RETIREMENT FUNDS OVER \$500 MILLION EACH

Percentiles

5th	49.6	-0.2	36.2	41.2	34.1	0.0	69.2
25th	32.6	-5.8	25.1	37.9	31.5	-6.1	65.5
Median	28.6	-6.8	22.6	37.0	30.6	-8.1	60.6
75th	25.3	-9.3	20.4	34.3	27.4	-9.6	58.0
95th	22.0	-10.5	17.8	30.5	18.5	-14.8	52.7

MARKET INDICES

S&P 500 Index	29.1	-6.9	25.2	35.9	31.0	-4.6	61.2
Dow Jones 65 Index	29.9	-11.7	25.5	31.8	25.5	1.0	54.5

Prepared under contract by SEI CORPORATION

(*) - Alaska's rates of return prior to FY 1987 were not calculated by SEI CORPORATION.

(A) - up to 9-30-87 portfolio returns include money market (non-stock) investments, whereas the comparative returns for state retirement funds are for stocks only.

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EXHIBIT 3

State of Alaska

PUBLIC EMPLOYEES RETIREMENT FUND

Quarter Ending
June 30, 1988

COMMON STOCK PORTFOLIO
AS COMPARED TO CORPORATE RETIREMENT FUNDS AND MARKET INDICES
 (Annualized Rates of Return at Market Values)

<u>Common Stock Portfolio</u>	<u>Quarter</u> <u>06/30/88</u>		<u>FY 1988</u>		<u>FY 1987</u>		<u>(*)</u> <u>FY 1986</u>		<u>(*)</u> <u>FY 1985</u>		<u>(*)</u> <u>FY 1984</u>		<u>(*)</u> <u>FY 1983</u>	
	<u>%</u>	<u>Rank</u>	<u>%</u>	<u>Rank</u>	<u>%</u>	<u>Rank</u>	<u>%</u>	<u>Rank</u>	<u>%</u>	<u>Rank</u>	<u>%</u>	<u>Rank</u>	<u>%</u>	<u>Rank</u>
DOMESTIC EQUITY FUND (Note A)	25.8	74	-5.4	32	17.7	89	37.5	39	28.8	71	-15.1	92	67.3	51

CORPORATE RETIREMENT FUNDS OVER \$500 MILLION EACH

Percentiles

5th	46.9	-1.6	30.1	42.5	33.6	-7.3	80.0
25th	35.0	-5.1	24.6	39.3	31.4	-8.8	72.4
Median	30.1	-6.6	22.4	36.4	30.1	-10.2	67.6
75th	24.8	-7.6	19.5	34.3	28.3	-12.7	62.9
95th	20.2	-9.6	14.1	31.6	26.3	-15.4	60.8

MARKET INDICES

S&P 500 Index	29.1	-6.9	25.2	35.9	31.0	-4.6	61.2
Dow Jones 65 Index	29.9	-11.7	25.5	31.8	25.5	1.0	54.5

Prepared under contract by SEI CORPORATION

- (*) - Alaska's rates of return prior to FY 1987 were not calculated by SEI CORPORATION.
 (A) - Includes money market investments (non-stocks), whereas the comparative returns for corporate retirement funds are for stocks only.

078012

EXHIBIT 3

State of Alaska

PUBLIC SCHOOL FUND

Quarter Ending
June 30, 1988

COMMON STOCK PORTFOLIO
AS COMPARED TO LARGE STATE RETIREMENT FUNDS AND MARKET INDICES
 (Annualized Rates of Return at Market Values)

Common Stock Portfolio	Quarter 06/30/88		FY 1988		FY 1987		(*) FY 1986		(*) FY 1985		(*) FY 1984		(*) FY 1983	
	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank
DOMESTIC EQUITY FUND (Note A)	25.3	72	-4.5	21	34.4	100								

STATE RETIREMENT FUNDS OVER \$500 MILLION EACH

Percentiles:

5th	49.6	-0.2	60.3
25th	32.6	-5.8	50.1
Median	28.6	-6.8	46.3
75th	25.3	-9.3	42.2
95th	22.0	-10.5	40.9

MARKET INDICES

S&P 500 Index	29.1	-6.9	25.2	35.9	31.0	-4.6	61.2
Dow Jones 65 Index	29.9	-11.7	25.5	31.8	25.5	1.0	54.5

Prepared under contract by SEI CORPORATION

- (*) - Alaska's rates of return prior to FY 1987 were not calculated by SEI CORPORATION.
 (A) - Includes money market (non-stock) investments, whereas the comparative returns for state retirement funds are for stock only.

078027

EXHIBIT 3

State of Alaska

TEACHERS RETIREMENT FUND

Quarter Ending
June 30, 1988

FUND ASSET ALLOCATION
AS COMPARED TO STATE RETIREMENT FUNDS
(at Market Values)

	Quarter 06/30/88		6-30-87		(*) 6-30-86		(*) 6-30-85		(*) 6-30-84		(*) 6-30-83	
	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank
<u>Asset Allocations</u>												
COMMON STOCKS	33.8	52	35.0	57	35.2	55	26.3	64	21.6	66	26.2	59
BONDS	56.4	49	51.4	32	53.0	51	46.3	52	66.8	25	57.4	39
MONEY MARKETS & CASH	9.8	35	13.6	48	11.8	35	27.4	1	11.7	45	16.4	12

STATE RETIREMENT FUNDS OVER \$500 MILLION EACH

COMMON STOCKS	35.1	40.9	37.3	37.0	37.4	29.0
BONDS	56.0	51.2	51.2	53.5	52.4	51.0
MONEY MARKETS & CASH	8.2	10.6	7.0	9.5	10.6	9.8

Prepared under contract by SEI CORPORATION

(*) - Alaska's rates of return prior to FY 1987 were not calculated by SEI CORPORATION.

0780114

CORRECTION

**THIS DOCUMENT
HAS BEEN REPHOTOGRAPHED
TO ASSURE LEGIBILITY**

EXHIBIT 3

State of Alaska

TEACHERS RETIREMENT FUND

Quarter Ending
June 30, 1988

FUND ASSET ALLOCATION
AS COMPARED TO STATE RETIREMENT FUNDS
(at Market Values)

	Quarter 06/30/88		6-30-87		(*) 6-30-86		(*) 6-30-85		(*) 6-30-84		(*) 6-30-83	
	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank
<u>Asset Allocations</u>												
COMMON STOCKS	33.8	52	35.0	57	35.2	55	26.3	64	21.6	66	26.2	59
BONDS	56.4	49	51.4	32	53.0	51	46.3	52	66.8	25	57.4	39
MONEY MARKETS & CASH	9.8	35	13.6	48	11.8	35	27.4	1	11.7	45	16.4	12

STATE RETIREMENT FUNDS OVER \$500 MILLION EACH

COMMON STOCKS	35.1	40.9	37.3	37.0	37.4	29.0
BONDS	56.0	51.2	51.2	53.5	52.4	51.0
MONEY MARKETS & CASH	8.2	10.6	7.0	9.5	10.6	9.8

Prepared under contract by SEI CORPORATION

(*) - Alaska's rates of return prior to FY 1987 were not calculated by SEI CORPORATION.

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EXHIBIT 3

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State of Alaska

PUBLIC EMPLOYEES RETIREMENT FUND

Quarter Ending
June 30, 1988

FUND ASSET ALLOCATION
AS COMPARED TO STATE RETIREMENT FUNDS
(at Market Values)

	Quarter 06/30/88		6-30-87		(*) 6-30-86		(*) 6-30-85		(*) 6-30-84		(*) 6-30-83	
	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank
<u>Asset Allocations</u>												
COMMON STOCKS	32.6	55	33.8	59	34.9	55	26.5	65	18.3	67	17.3	65
BONDS	58.1	45	48.8	54	51.3	51	48.1	57	69.9	25	62.2	37
MONEY MARKETS & CASH	9.2	38	17.4	12	13.8	22	25.4	1	11.8	41	20.5	1

STATE RETIREMENT FUNDS OVER \$500 MILLION EACH

COMMON STOCKS	35.1	40.9	37.3	37.0	37.4	29.0
BONDS	56.0	51.2	51.2	53.5	52.4	51.0
MONEY MARKETS & CASH	8.2	10.6	7.0	9.5	10.6	9.8

Prepared under contract by SEI CORPORATION

(*) - Alaska's rates of return prior to FY 1987 were not calculated by SEI CORPORATION.

078016

EXHIBIT 3

State of Alaska

PUBLIC SCHOOL FUND

Quarter Ending
June 30, 1988

FUND ASSET ALLOCATION
AS COMPARED TO CORPORATE RETIREMENT FUNDS
(at Market Values)

	Quarter 06/30/88		6-30-87		(*) 6-30-86		(*) 6-30-85		(*) 6-30-84		(*) 6-30-83	
	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank
<u>Asset Allocations</u>												
COMMON STOCKS	30.0	100	26.6	100	0.0	100	0.0	100	0.0	100		
BONDS	65.0	1	59.4	1	62.2	3	74.1	1	73.1	1		
MONEY MARKETS & CASH	5.0	100	14.0	20	37.8	1	25.9	1	26.9	1		
	<u>CORPORATE RETIREMENT FUNDS OVER \$500 MILLION EACH</u>											
COMMON STOCKS	55.3		58.5		51.8		56.8		56.5		59.5	
BONDS	28.2		28.0		29.1		32.5		25.4		27.1	
MONEY MARKETS & CASH	10.4		10.6		8.7		7.3		12.7		7.8	

Prepared under contract by SEI CORPORATION

(*) - Alaska's rates of return prior to FY 1987 were not calculated by SEI CORPORATION.

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EXHIBIT 3

State of Alaska

PUBLIC EMPLOYEES RETIREMENT FUND

Quarter Ending
June 30, 1988

FUND ASSET ALLOCATION
AS COMPARED TO CORPORATE RETIREMENT FUNDS
(at Market Values)

	Quarter 06/30/88		6-30-87		(*) 6-30-86		(*) 6-30-85		(*) 6-30-84		(*) 6-30-83	
	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank
<u>Asset Allocations</u>												
COMMON STOCKS	32.6	100	33.8	93	34.9	90	26.5	99	18.3	99	17.3	100
BONDS	58.1	1	48.8	6	51.3	7	48.1	11	69.9	1	62.2	17
MONEY MARKETS & CASH	9.2	67	17.4	16	13.8	15	25.4	1	11.8	52	20.5	1

CORPORATE RETIREMENT FUNDS OVER \$500 MILLION EACH

COMMON STOCKS	55.3	58.5	57.8	56.8	56.5	59.5
BONDS	28.2	28.0	29.1	32.5	25.4	27.1
MONEY MARKETS & CASH	10.4	10.6	8.7	7.3	12.7	7.8

Prepared under contract by SEI CORPORATION

(*) - Alaska's rates of return prior to FY 1987 were not calculated by SEI CORPORATION.

078017



alaska judicial council

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Daniel L. Callahan
William T. Council

May 4, 1990

CHAIRMAN, EX OFFICIO
Warron W. Matthews
Chief Justice
Supreme Court

Senator John Binkley
Alaska State Legislature
P.O. Box V (MS 3100)
Juneau, Alaska 99811

Re: HB 491: Alaska Sentencing Commission

Dear Senator Binkley:

I am writing to encourage the Senate Finance Committee to schedule and pass out the above referenced legislation which would create an Alaska sentencing commission. The Alaska Judicial Council supports this legislation and I would be happy to attempt to answer any questions you might have about it.

Please feel free to give me a call.

Very truly yours,

A handwritten signature in cursive script that reads "William T. Cotton".

William T. Cotton
Executive Director

TWC/jmz

THE FOLLOWING DOCUMENT HAS
NOT BEEN FILMED BUT IS
AVAILABLE IN THE ORIGINAL
FILE

A SPECIAL REPORT ON THE
DEPARTMENT OF REVENUE
TREASURY DIVISION
PUBLIC EMPLOYEES' AND TEACHERS'
RETIREMENT FUNDS

June 19, 1989

Audit Control Number

04-4345-89-S

Commissioner, Department of
Revenue

Hugh Malone

Deputy Commissioner, Department
of Revenue

Milton B. Barker

STATE OF ALASKA

THE LEGISLATURE

BUDGET AND AUDIT COMMITTEE

AUDIT DIVISION
P.O. BOX W
JUNEAU, ALASKA 99811-3300

June 19, 1989

Members of the Legislative Budget
and Audit Committee:

In accordance with a Legislative Budget and Audit Committee special request and the provisions of Title 24 of the Alaska Statutes, the attached report is submitted for your review.

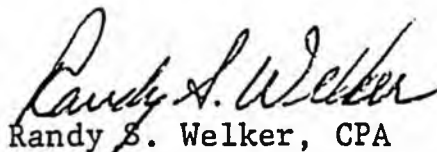
A SPECIAL REPORT ON THE
DEPARTMENT OF REVENUE
TREASURY DIVISION
PUBLIC EMPLOYEES' AND TEACHERS'
RETIREMENT FUNDS

Audit Control Number

04-4345-89-S

The purpose of this audit is to examine the accounting and oversight of the Public Employees' and Teachers' Retirement Funds administered by the Department of Revenue, Treasury Division.

The audit was conducted in accordance with generally accepted governmental performance auditing standards. The audit approach is discussed in the Report Objectives, Scope, and Methodology section of this report. The audit results may be found in the Findings and Recommendations section.



Randy S. Welker, CPA
Legislative Auditor
Division of Legislative Audit

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REPORT OBJECTIVES, SCOPE, AND METHODOLOGY

In accordance with Title 24 of the Alaska Statutes and a special request of the Legislative Budget and Audit Committee, we reviewed the Public Employees' and Teachers' Retirement Funds. The purpose was to review accounting procedures used for the retirement funds' foreign investment portfolio and to ascertain the extent of investment oversight the retirement funds are subject to.

The policy and audit approach utilized by the Division of Legislative Audit for special and performance reports can best be described as "audit by exception." This methodology focuses the audit effort on areas of an auditee's operation that have been identified by a preliminary survey as having a high degree of probability for needing improvements.

Therefore, by design, finite audit resources are used to identify where and how improvement can be made, and little time is devoted to reviewing well-run operations or programs. Consequently, this report highlights those areas needing improvement and does not emphasize those operations and programs that are properly functioning.

Discussion of the objectives, scope, and methodology of our review follows.

OBJECTIVES

In response to public allegations about mismanagement of the retirement funds and "deceptive accounting practices," the Legislative Budget and Audit Committee requested a review of certain management practices of the Public Employees' and Teachers' Retirement Funds.

The first objective of our review was to determine the type of management and investment oversight provided over the operations of the retirement funds.

The second objective was to ascertain the management and investment oversight styles applied to other similar funds.

Our third objective was to determine if proper accounting practices were applied to the funds' foreign investments.

Finally, we identified the various rates of returns earned by the retirement funds and the Permanent Fund, and we reviewed the cost of managing and investing those funds.

SCOPE AND METHODOLOGY

We met with officials of the Department of Revenue, Treasury Division, including the deputy commissioner, chief investment officer, other investment officers, and the state

comptroller; the director of the Division of Risk Management; officials of the Alaska Permanent Fund Corporation; certified public accountants under contract with the Treasury Division; and a member of the brokerage community.

We also reviewed various reference materials and publications; reports, and supporting documentation, prepared by the Senate Advisory Council; fund performance evaluation reports prepared for the retirement funds and the Alaska Permanent Fund; and, various literature provided by other states on their retirement funds.

Additionally, we prepared and distributed a questionnaire to all other states inquiring about certain aspects of their public employees retirement funds.

We also engaged a consultant, who as a former employee of Merrill Lynch had past experience in evaluating the performance of the Public Employees' and Teachers' Retirement systems, to assist us in interpreting the externally prepared performance reports on the retirement funds and the Permanent Fund.

ORGANIZATION AND FUNCTION

The Department of Revenue, Division of Treasury (Treasury) is responsible for, and has sole discretion over, the prudent investment and management of the Public Employees' Retirement Fund (PERS) and the Teachers' Retirement Fund (TRS).

Chapter 141, SLA 1988 amended PERS and TRS statutes by designating the funds as retirement trust funds and appointing the commissioner of Revenue as treasurer of the retirement systems and fiduciary of the funds. Under the amending legislation, the commissioner of Revenue shall:

1. Consider the status of the funds' investments and the system's liabilities on both a current and a probable future basis.
2. Determine the appropriate investment objectives for the funds.
3. Establish investment policies aimed at achieving the objectives.
4. Act only in regard to the best financial interests of the system's beneficiaries.

The amendments also repealed the "legal list" of investments the retirement funds were restricted to and placed upon the commissioner of Revenue, or his designee, the responsibility of fund fiduciary. Treasury also employs external investment managers who manage a substantial portion of the retirement funds.

Additionally, there are two boards which oversee the administrative aspects of the retirement systems. The Public Employees' Retirement Board is composed of five members, three of whom are members of the Department of Administration personnel board and two who are members of the system and elected by the membership of the system. The Teachers' Retirement Board consists of five members appointed by the governor. Both boards are mostly administrative in nature, being responsible for governing the regulatory aspects of the retirement systems.

The Alaska Permanent Fund is managed by an executive director, who reports to a six-member board of trustees appointed by the governor.

(Intentionally left blank)

FUND COMPARISONS AND DISCUSSION:
PUBLIC EMPLOYEES' RETIREMENT FUND, TEACHERS'
RETIREMENT FUND, and ALASKA PERMANENT FUND

BACKGROUND

There is no validity to the statement that "a fund is a fund" as each fund has its own unique characteristics. Although funds such as those set up as trusts and endowments may have few obvious differences, there are deeper, less clearly defined differences such as fund objectives, philosophy over fund management, and investment styles. A slight difference in fund objectives and philosophy may, and usually does, result in different investment styles and, therefore, differing returns on investment. The varied fund management styles and investment philosophies create a danger in across-the-board rate of return comparisons and forming conclusions drawn from those comparisons. There are several ways of assessing investment results. It is not, for example, appropriate to compare the results of funds with very different objectives or constraints. Funds with different types and mixes of investments are also difficult to compare directly. To properly assess investment results, comparisons must reflect similar objectives, constraints, opportunities, and all things that go into the investment process.

The Alaska Permanent Fund, while not legally defined as one, is in all probability a trust fund like the Public Employees' (PERS) and Teachers' (TRS) Retirement Funds. The Alaska Permanent Fund Corporation (PFC) holds the Permanent Fund out as a "Public Trust Investing for Alaska's Future," has a Board of Trustees, and is intent on earning revenue for beneficiaries while preserving principal. The obvious similarities between PERS/TRS and the Permanent Fund end here - at considering both funds as trusts.

PFC has chosen a more cautious, less risky approach towards its investments. In an informational pamphlet dated May 1989, PFC stated:

The Fund invests its assets to earn income. To minimize the risk that Fund assets could be destroyed by bad investment decisions, the Fund is invested very conservatively. Indeed, the primary emphasis in all Fund decision-making is maintaining the safety of principal. The maximizing return on investment is the secondary consideration.

This contrasts to the Department of Revenue, Division of Treasury (Treasury) investment philosophy of the PERS/TRS which has been stated as:

The most important characteristic of the funds for investment policy purposes is their perpetual nature and, in the case of the Public Employees' Retirement System, the long number of years before it will encounter any net outflows (probably 15 to 20 years). A long time span accommodates investments which should enjoy higher returns over the long-run, although they may be slow to materialize, or be erratic in the short-run, and it allows greater use of investments which may have substantial market valuation risks. This characteristic expands the universe of investment possibilities and increases the potential for achieving higher returns on the investments.

The PERS/TRS has opted for more growth through a higher asset allocation to equities. To achieve that end, PERS/TRS follows an investment technique known as active management versus a passive management investment style. Passive management is a term used to describe an investment strategy that attempts to follow a predefined market index, such as the Standard and Poor's (S&P) 500, and fashions the portfolio to mirror the results of that index. Passive management follows a process of rebalancing the portfolio to reflect the index, not necessarily to enhance or maximize a return. Active management, on the other hand, involves portfolio management that is involved in the active investment process of buying and selling in an attempt to enhance the portfolio's performance. The active management strategy can be characterized as continually monitoring the market to determine what is the best selection of investment to produce the best returns within a predetermined set of risk parameters.

PFC is legally limited in its investment diversification by statute which defines a specific "list" of permitted investments. The Treasury did have investment limitations, but the statutory restrictions were repealed by Chapter 41, SLA 1988. This allows Treasury more investment flexibility. With this flexibility, Treasury can assume additional risk, and theoretically achieve higher returns for the PERS/TRS Funds.

ASSET ALLOCATION

An informative way to examine the assumed risk is to analyze the asset allocations of the various funds. At March 31, 1989, the various funds' holdings were (stated in percentage of portfolio at market values):

	<u>PERS</u>	<u>TRS</u>	<u>PFC</u>
Equities (1)	32.8%	34.9%	12.9%
Fixed Income	54.7%	51.3%	77.6%
Real Estate	6.4%	6.0%	5.6%
Other (2)	6.1%	7.8%	3.9%

(1) includes domestic and foreign equity holdings of the PERS and TRS. PFC does not yet invest in foreign markets.

(2) includes mortgages, cash, and interest and dividends receivable.

As can be seen, the PERS/TRS Funds hold 2.5-to-3 times more equity than does PFC. Conversely, PFC holds 1.5 times more fixed income investments than does the PERS/TRS Funds.

By their nature, equities have more risk than fixed income (debt) investments. As mentioned earlier, theoretically the riskier the investment, the higher the potential rate of return.

FUND PERFORMANCE

This section and the following section ("Other Rate of Return Data") present statistical data which show various rates of return earned not only by the PERS/TRS and Permanent Fund but other interest-bearing investments. As noted above, and throughout the report, direct comparisons between these funds and other investments are not practical for assessing how one fund "performed or out performed" another fund. This is mainly due to the differences in purpose, goals, and philosophy of each particular fund. However, the presentations provided here are done so for the benefit of interested parties who can review the returns earned by the funds and relate those to other commonly known investments.

It has been alleged that Treasury managed PERS/TRS Funds are among the worst performers within the universe of funds used for performance measurement and comparison (see Recommendation No. 2). While the allegations themselves are substantially accurate in the context they were submitted, the facts must be kept in perspective in light of the long-term nature of the retirement funds. The allegations were made from looking at just one, short period of time that the PERS/TRS funds were evaluated. One must be careful about the period of time used for measurement as investment results measured over short periods of time are very misleading. The best results today may be the worst tomorrow. What matters is consistent, long-term results.

With the above thoughts in mind, the PERS, TRS, and PFC performance can be reviewed together with returns of other, although non-comparable, commonly known investments.

Total rate of return (time-weighted) is a useful technique that is widely accepted for comparing investment results. It combines current yield plus changes in current market values for determining a portfolio's investment rate of return.

Total rate of return (time-weighted) for PERS, TRS, and PFC is shown below:

TIME-WEIGHTED TOTAL RATES OF RETURN(%)
AS OF JUNE 30, 1988 and DECEMBER 31, 1988 (a)
(unaudited)

	<u>PERS</u>	<u>TRS</u>	<u>PFC</u>
Year ending 6/30/88	3.79	3.76	5.3
Two years	7.46	7.85	6.5
Three years	13.80	13.37	11.8
Four years	15.02	14.62	(1)
Five years	(2)	(2)	13.1
Year ending 12/31/88	11.65	11.93	8.5
Two years	6.48	6.44	5.9
Three years	10.72	10.20	9.3
Four years	13.72	13.31	(1)
Five years	(2)	(2)	12.9

(a) source: PERS/TRS information obtained from Department of Revenue, Treasury Division internally calculated time-weighted rates of return. PFC information obtained from externally evaluated SEI Large Plan Report. Percentages presented are annualized time-weighted rates of return.

(1) four-year data not available for PFC from SEI external reports.

(2) five-year data not available for PERS/TRS for years ending June 30 and December 31, 1988.

As can be seen, the PERS/TRS Funds time-weighted rate of return generally exceeds that of the PFC. This is probably a reflection of the additional risk the retirement funds assume versus the more conservative approach taken by the PFC in its investments and asset allocation.

Another performance measurement would be reviewing the return of segments of the PERS/TRS and PFC portfolios; for example, reviewing PERS/TRS and PFC domestic equity investments to the S&P 500 or the fixed income investments to the Shearson Lehman Bond Index (SL-BONDS). Such an analysis would show:

PERS/TRS/PFC EQUITY AND FIXED INCOME TIME-WEIGHTED RETURNS
COMPARED TO SPECIFIC MARKET INDICES
ANNUALLY-COMPOUNDED RATES OF RETURN
FOR YEARS ENDING DECEMBER 31, 1988 (a)
(unaudited)

DOMESTIC EQUITIES

	<u>1 year</u>	<u>2 years</u>	<u>3 years</u>	<u>4 years</u>	<u>5 years</u>
PERS	18.21	9.75	12.98	17.38	(1)
TRS	18.21	10.04	12.95	17.27	(1)
PFC	15.50	11.10	13.50	(2)	15.00
S&P 500	16.80	10.90	13.40	17.80	15.30

FIXED INCOME

	<u>1 year</u>	<u>2 years</u>	<u>3 years</u>	<u>4 years</u>	<u>5 years</u>
PERS	8.73	5.14	9.37	12.33	(1)
TRS	9.10	5.01	8.58	11.71	(1)
PFC	7.20	4.30	8.10	(2)	12.10
SL-BONDS	7.60	4.90	8.40	11.50	12.20

(a) source: Dept. of Revenue, Division of Treasury internally calculated time-weighted rates of return; PFC externally evaluated SEI Large Plan Report; and, independent sources of market indices.

(1) five-year data not available for PERS/TRS.

(2) four-year data not available for PFC on SEI external reports.

The above analysis shows that for the most part PERS/TRS and PFC achieved a competitive return on its domestic equity investments compared to the S&P 500 index. PERS/TRS fixed income investments outperformed the Shearson Lehman Bond Index in each of the four years compared above. PFC also achieved a competitive return on its fixed income holdings when compared to the bond index.

Another informative comparison is reviewing the annual (each year standing on its own, unlike the cumulative returns used in the previous comparisons) rate of return and how that return fits into the universe of funds used for comparative purposes.

PERS/TRS/PFC
ANNUAL RATES OF RETURN AT MARKET VALUES
AND PERCENT RANKING IN COMPARATIVE UNIVERSE (a)

	1984		1985		1986		1987		1988	
	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank
<u>Equities</u>										
PERS	-15.1	100	28.8	63	37.5	38	17.7	96	-5.4	23
TRS	-15.1	100	28.8	63	37.5	38	18.5	90	-5.2	22
PFC	-9.6	28	30.6	46	37.2	59	24.8	27	-6.4	55
<u>Fixed Income</u>										
PERS	1.1	55	27.9	65	22.9	3	5.0	59	7.6	51
TRS	0.8	57	28.2	61	23.4	1	4.3	79	8.8	3
PFC	4.4	56	27.2	12	20.5	25	4.3	91	7.0	71

(a) source: PERS/TRS data from SEI report for quarter ending 6/30/88. PFC data from SEI large plan report for period ending 6/30/88.

The rates of return above are based on the market value of the equity and fixed income portfolios and includes unrealized gains. PERS/TRS rankings are based on a comparison with a universe of approximately 30 large state retirement funds. PFC rankings are based on a universe comparison of 63 funds. The "rank" describes (using percentages) how the fund performed in relation to the other funds of the universe. For example, a rank of 100 indicates the fund had the lowest performance and 99% of the universe performed better. Conversely, a rank of 1 indicates the fund performed the best and 99% of the universe achieved lower returns. A rank of 55 indicates the fund performed near the median (50%), and that 45% of the universe performed worse while 54% achieved better returns.

OTHER RATE OF RETURN DATA

While not truly comparable, investment fund returns can be reviewed against other fixed income returns.

PERS/TRS/PFC ANNUAL REALIZED (NOMINAL) RATES OF RETURN
COMPARED TO OTHER FIXED RATE RETURNS (a)
(unaudited)

YEAR	Realized Rate of Return(%)			Fixed Rates of Return(%)		
	PERS	TRS	PFC	SBS(1)	DCP(1)	CD(1)
1980	9.54	10.41	11.29	10.40	n/a	12.91
1981	10.73	11.02	16.00	10.75	n/a	15.91
1982	8.52	6.98	15.10	12.35	n/a	12.04
1983	11.09	11.32	12.76	12.55	n/a	8.96
1984	10.66	9.47	10.89	12.00	n/a	10.17
1985	9.96	9.84	11.61	11.80	n/a	7.97
1986	13.16	13.12	14.36	11.87	9.30	6.62
1987	13.98	13.94	13.37	11.54	9.08	6.74
1988	8.20	8.20	9.01	11.00	9.93	7.58

(a) source: Division of Legislative Finance; Department of Administration, Division of Retirement and Benefits.

(1) SBS - State Supplemental Benefit System
DCP - State Deferred Compensation Plan
CD - Certificates of Deposit

n/a - not available

The comparisons above are not an accurate measurement of determining how PERS/TRS or PFC is performing in comparison to other funds or instruments. While it does demonstrate differing returns by different investing funds or instruments, it does not indicate nor provide a basis for comparing how similarly designed funds invested in similar securities are performing. Each of these funds or instruments, with the exception of PERS/TRS, have different objectives and goals and, therefore, have varying investment strategies and policies.

Also, the schedule above presents a different picture than the prior example. Here, annual realized (nominal) rates of return are presented. Realized rates of return do not include changes in market value and, therefore, are not usually used for comparing performance. In this schedule, PFC outperforms PERS/TRS in all but one annual period presented. This compares to the previous time weighted presentation that shows PERS/TRS outperforming PFC in all but one period presented. This exemplifies how, depending on a desired outcome, rate of returns can be used to make a point. Since PERS/TRS are pensions funds, their return

analyses should be based on a long-term view, not just how the funds performed in any one annual period.

Another review of returns can be made between the retirement funds and other market indices. Like the above, the returns are not truly comparable. These market indices reflect returns for certain investments, whereas the PERS/TRS and PFC Funds results reflect a total return on a balanced portfolio of many types of investments. For example, the Standard and Poor's 500 (S&P 500) index reflects returns on equities only; the 91 day Treasury Bill index (T-BILL) reflects short-term fixed income investments; and, the Shearson Lehman bond index (SL-BONDS) reflects returns on bond investments.

PERS/TRS/PFC TIME-WEIGHTED TOTAL RATES OF RETURN
COMPARED TO MARKET INDICES ANNUALLY-COMPOUNDED
RATES OF RETURN(%)
AS OF DECEMBER 31, 1988 (a)
(unaudited)

	<u>1 Year</u>	<u>2 Years</u>	<u>3 Years</u>	<u>4 Years</u>	<u>5 Years</u>
PERS	11.6	6.5	10.7	13.7	(1)
TRS	11.9	6.4	10.2	13.3	(1)
PFC	8.5	5.9	9.3	(2)	12.9
S&P 500	16.8	10.9	13.4	17.8	15.3
T-BILL	6.7	6.0	6.0	6.5	7.1
SL-BONDS	7.6	4.9	8.4	11.5	12.2

(a) source: Department of Revenue, Division of Treasury, and independent sources of market indices. PFC data from 12/31/88 Large Plan Report.

(1) five-year data not available for PERS/TRS.

(2) four-year data not available for PFC on SEI external reports.

The misleading nature of drawing conclusions solely from this analysis must be emphasized. For example, for the three years ending December 31, 1988 the S&P 500 had achieved an annualized return of 13.4%; contrasted to PERS, TRS, and PFC returns of 10.7%, 10.2%, and 9.3% respectively. The S&P 500 is an index that measures only equities traded on the exchanges. The PERS/TRS and PFC portfolios not only contain stocks but also bonds, other fixed income securities, and real estate. Additionally, PERS/TRS holds investments in foreign equities, whereas the S&P 500 reflects only domestic equity.

PERS/TRS and PFC may have achieved a return on its equity portfolio competitive to that of the S&P 500. However, fluctuations in bond, other fixed income, and real estate

investments may have affected the overall total portfolio rate of return. Therein lies the danger of relying solely on a comparison of fund performance to any one market index.

COST OF MANAGING AND INVESTING PERS/TRS AND PFC FUNDS

It has been alleged that the cost of administering the PERS/TRS Funds are "out of control" compared to the PFC. In reviewing the cost of administering the retirement funds versus the Permanent Fund the facts must again be kept in perspective and require closer scrutiny before drawing conclusions, similar to the closer analysis needed when comparing PERS/TRS and PFC rates of return.

The Department of Revenue, Treasury Division is responsible for, among other functions, the investment and management of the State of Alaska general investment fund; AHFC pledged fund; international airports construction fund; international airports revenue fund; state mortgage insurance fund; public employees' retirement trust fund; teachers' retirement trust fund; judicial retirement trust fund; military retirement trust fund; public school trust fund; and the University of Alaska trust fund. Also, the division is responsible for state cash management, debt management, and investment accounting.

By far the largest cost centers in the management of the PERS/TRS Funds are personal services (salaries) and contractual fees.

It has been alleged that it takes between 25-to-27 positions to manage the PERS/TRS Funds as compared to the PFC requiring 16 positions to manage their portfolio.

The 25-to-27 positions referred to above represents the total staffing of the Treasury Division. These positions do many tasks, as discussed above. Not all of those positions have duties related to the PERS/TRS Funds. We examined the job descriptions of employees in the Treasury Division and verified those descriptions with some employees through personal interviews. We also identified salary and benefits costs for each of the Treasury Division employees and for the division in total.

We have calculated that Treasury utilizes a full-time equivalent (FTE) staffing of 11.3 positions to manage, invest, and account for the PERS/TRS Funds in fiscal year 1988 at a cost of \$655,273. These positions are responsible for executive management, asset accounting, portfolio management, real estate investments, and cash management as it relates to the PERS/TRS Funds. This compares to the fiscal year 1988 PFC staffing of 16 positions at a cost of \$863,000.

Contractual fees comprise the largest cost of managing the PERS/TRS and PFC Funds. These costs consist of payments made for the services of professional money managers, external performance analysis, external auditors, consultants, and custody and safekeeping fees.

PERS/TRS fiscal year 1988 contractual payments amounted to \$4,841,564 compared to PFC expenditures of \$3,428,000. PERS/TRS incurs expenses that the PFC does not. PERS/TRS, being two separate funds, has increased costs for services such as investment processing, external auditors, and the external performance analysis. The retirement funds also incur additional costs due to PERS/TRS higher asset allocation to equities which, under an active investment strategy, necessitates additional trade costs and because PERS/TRS invests in foreign equities which require higher fees than does a domestic equity. PFC does not invest in the foreign markets, has a smaller asset allocation to domestic equity, and utilizes an index equity portfolio resulting in reduced management fees. As the PFC moves into the foreign markets and reevaluates asset allocation, one would expect to see an increase in their management fees.

The industry evaluates management and funds costs on a "basis point" system. A "basis point" reflects the cost to manage \$1,000. We performed a "basis point" cost evaluation of the PERS/TRS and PFC Funds, as follows:

	<u>PERS/TRS</u>	<u>PFC</u>
Personal Services	1.90	.88
Travel	.05	.15
Contractual	14.02	3.48
Other (capital outlay, communications, rent, depreciation)	.08	.67
<u>Total "Basis Point"</u> <u>cost per \$1,000</u>	<u>16.05</u>	<u>5.18</u>

As can be seen, the cost of PERS/TRS contractual is approximately four times that of the PFC. This reflects the additional costs PERS/TRS incurs due to its higher allocation to domestic equities, investment in foreign equities, the increased costs for identical services since these are two separate funds, and the economies of scale inherent in a large fund such as the PFC.

We do not feel a simple analysis with an allegation that PERS/TRS costs three times more to manage than the PFC is justified. A closer review shows valid reasons why PERS/TRS Funds are more expensive to manage than the PFC fund.

FINDINGS AND RECOMMENDATIONS

Recommendation No. 1

A Board of Trustees concept or structure should be established that has broad powers and can exercise an active role in the management and investment oversight of the PERS and TRS Funds.

At present, the PERS and TRS boards (nor any other body) have minimal, if any, investment and management oversight responsibility over the nearly \$3.5 billion of retirement fund assets invested and managed by Treasury. What little investment oversight authority the boards may have had was eliminated by amending legislation in 1987/1988.

Currently the PERS and TRS boards are mostly administrative in nature, handling the administrative aspects of the retirement systems. The boards have no authority to direct or establish investment policy or guidance nor do they have the ability to effectively object to a direction the funds may be heading and enforce an alternative.

We believe the State and other governmental employers, fund beneficiaries, and active participants would be better served by a restructuring of the current PERS and TRS boards and the process of reporting to those boards.

We conducted a survey of all states' public employees' and teachers' retirement systems and discovered that Alaska PERS and TRS Funds investment management oversight is severely lacking when compared to other larger, older, more experienced funds.

An overwhelming number of respondents to our survey have an investment oversight function that rests with an independent body apart from the investment activity itself. This oversight authority is vested in authoritative retirement boards, boards of trustees (ranging from 3 to 4 and up to 16 members), investment committees and councils (usually a subcommittee of a board of trustees), or a statewide investment commission or board. We believe a similar structure is warranted for the PERS and TRS Funds.

The PERS and TRS statutes should be rewritten to allow, and the boards should be restructured to accept, a new, stronger investment management oversight responsibility. We recommend that:

1. The current PERS and TRS boards be consolidated into one overall board of trustees. The board of trustees should be structured so that individuals with the necessary and appropriate expertise are appointed, as well as PERS and TRS beneficiaries and active participants. Additionally, Treasury officials and, barring

constitutional prohibitions, members of the legislature should be active participants on the board.

2. Subcommittees of the board of trustees could be established to handle the respective administrative duties of the PERS and TRS Funds.
3. The board of trustees should be vested with the authority to employ outside investment advisors to review investment policies and make recommendations; to establish investment policies; to engage the independent certified public accountants for the funds' audits and have results reported directly to the board; to contract with external performance evaluators who would report directly to the board; and to review Treasury investment and asset allocation decisions.

A Board of Trustees with overlapping and staggering appointments will also provide continuity from one administration to another. Retirement funds such as the PERS and TRS are perpetual in nature. They are considered to exist forever. As such, a continuity in management is required, one that can provide the historical perspective of past actions and effects. The nature of the political environment is quite opposite. Administrations come and go, as do the political appointees that make the decisions that affect the retirement funds. Presently, the commissioner of Revenue, an appointed position, is the fiduciary of the retirement funds. A political appointment of two or four years pales in comparison to the longevity of the retirement funds. A "changing of the guard" every two-to-four years does not provide the needed continuity in fund administration. An independent board of trustees, with oversight authority, would provide the needed oversight and continuity over these funds.

It has been argued that since the PERS and TRS Funds are designated as trusts and the commissioner of Revenue is designated fiduciary of the funds, that the boards cannot and will not accept the fiduciary responsibility of managing the funds.

In our discussions with PERS and TRS board chairpersons we learned that the boards do want to assume more investment oversight responsibility over the funds but at present do not have the statutory ability to do so.

It has also been stated that the boards would not accept the liability associated with acting as a fund fiduciary. According to the Division of Risk Management of the Department of Administration, the PERS and TRS boards are currently covered by the Directors and Officials liability protection policy. This coverage, in the amount of \$100 million (with a \$5 million self-insured clause), covers any board or

commission that is created by law and that the policy coverage would extend to any actions taken by the boards or commissions that are within its official duties. At present, the commissioner of Revenue, as fiduciary, is similarly covered by this policy. Additionally, the director of Risk Management stated that if the funds incur a loss due to a breach of fiduciary duty, the Directors and Officers liability insurance policy may make funds whole, depending on the circumstances, if the payments are a legal liability. Based on the above, it is our opinion that the insurance coverage presently available to the commissioner of Revenue is likewise available to the current PERS and TRS boards and would be available to a duly created board of trustees acting in the capacity of fund fiduciary.

Therefore, we recommend that the administration and the legislature establish a board of trustees concept or structure to provide investment oversight on the Treasury investment operations, particularly the PERS and TRS Funds. Some members of the board of trustees should have the necessary professional skills. Other members should represent fund beneficiaries, active fund members, the Treasury, and, barring constitutional prohibitions, the legislature. The board of trustees should have the authority to contract for audits, external performance evaluations, and professional advice. Additionally, the board of trustees should review on an ongoing basis Treasury's implementation of investment policy and asset allocations.

Recommendation No. 2 *AS Oversight*

The entire portfolio of the PERS and TRS Funds should be subjected to an external performance review. Also, the external performance reports should be presented directly to the boards and should be in a complete, understandable, and acceptable format according to industry patterns and customs.

Presently, the PERS and TRS performance evaluation analyses conducted by an independent evaluation service do not review the entire retirement funds portfolios; are not in the usual and customary format; do not contain the usual and customary presentations; and do not compare the PERS and TRS Funds with an acceptably large enough universe of other funds.

We found it difficult to glean information on the PERS and TRS Funds operating results from the performance evaluation reports prepared by the external fund performance contractors. To assist us in understanding those performance reports, we contracted with the individual who had analyzed PERS and TRS Fund performance in the past.

Our contractor had similar difficulty in understanding the performance reports as presented. We subsequently discovered that the difficulty in understanding the reports and

determining fund performance lied not with the reader, but with the unconventional format that the PERS and TRS Funds results were presented.

According to representatives of SEI (Treasury's performance reporting contractor) the State's chief investment officer had instructed SEI to prepare the performance reports according to his own design. This format per our contractor causes confusion and difficulty in analyzing fund results. It is interesting that even SEI, the firm who prepared the reports according to Treasury's custom design, finds them difficult to understand. If people knowledgeable in this area find the performance reports difficult to read and analyze, we wonder how members of the PERS and TRS boards and interested beneficiaries and active participants can determine how their funds are performing.

Another area that our contractor found unique was the abbreviated form of the performance reports. The reports do not include a number of standard comparisons, analyses, and graphic presentations. These presentations assist in understanding the fund performance and how they compare to other funds. For example, the performance reports have no presentations of asset growth summaries; total plan rates of return; cumulative rates of return for market cycles (falling markets and rising markets); reward versus risk analysis; equity and bond purchases and sales turnover analysis; equity portfolio profiles (showing capitalization of investees, dividend yields, price/earning ratios, return on net worth, earnings growth rates, market/book ratios); diversification and rate of return by industry sectors; and other graphic and numerical presentations. It is argued that this type of information is of little value in establishing investment policy and asset allocation. However, all these analyses combined assist in formulating an informed judgement as to how the retirement funds are performing by interested parties other than those responsible for investment policy and asset allocation. These analyses, and many others, are used by the Permanent Fund Corporation Board of Trustees to review the performance of the Permanent Fund. These types of analyses are not report cards on a fund, but rather a presentation of how one particular fund is performing compared to other funds competing for a return on investment.

Other areas of the PERS and TRS performance reports identified as lacking are that a total plan analysis is not performed on the entire portfolio and that the universe of funds used for performance comparison is too limited.

The major benefit of an external performance evaluation is the identification of how one particular fund is performing and how it compares to other funds (known as the "fund universe"). To have a thorough evaluation/comparison, the

entire portfolio must be externally evaluated. Presently, the PERS and TRS portfolio does not have an externally generated total plan rate of return analysis because the funds' real estate investments and foreign investments are not taken into consideration. Most respondents to our survey indicate their entire portfolios are externally evaluated. Most of those funds also have investments in equities, fixed income, some foreign investments, real estate, mortgages, leveraged buyouts, and venture capital.

The PERS and TRS Funds are compared to a fund universe consisting of only 28 other funds. This contrasts to the Permanent Fund's evaluation which compares itself to a balanced fund population (where the funds have at least 5% invested in equities and 5% in bonds) of 910 funds and a Large Plan Report of 63 funds. We believe the PERS and TRS Funds comparison is too restrictive and should be enlarged. Comparing fund performance to a larger fund universe would provide a better indication of how the PERS and TRS Retirement Funds are performing compared to other funds.

We recommend that the entire PERS and TRS Funds be externally evaluated thereby generating a total plan rate of return; that the evaluations be performed and reported in the standard informative formats with all appropriate graphic and numerical presentations; that these reports should be presented directly to the boards; and that the PERS and TRS Funds be compared against an acceptable fund universe.

The boards and/or Treasury should provide as much information as possible to the beneficiaries, active members, executive and Legislative branches, and the public that is clear and direct. By doing so, it would enhance public accountability.

Recommendation No. 3

The Department of Revenue, Treasury Division (Treasury) should follow generally accepted accounting principles in its accounting of investments for the Public Employees' Retirement System (PERS) and the Teachers' Retirement System (TRS) Funds.

Treasury does not account for PERS and TRS foreign equity investments in accordance with industry generally accepted accounting principles.

The term "generally accepted accounting principles" (GAAP) as used in reporting results of operations on the financial statements refers to a body of theory and practice developed by the accounting profession in association with industry and other organizations that may be impacted by the adoption of standards which include not only accounting principles and practices but also the methods of applying them. GAAP

is a technical accounting term encompassing a common set of accounting concepts, standards, and procedures necessary in order to render financial statements comparable between enterprises and between accounting periods. Without adherence to GAAP, users of financial statements would have no uniform standard for judging the presentation of financial position, results of operations, and changes in financial position in those financial statements.

A user of financial statements expects those statements to present fairly, clearly, and completely the economic facts of the existence and operation of an enterprise on a consistent and comparable basis. A departure from GAAP results in financial statements that may not meet the user's criteria and will generally result in a qualified auditor's opinion disclosing the departure and what effect that departure has on the financial statements. Treasury realizes the importance of an unqualified audit opinion. Treasury, in Appendix J of its General Investment Policies, requires an applicant for commercial real estate loans to submit audited financial statements that contain unqualified audit opinions. The presentation of PERS and TRS financial statements by Treasury are departures from GAAP.

Treasury does not properly account for and report investment transactions occurring in the PERS and TRS foreign investment portfolio. Treasury did properly account for and report on its foreign portfolio activities through fiscal year 1987; however, in fiscal year 1988, a departure from GAAP was made, with which we do not agree is appropriate or justifiable.

An important element of a financial statement, and a framework of modern accounting, is the presentation of the historical cost of assets, including investments.

Treasury forwards funds to its London-based foreign managers. These managers then invest in foreign equities. The amount of the funds transferred to the foreign managers is recorded as the cost of the PERS and TRS investment in foreign equities. When the foreign equities are subsequently sold by the foreign managers, the amount received from the sale, which may include a gain on the sale, is usually reinvested in foreign equities. Contrary to GAAP, the reinvestment of proceeds from the sale of the equities are not recorded in the accounting records and the cost basis of the foreign portfolio is not adjusted to properly reflect the new cost basis of the retirement funds' investments. This accounting treatment was implemented over the initial written objections of the state comptroller. The sale, gain, and reinvestment of funds should be accrued and recorded in the accounting records at the date of the transaction in accordance with generally accepted accounting principles.

This irregular accounting treatment causes a material understatement of the cost basis that PERS and TRS has invested in foreign equity holdings. The understated cost as presented in the PERS and TRS financial statements is misleading to the average reader who is not aware of the non-GAAP accounting treatment accorded these transactions by Treasury.

In their June 30, 1988 balance sheet, Treasury shows the cost and market value of PERS and TRS foreign portfolio as follows:

	<u>Cost</u>	<u>Market Value</u>
PERS	\$77,847,000	\$138,421,000
TRS	51,756,000	91,246,000

At first glance, a reader of the financial statements would think that PERS and TRS had generated a \$60,574,000 and \$39,490,000 (respectively) market gain.

However, had GAAP been applied to the accounting of the foreign portfolio, cost and market value would have been presented as follows:

	<u>Cost</u>	<u>Market Value</u>
PERS	\$134,626,000	\$138,421,000
TRS	48,711,000	91,246,000

Under GAAP foreign portfolio market gains for the PERS and TRS Funds have been \$3,795,000 and \$2,535,000, respectively. As reflected in the financial statements, PERS and TRS market gains are overstated by approximately 1,500 percent.

The Treasury Division, chief investment officer has stated that this accounting treatment is necessary because of "investment accounting principles," "fiduciary law," and "the IRS code." None of those references, even if they do address this issue, override GAAP and Alaska state law in these circumstances.

Alaska Statute 37.05.150 states, in part, "The accounting system must be in accordance with accepted principles of governmental (fund) accounting" Generally accepted governmental accounting principles are embodied in the Governmental Accounting, Auditing, and Financial Reporting publication prepared by the Government Finance Officers Association. In this handbook of governmental accounting, the jurisdiction of the Governmental Accounting Standards Board (GASB) is defined as "The GASB will establish standards for activities and transactions of state and local governmental entities" The handbook further defines

the hierarchy of GAAP for financial statements issued by state and local governmental units. This hierarchy is:

1. Pronouncements of the GASB are to be followed for accounting and reporting by state and local governmental units.
2. In the absence of a GASB pronouncement regarding accounting treatment, pronouncements of the Financial Accounting Standards Board (FASB) are to be followed.
3. Pronouncements of bodies composed of expert accountants that follow a due process procedure. This category includes audit and accounting guides and statements of position issued by the American Institute of Certified Public Accountants.
4. Practices or pronouncements that are widely recognized as being generally accepted because they represent prevalent practice in a particular industry or the knowledgeable application of pronouncements to specific circumstances.

Since GASB is silent regarding the treatment of foreign investments, pronouncements of the FASB must be followed. In this case, generally accepted accounting principles established by the FASB, and its predecessor the Accounting Principles Board, should be followed by the Treasury Division.

We recommend that Treasury account for and report on the PERS and TRS Funds, including its foreign portfolio activity, in accordance with generally accepted accounting principles.

STATE OF ALASKA

STEVE COWPER, GOVERNOR

DEPARTMENT OF REVENUE

TREASURY DIVISION

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August 22, 1989

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LEGISLATIVE
AUDIT

Randy S. Welker, CPA
Legislative Auditor
Division of Legislative Audit
P. O. Box W
Juneau, Alaska 99811-3300

Dear Mr. Welker:

I have reviewed the Division of Legislative Audit's preliminary report entitled "A Special Report on the Department of Revenue Treasury Division Public Employees' and Teachers' Retirement Funds".

At your request, I offer the following comments:

1. With regard to the discussion of realized returns on page eleven, I would like to point out:
 - a. The Financial Analysts Federation has endorsed the enclosed "Performance Presentation Standards". These standards are the first and only such standards in the industry for guidance on how to calculate and report investment performance. Section V.B. specifies that the use of total return, including income and capital appreciation, is mandatory in the presentation of investment performance data. Realized rates-of-return, as pointed out in your report, do not include unrealized capital appreciation.
 - b. Realized returns are relevant for a fund which has net cash flow requirements during the period being measured; in the case of retirement funds, a net cash flow from investments is not estimated by the funds' actuary to be required generally before FY 2005. See the enclosed "PERS and TRS Financial Projections", February 21, 1989, Mercer Meidinger Hansen. Sensitivity analyses in the projections indicate there may be some chance that a small portion of TRS investment earnings (no more than one-tenth) will be needed as cash to cover benefit payments after FY 1991;
 - c. The timing of actual realization of unrealized gains is at a fund manager's discretion and may be affected by a fund's cash flow requirements. Thus, realized returns may reflect not only investment policy, as shaped by cash flow requirements, and a portion of investment returns, but also asset liquidation decisions prompted by cash flow needs.

Randy S. Welker, CPA
August 22, 1989
Page 2

2. On page 12, as your report points out, there are difficulties in comparing total fund returns to market indices for individual classes of investments. The most appropriate comparison would be to an average of the relevant indices weighted by the asset allocations of a fund. This would be similar to the approach prescribed by the Financial Analysts Federation in section V.I.6.a. of their "Performance Presentation Standards" (enclosed) for comparing results of balanced accounts managed by investment advisors.
3. I am in basic agreement with Recommendation No. 1. There are obviously many issues to be considered in trying to develop the best possible structure for governance of PERS and TRS investment management. The Department of Revenue would be happy to work with Legislative members or bodies in developing legislation to reform the structure.

To address these same concerns, the Department has developed a proposal to create an independent trust company. The proposed structure would provide for the investment management of other State retirement and endowment trust funds, as well as PERS and TRS. It also would greatly improve State cash management procedures by allowing direct access to certain Federal Reserve System services, rather than through an intermediary custodian bank.

The Department's proposal has been endorsed by resolutions of the PERS and TRS boards and has been reviewed by the State's fiduciary counsel, Willkie, Farr & Gallagher.

There is one issue addressed in your report to which I should respond. The discussion of liability for fiduciary acts on page 17 does not take account of AS 37.10.071(d) and (e) which make fiduciaries personally liable and extends state indemnification of their liability only insofar as their actions are prudent, even though insurance would cover all fiduciary acts whether prudent or not. These statutory provisions were adopted to assure the most careful adherence by fiduciaries to the dictates of prudence. I do not concur with the suggestion that board members be allowed to avail themselves of the State's insurance coverage of liability for fiduciary acts when those acts fail to meet the statutory standard of professional prudence contained in AS 37.10.071(c).

4. I am in agreement with portions of Recommendation No. 2. My specific comments are:
 - a. I agree that performance reports should cover the total fund and include cumulative rates-of-return, a reward versus risk analysis, and relevant graphics. The Department has awarded a new contract for outside performance measurement services that includes such information. The first reports under the new contract will be available following the end of the first quarter of fiscal year 1990.

- b. I do not feel that other detailed analyses, mostly of individual manager portfolios, recommended in your report are useful either in establishing investment policy and asset allocations or evaluating manager or fund performance. Performance measurement data needs to be confined to comparative information that focuses on the bottom line -- rates-of-return -- and the critical policy variables -- asset allocation, bond maturity, and bond quality -- that contribute to it. The worst thing to do, if trying to ensure accountability, is to inundate fiduciaries with so much data that they can't see the forest for the trees or have time to adequately review the more critical information.
- c. If there are particular problems with the format of the report, the audit should identify them and I would be happy to consider changes. As part of the new performance measurement contract the Department will obtain any specific suggestions the contractor has for revising the format. However, the Department will not relieve the contractor of the obligation of supplying the reports in the format specified by the Department if revisions to the format decrease the report's intelligibility or appear to be for the convenience of the contractor. There is no industry standard for most of the presentations in these reports, the only possible exception being certain basic information set out in Tables I and II of the enclosed "Performance Presentation Standards" which no firm has yet adopted. Various performance measurement firms have various formats. Each has its own "standard" format and is reluctant to provide custom reports as required by the Department due to the extra time and expense involved.
- d. I agree that comparing performance to a larger universe is desirable, provided that, as your report stresses in several other places, the comparisons are meaningful. Under the circumstances it is not clear that the contractor can provide any larger universe that would be meaningful. The contractor, SEI Corporation, had the largest universes specified by the Department of the two firms responding to the RFP for these services. As part of the new contract, the Department will obtain the advice of the contractor on whether the universes can be meaningfully expanded.

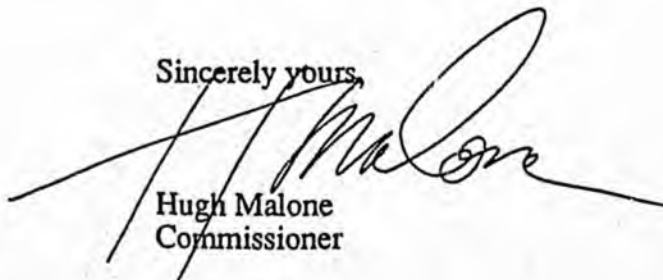
The PERS and TRS funds are compared to two universes consisting of pension funds over \$500 million -- one State pension funds, the other corporate. These universes were established to provide more meaningful comparisons than a universe including many small pension plans. Small plans for the most part operate under more restrictive constraints, have less diversification into the various asset classes represented in PERS and TRS, and are less likely to have professional management. As pointed out on page 5 of your report, similarity in objectives, constraints, opportunities, and resources are critical to achieving valid comparisons.

Randy S. Welker, CPA
August 22, 1989
Page 4

Not unexpectedly, larger plans generally seem to have superior investment returns as indicated by the enclosed "EXHIBIT 7" prepared by SEI. The segregation of corporate and state plans is useful because their significant difference in asset allocations to equities, which results in significantly higher returns for corporate plans, focuses attention on this critical policy variable.

5. The Department will comply with Recommendation 3, beginning with its audited financial statements for fiscal year 1989. However, I would like to make three comments:
 - a. The statements on page 19 and 20 that Treasury does not account for foreign equity investments properly or in accordance with generally accepted accounting principles are overly broad. Treasury does account for foreign equity investments in accordance with generally accepted accounting principles, with the exception of its treatment of historical cost and the point of realization of foreign gains or losses. Treasury's statement of market value and total investment income for foreign equities is in accordance with generally accepted accounting principles. As stated by Ernst & Whinney in their annual audit of Treasury investments, the "differences would have no effect on total investment income".
 - b. The departure from GAAP and its effects are fully disclosed in Treasury's financial statements. Your report should acknowledge this. The statement on page 20 that "A departure from GAAP...will generally result in a qualified auditor's opinion disclosing the departure and what effect that departure has on the financial statements." may leave the reader with the impression that Treasury did not make this disclosure.
 - c. The departure from GAAP was based on consideration of a number of issues. These issues were fully discussed by Treasury staff and its independent auditors. The decision was personally reviewed by me. The issues are summarized in the enclosed memo of November 1, 1988. The report's failure to address the issues contained in the memo, which was provided to Legislative Audit, and its failure to acknowledge the Department's review of the issue may leave the reader with the impression that the departure was made arbitrarily or capriciously. In fact, the issues involved are very "close" as to what is the best accounting treatment. This is reflected in the fact that FASB-52, which is the accounting principle at issue here, was highly controversial and was adopted by the Financial Accounting Standards Board only by a 4-3 vote.

Sincerely yours,



Hugh Malone
Commissioner

HM/MBB/ph

encls.

PERFORMANCE PRESENTATION STANDARDS

Presented by the Committee for
Performance Presentation Standards

Claude Rosenberg, Jr., Chairman
R.H. Jeffrey
Robert Kirby
Dean LeBaron
John J.F. Sherrerd

Endorsed by the
Financial Analysts Federation

January 12, 1989

I. *The FAF has endorsed the following standards for investment management performance presentation. Up to now, this all-important subject has been given insufficient attention; as a result, investment advisers (despite registration with the SEC) have been left to follow their own standards, which have been varied, uneven, and, in some instances, outright irresponsible and dishonest. If the investing public is to be treated fairly, and if the investment management industry is to represent the highest ethical and moral standards, a fair and understandable policy should be followed. The standards recommended earlier have been endorsed by the FAF Board of Directors after consideration of comments from its membership (which includes investment advisers, brokers, consultants, academicians and other interested parties).*

II. *The overall philosophy underlying these standards is the need for full disclosure of investment performance data to clients and client prospects. Certain statistics and presentation data have been delineated as requirements; but the main theme is that investment managers may present any reasonable statistics provided that their derivation, and particularly any exclusions therefrom, are highlighted and made abundantly clear.*

III. *Parties affected by these standards.*

These standards are directed to "investment managers," which obviously includes all registered investment advisers, but the

standards also apply to other organizations and individuals, such as:

A. *Stock brokers acting as "portfolio managers" for clients, particularly those who charge separate (from normal commissions) fees for their management services.*

B. *Mutual funds, where certain regulatory presentation practices can be deceptive (but which exist under different jurisdictions).*

C. *Consultants, where it is recommended that similar standards be set by a separate FAF Committee.*

IV. *While clients and client prospects are encouraged to make extensive qualitative judgments of investment managers, these FAF guidelines concentrate on the quantitative—on a complete, accurate and fair presentation of investment performance data.*

V. *Performance Calculation.*

A. *Time-weighted performance calculation is the mandatory methodology, since it represents the only practical method for comparing manager results over time.*

B. *Total return, including income and capital appreciation, is also mandatory.*

V. Performance Calculation (Continued)

C. To allow for the most efficient judgment of manager efficiency and client investment returns, results should be presented before fees so long as the manager's fee schedule is included with performance presentation.

D. Managers and new clients should agree in advance on the starting date for performance calculation.

1. This starting date should be part of the Management Agreement and calculations should conform to such agreed-to date.

2. Since the precise starting date for managed funds is not always definite (due to legal problems, delay of receipt of funds, etc.), it is recommended that a specified period (i.e., 30 days after funds have become available for investment) be set as inception for performance calculation. Again, the time period will vary from manager to manager, dependent on manager style or client preference; but agreement in advance between manager and new client eliminates potential confusion and sets a consistent standard.

E. Computational Standards.

1. Portfolios should be valued at least quarterly. Monthly valuation (and linking) is the preferred frequency where practical.

2. A time-weighted return formula which minimizes the effect of contributions and withdrawals must be utilized. Daily accounting for contributions and withdrawals is the preferred method.

3. When a contribution (or withdrawal) is significant (e.g., over 10%) in relation to the latest calculation of market value, a portfolio is best revalued on the date of the contribution (or withdrawal) in order to reduce possible distortion.

4. Investment income should be included on a full accrual basis (as opposed to cash basis).

F. Performance results for any one asset class (such as equities) should include cash equivalents and any other securities (e.g., convertible securities in an equity portfolio) held by the manager in place of that asset.

V. Performance Calculation, Paragraph F.
(Continued)

1. If managers present performance results for any particular asset class excluding cash or other securities used by the manager in place of the asset class, performance with cash and the other securities should likewise be presented along with a statement that results so presented conform to FAF standards.

G. Compound annualized performance returns should be presented for all periods covered in presentation.

H. Exclusions from account performance calculations and presentation should be clearly stated.

1. Complete information on inclusions and exclusions of data should be presented, as per attached Tables I and II.

a. Managers should provide the percentages of their inclusions and exclusions to prospects. Thus, if the presented data constitutes 85% of the asset class (e.g., equities) managed, with 15% excluded, this should be so stated. If the presented data constitutes 50% of a particular type of in-

vesting within that asset class (e.g., small-to-medium capitalization equities), this should also be stated.

b. Examples of such exclusions might include:

Special category investments, such as assets not carrying full discretionary power within a manager's business in which other accounts are normally discretionary.

Client assets not being charged a fee, within a manager's business which is normally fee-based. As indicated throughout Section VIII., the performance of all fee-based accounts should be accounted for in manager measurement and presentation.

I. *Balanced accounts.*

1. *Balanced accounts, with both equity and fixed income assets, should be separated into two distinct equity and fixed income categories. Each such category should be assigned its own cash balances so that the performance of each*

V. Performance Calculation, Paragraph I.
Number 1. (Continued)

investment class will include returns specifically reflecting the use of cash equivalents and other substitutions. While managers may be able to supply sufficient risk and volatility information on each investment class to allow clients to make a reasonable judgment of results as if cash had been included, the information content from the separation of balanced portfolios into distinct asset "pots" (each with its own cash equivalent or substitute holdings) is too valuable to leave to manager choice.

2. Assuming that the balanced account manager's assignment from the client is to periodically change the asset mix, managers altering the ratios between equities and fixed income should make bookkeeping transfers of cash from one category to the other. Accounting for such transfers should, of course, be based on the specific cash transfer dates.

3. Performance results from balanced accounts should, therefore, include the following:

a. Equities, including cash or substitute securities designated for potential investment in equities.

b. Fixed income, including cash or substitute securities designated for potential investment in fixed income.

c. Total account.

4. 3.a. and 3.b. results should be compared against their respective, comparable indexes, as if they were separate equity and fixed income accounts.

5. While separating the parts of a balanced account as recommended provides valuable insights into the capabilities of managers in each distinct asset class, the most significant performance criterion is still the combined, total account results.

6. Results for the total account are best compared against equity and fixed income proportions that reflect client objectives/guidelines; these proportions should be agreed to in advance by client and manager.

a. Comparative performance should then be calculated by apportioning the returns from each of the indexes chosen to represent each asset class to the agreed-to

V. Performance Calculation, Paragraph I. Number 6. (Continued)

percentage bogey for that asset class. Assume, therefore, that client and manager have agreed to a balanced account risk posture of 60% equities and 40% fixed income. The comparative indexes used for equities (assume the S&P 500) should be weighted at 60%, while the appropriate fixed-income indexes (assume the Shearson/Lehman Corporate/Govt. Index) should be weighted at 40%, producing a number against which the total account performance return should be compared.

J. *In addition to actual results, performance for accounts utilizing leverage should be calculated and presented as if they had been made for all-cash (no leverage).*

VI. *Indexes used for performance comparisons.*

A. *Managers should explain in advance any indexes used for performance comparisons to clients and prospects. These indexes should parallel the risk or investment styles the client account is expected to track.*

B. *Comparisons with specific measures (e.g., real returns adjusted for inflation, riskless returns from T-Bills, etc.) may be used so long as FAF standards on other factors, as presented herein, are followed.*

VII. *Treatment of convertible securities.*

A. *Convertible securities should normally be included in equity performance, unless manager and client agree in advance to their inclusion in fixed income. If convertibles are subsequently shifted from equity segments to fixed income, or vice versa, clients should be notified at the time of such shifting.*

VIII. *Formation and presentation of composite performance results by managers.*

A. *All managers should construct and present accurate composites of investment performance. Rules for such composites include:*

1. *Managers should compile and present such results for as long a period of time as accurate accounting can be accomplished, no less than 10 years if possible and up to 20 if practical.*

2. *Management organizations in business for less than 20 years should include results from the very first full calendar year since their inception.*

VIII. Formation and presentation of composite performance results by managers, Paragraph A. (Continued)

3. Each and every year of such results should be presented to prospective clients, unless specific requests are for different periods.

4. Results presented to client prospects should be shown both for individual years and cumulative periods, as indicated in attached Table I.

5. All client accounts should be included for whatever period such accounts were under management; portions of periods under management (i.e., managers choosing inclusion of portions) is prohibited.

6. Clients' accounts no longer under management should be included in composite(s). So-called "survivor" performance results are to be avoided.

7. Changes in a manager firm's organization should not lead to an altering of composite results. Results achieved by an organization are the organization's responsibility; changes in personnel do not constitute a justifiable reason to alter composite performance results.

8. Managers are encouraged to construct separate composites where valid reasons exist for doing so. A differentiation between taxable versus nontaxable accounts; fully discretionary versus not-fully-discretionary; and other categories which entail varied investment styles, controls, or risks constitute valid reasons for separate composites. As indicated in Paragraph 9.d. below, however, managers should list all of their composites, with performance figures and other pertinent information on each, whenever performance results are presented. Any and all exclusions from any presentation of performance results should be clearly stated.

9. Composite performance calculation and presentation should be weighted by account sizes. A median of unweighted results may also be presented, but this should be accompanied by results weighted by account size, along with the statement that the latter is the recommended procedure as set by the FAF.

VIII. Formation and presentation of composite performance results by managers, Paragraph A, Number 9. (Continued)

Managers should also clearly delineate the following:

- a. The number of client relationships included in each (and all) composite(s);*
 - b. The total size of the composite for the beginning (January 1) and end of each year;*
 - c. The weighted average size of accounts constituting the composite.*
 - d. As indicated above, information on all excluded assets from any composite presentation should be presented.*
- 10. Fixed income and equity portions of balanced accounts should be included in their respective equity and fixed income composites, provided they conform to Section V., Paragraph I. above on balanced account calculations.*
 - 11. Balanced account composites should include only those accounts where the manager has*

discretion over changes from one asset to another. If the client has set balanced limits from which the manager should not deviate, the segregated assets (with their respective cash positions) should be included only with their like asset composite. (Example: Client gives Manager \$6 million for bond management and \$4 million for stock management, with no changes in mix to be made by Manager. The \$6 million should be added to the Manager's bond composite and \$4 million added to Manager's stock composite—nothing to be included in Manager's balanced account composite.)

- 12. Since performance results will be reported to clients along with either actual or average fee information (See Section V., Paragraph C.), composite figures should likewise contain sufficient information to enable clients and prospects to compute performance on both a pre- and post-fee basis.*

- 13. Managers should indicate typical indexes against which any and all composites are normally judged by respective clients. Thus, a manager's equity composite which includes accounts with both large and small capitalization equities of comparable weighted size*

VIII. Formation and presentation of composite performance results by managers, Paragraph A, Number 13. (Continued)

to the S&P 500 should be compared against the S&P 500, while a small-to-medium capitalization stock composite should be compared against NASDAQ, Russell 3000, etc. An account with, for example, 50% of its total in small-to-medium capitalization stocks and 50% in large capitalization stocks should be compared against similar-weighted separate indexes, rather than against either one of the two.

14. *Composites should follow the same treatment of returns with and without cash as indicated in Section V., Paragraph F.*

15. *Presentation of risk measurements such as Alpha, Beta and Standard deviation for individual account returns within any composite is encouraged.*

16. *Other pertinent information for use in performance analysis should be added to composite presentations. For example, managers are encouraged to include (for each period) average market capitalization of stocks held, average quality and duration of bond holdings, etc.*

B. *Table II provides a sample recommended format for composite performance presentation to client prospects and consultants. Table II should accompany the specific performance results as presented in Table I.*

IX. Verification of composites.

A. *Audited composite and other performance figures are encouraged. At the very least, managers presenting performance data should make a positive written statement that full disclosure of assets included and excluded has been made and that calculations conform to FAF standards. Any deviations from these FAF standards should be specifically stated.*

B. *The principles of these FAF performance presentation standards should apply to all individuals and organizations serving investment management functions. Consultants are likewise encouraged to adopt similar standards and principles in reporting performance data.*

X. *Table III is a checklist for managers and clients—to assure proper conformance to the standards presented above.*